

India Microfinance Review 2007



Micro-Credit Ratings International Ltd



India Microfinance Review 2007

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India Microfinance Review 2007

Overview Growth with Equity & Efficiency

The past 18 months have seen a series of critical developments in the Indian MFI sector. These are both positive and negative. On the positive side, MFIs have started to leverage their new found management expertise to achieve scale and to spread their operations well beyond their traditional operational areas. Thus, some of the leading MFIs in the country have recorded high growth rates of the order of 80% per annum in terms of numbers of borrowers and around 40% per annum in terms of portfolio reaching from 300,000 to one million clients each. Also positive is that a significant part of that expansion has been either to less developed areas of the country – Orissa, Jharkhand, Rajasthan, Madhya Pradesh, Tripura, Assam – or to areas such as Maharashtra that also have substantial numbers of low income families in some regions even if their overall development indicators are not as low as those for the other states.

On the negative side, MFIs have been under attack from politicians and bureaucrats in some of their traditional operational areas in Andhra Pradesh and Karnataka (with questions even being asked in Orissa). Their loan recovery practices have been questioned and their interest rates described as exorbitant. The related publicity has vitiated the credit culture in the traditional microfinance states forcing a lowering of interest rates and increasing the necessary level of loan loss reserves and provisioning. Operationally, the increase in costs has been compounded by the spread of the operations of individual MFIs simultaneously (and inorganically) to a number of non-traditional states. This has put pressure on operating efficiency and resulted in slowing the trend to lowering unit costs.

The growth of the microfinance sector has been fuelled by continuing interest from banks in increasing their exposure to microfinance resulting in a highly leveraged industry with capital adequacy ratios down below 10% and debt-to-equity ratios of the order of 11:1. Given the pressure on margins (which has already reduced the collective return on assets of the sector to negligible, if still positive, levels) it is unclear for how long such high leverage ratios can be sustained.

The increased coverage of clients made possible by the high growth rates of Indian MFIs is laudable. Even as it increases outreach, the industry continues to be amongst the most efficient in the world. But, high growth brings with it possible dangers of mission drift as many MFIs emphasise commercial behaviour and may not strategically balance this with their original social mission, or with social values expected in microfinance. The social rating service offered by M-CRIL over the past couple of years has found that MFI poverty outreach (the proportion of new clients below the \$1 per day international poverty line at purchasing power parity) is around 30-35%. Is this the level of poverty outreach expected in microfinance? Whilst some MFIs may target small enterprises, most include poverty outreach and poverty reduction in their mission statements. It is apparent that while MFIs have learnt much in terms of operational efficiency a substantial effort is required in the areas of clarifying social objectives, poverty targeting, product development and client orientation. The challenge for MFIs over the next few years is to achieve growth with equity as well as efficiency.

This report presents a detailed analysis of the information obtained by M-CRIL during its ratings of 58 Indian MFIs over the 18 month period January 2006 to June 2007 (after excluding 5 institutions that were outliers). The overview of the performance of Indian MFIs emerging from this analysis is placed in perspective by a comparison with the benchmarks emerging from the database of the MIX's latest set of 37 reporting MFIs (for March 2007)¹.

¹ A list of the MFIs in each sample is provided in Appendix 2.

Section 1

Microfinance in India

—as seen through M-CRIL's sample of 58 rated and the MIX's 37 reporting MFIs

The samples used in this analysis provide a picture of the broad trends in Indian microfinance and capture the changing face of the sector. Despite the continued concentration of MFIs in South India, an increased representation of MFIs in the east reflects the growth of microfinance in that region. Client and portfolio concentration among large MFIs has also reduced over the years. High client and portfolio growth rates in recent years have increased the number of large MFIs but the number of small MFIs (portfolio <Rs2.05 crores, \$0.5 million) in the sample continues to be significant (41%). With a number of new-age MFIs established in recent years, the traditional correlation between portfolio size and age has broken down.

While the traditional SHG model and bank-linkage programme continue to be popular, increasingly borrowers obtain their financial services through Grameen-oriented, for-profit companies. There is an India-wide trend towards the formal registration of MFIs as for-profit non-bank finance companies (NBFCs) so that more than 25% of the sample now consists of such institutions. In their quest for sustainability and growth, an increasing number of both new & leading MFIs in India now follow the Grameen microfinance methodology, though the sector continues to innovate and experiment with a wide range of models to cater to client needs more effectively.

Microfinance services are provided in India through a variety of delivery methodologies ranging from the very popular Self Help Group (SHG) methodology traditionally pursued in the country to Grameen and joint liability groups, as well as the individual banking arrangements of the Savings and Credit Cooperative Societies (SCCS). Over the years, through an ongoing process of experimentation and innovation undertaken by Indian MFIs these models have become blurred at the edges resulting in a spectrum as illustrated in Exhibit 1.1

Exhibit 1.1

Microfinance models employed in India

SHG	Mixed	Grameen	SCCS	MACS	Urban Cooperative Banks
Village banking		Joint liability		Individual banking	

In addition to the microfinance delivery methodologies, the performance of MFIs is influenced by the legal framework within which an institution operates and various other factors. For the purpose of this analysis, the classification of the information available to M-CRIL and MIX has been undertaken by

- region
- institutional characteristics microfinance methodology, age of MFI and form of legal registration
- portfolio size, and sometimes by
- performance defined as the M-CRIL rating grade achieved.

Further information about each of these classifications is provided in **Appendix 1**.

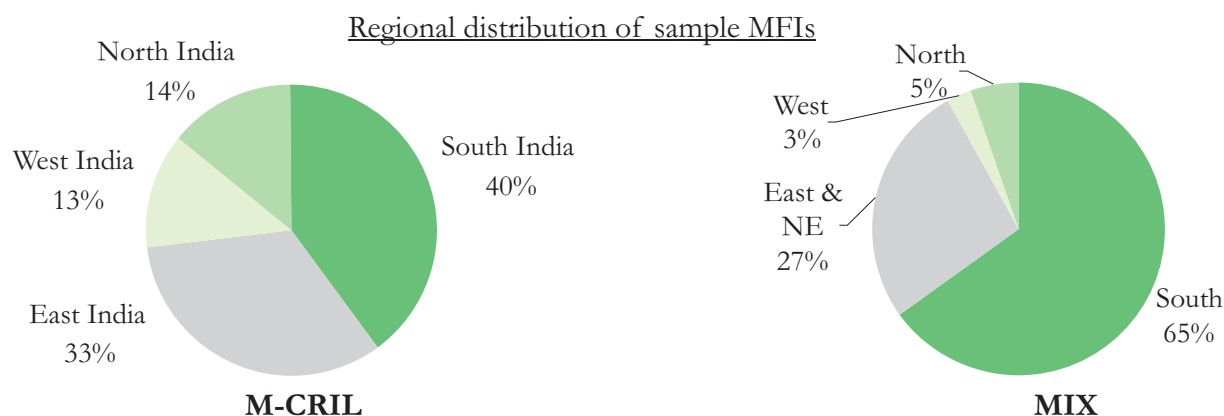
1.1 Regional distribution of MFIs covered by this analysis

—leading MFIs across India with the south still very important, due to concentration of MFIs in the region, but no longer dominant

Regionally, this analysis provides a comprehensive picture of microfinance in India. The samples used contain a large number of MFIs from South India. This is *de facto* recognition of the fact that South India MFIs provide a substantial portion of client coverage in Indian microfinance. **Exhibit 1.2** presents a broad regional analysis of the samples.

Exhibit 1.2
Regional distribution of Indian MFIs rated by M-CRIL

Region	M-CRIL			Update sample	MIX	
	Rated	Sample	% of sample		2005-06	2006-07
South	27	24	41	18 (62)	28	24 (64.9)
East & NE	24	20	34	8 (28)	8	10 (27.0)
West	10	6	10	1 (3)	0	1 (2.7)
North	11	8	14	2 (7)	2	2 (5.4)
India	72	58	100	29 (100)	38	37 (100.0)



It is because of the concentration of MFIs in the south that such a large number of MFIs from the region are rated by M-CRIL and why so many from the South report to MIX. However, with the establishment and growth of MFIs in other parts of the country particularly in the east there is no longer a preponderance of MFIs in south India used in this analysis and the number of MFIs from the east is also increasing. The distribution in the table (broadly) reflects the distribution of microfinance activity in India.

This institutional concentration naturally means also a concentration of clients served by MFIs. This results in nearly three-fourths of all clients served by MFIs in India being located in the South. This is covered in more detail in the discussion of MFI outreach in the following section.

1.2 Institutional characteristics of sample Indian MFIs

–Disaggregated by model, age, legal status

There are many SHG-based microfinance programmes but, in recent years, most of the new MFIs have been established using the Grameen model. There has been a tendency for MFIs increasingly to adopt the Grameen model since this is seen by many as a means of accelerating their growth and progress towards sustainability. By and large, however, Indian MFIs have been innovating, experimenting with and growing out of the conventional mould of SHG and Grameen operations, to cater to the needs of their markets more effectively. The distribution of sample Indian MFIs based on microfinance models is shown in **Exhibit 1.3**. This distribution is a broad reflection of the pattern of microfinance undertaken through microfinance institutions (as opposed to the SHG-bank linkage programme) in India.

In the “universe” of MFIs in India, the early MFIs were all established in the 1970s, when cooperatives were still seen as the most appropriate means of ensuring outreach to the poor in a just and fair manner. It is for this reason that the oldest MFIs in India are all cooperatives,

classified here as individual banking models. It is also interesting to note that most of these are in the western region where the cooperatives have, traditionally, been more effective than those in other parts of the country. It is, perhaps, partly on account of this preference for cooperatives that the number of MFIs in western India is relatively small. More recently, a number of Mutually Aided Cooperative Societies (MACS) have been established in Andhra Pradesh but few of these need external support and, therefore, do not seek ratings or other forms of exposure to national and international observers.

The Grameen organisations had the lowest average age (5.5 years) until the previous Review (**Exhibit 1.4**). This is because more than half the Indian MFIs that belong to this category are new-age institutions that have preferred not to adopt traditional microfinance models. However, now these have graduated to being mature institutions while others have modified their methodologies to suit an increasingly diverse client base.

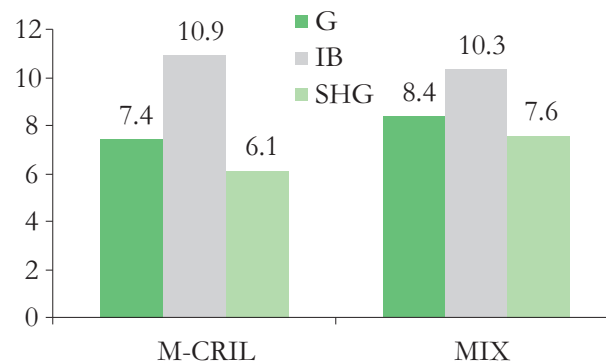
Exhibit 1.3

Distribution of sample Indian MFIs by microfinance model

Model	M-CRIL				MIX	
	2005	2007	Top 10	Updates	2005-06	2006-07
G	19	23	7	16	19	21
IB	15	8	1	6	14	15
SHG	50	27	2	10	25	21
Total MFIs	84	58	10	32	38	37

Exhibit 1.4
Average age of different types of MFIs

Methodology	M-CRIL	MIX
	MFI age in year	
G	7.4	8.4
IB	10.9	10.3
SHG	6.2	7.6
Sample	7.6	8.6
Top 10	7.8	
Global, median		9.0



Though there is a trend, India-wide, towards for-profit and formal registration of MFIs as finance companies, not-for-profit institutions continue to dominate by numbers of organisations in the provision of microfinance services. **Exhibit 1.5** shows the distribution of sample MFIs across legal forms. The 15 for-profit companies in the M-CRIL sample of 58 includes 5 institutions that were still registered as not-for-profit institutions (when rated) but are either in the process of transforming or have already transformed to companies (at the time of writing).

Also interesting in this context is the rural-urban orientation of MFIs. Microfinance activity in Asia is seen more as a rural than an urban activity quite unlike Latin America in this respect. Of the 58 institutions in the M-CRIL sample, 14 have predominantly urban programmes and 6 have a significant urban orientation. This compares with 25 out of 84 (30%) in the 2005 Review that had a significant urban orientation.

Exhibit 1.5
Distribution of sample MFIs by legal form

From of registration	M-CRIL	Top 10	MIX, 2006
Not-for-profit			
-societies & trusts	34	1	22
Cooperatives	4		1
Section 25 companies	5		2
Non-bank finance Companies/bank	15	9	12
Total MFIs	58	10	37

Of the 10 best institutions selected for the purpose of comparison with the overall sample, just two in this group have been replaced since the last review. However, while earlier six of the 10 were non-bank finance companies (NBFCs), all but one of the Top10 MFIs in India is now legally registered as such.

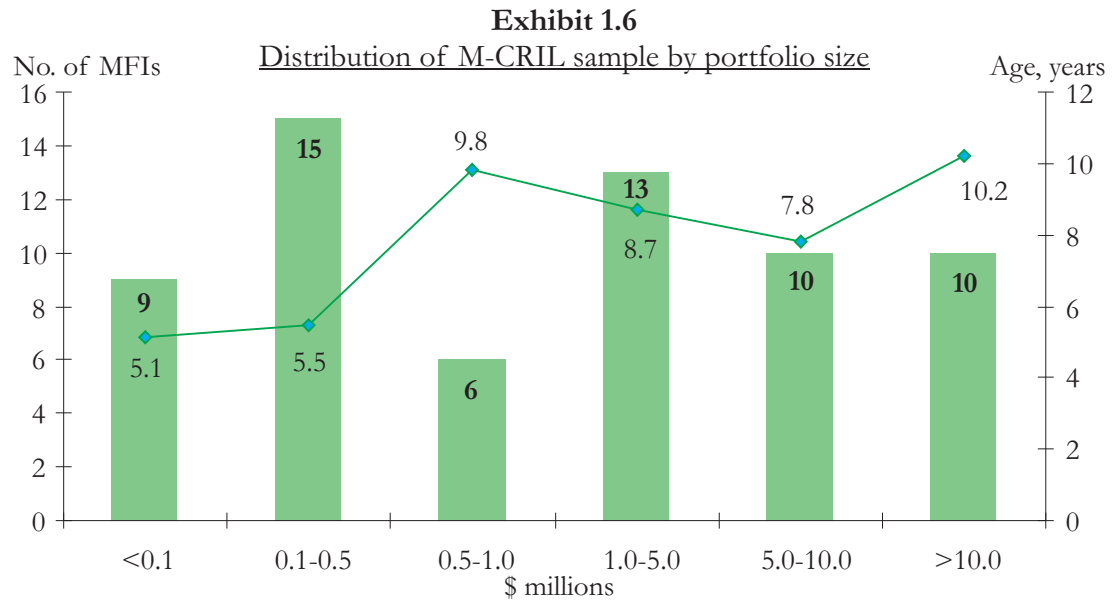
1.3 The sample by portfolio size

—many small MFIs but an increasing number of large ones

MFIs in the sample have been classified by the size of their outstanding portfolios at the close of the last six month period (end-March or end-September) before the latest rating field visit, as shown in **Exhibit 1.6**. There is a natural bias of the rating exercise towards large MFIs because it is only those that have reasonable performance that need (or opt for) a rating. Despite this, the 2005 Review sample had 50 out of 84 (60% of the sample) with portfolios below Rs2.5 crores (US\$0.55 million). With accelerating growth in recent years, however, the situation seems to be changing. The present sample has just 24 out of 58 (41%) that have portfolios less than Rs2.05 crores (\$0.5 million).

Exhibit 1.6 shows that there is no real correlation between portfolio size and the age of an MFI. Up to a portfolio of Rs4.1 crores (around \$1 million), following common business sense, as MFIs gain more experience those that continue to operate well also tend to expand. MFIs grow more rapidly from roughly the fifth to sixth year of operations at which stage their portfolios can range from Rs1-2 crores (\$240,000-480,000). The number of commercial sources of funds now available to MFIs has supplemented this portfolio expansion in recent years and the take-off point for rapid growth has now declined significantly. The most successful MFIs (28 of the 58 covered here) have now grown beyond the portfolio size of Rs4.1 crores (\$1 million). Beyond this stage, their size depends mainly on the microfinance potential of their operational areas and the capabilities of their managements; the correlation between age and size is no longer relevant.

The MIX set of MFIs with data for March 2007 (compared to M-CRIL's September 2006) has many (but not all) of the same MFIs at a later stage of growth so there are 17 MFIs with portfolios in excess of \$10 million (Rs41 crores) and 8 in the \$5-10 million (Rs20-41 crore) range. This is partly an indication of the rate of growth of Indian MFIs a feature that is discussed later in this report.



Section 2

Client Outreach

- outreach is low relative to the number of poor people in India but growing dramatically

Microfinance outreach in India has grown phenomenally over the past few years; both MFIs and the SHG-bank linkage programme. Overall outreach amounts to 15-20 million clients but research has shown that the poverty ratio of microfinance clients is of the order of 35%. Given some 70 million poor families in the country, this suggests an outreach to just 10% of the poor.

Microfinance The outreach of sample MFIs amounts to some 5.6 million clients (M-CRIL, September 2006) to 6.6 million clients (for the MIX dataset, March 2007). Around three-quarters of these are based in South India and another 20% in the East. The average rated institution grew 80% per annum to reach 64,000 active borrowers, 40% more than the typical South Asian MFI. MIX data from 37 leading institutions reflects even stronger outreach, with institutions serving 82,600 borrowers with \$8.6 million in loans.

Despite strong growth, penetration rates remain low. At \$106, the average loan balance benchmark amounts to just 15% of local income and is below the 21% median for Asia, a region renowned for its depth of outreach. Large pockets of the country, however, remain underserved with three-quarters of MFIs based in the south thanks to better governance and favourable environments that have fostered microfinance expansion. One-fifth of sample MFIs are based in the East, indicating that as the sector matures and MFIs grow, they are increasingly turning their attention to underserved parts of the country, particularly east and north India.

NBFCs using the Grameen methodology are at the forefront of this expansion. Grameen MFIs with over 130,000 clients each are the largest in the country and together serve over 50% of the total number of clients covered. The major share of the market is captured by NBFCs that reach three-fourths of borrowers and manage over two-thirds of the total portfolio, despite constituting less than one-third of the MFIs in the sample. In contrast with the growth in lending activities, a highly restrictive legal framework for deposit taking has severely constrained the offering of thrift services so client savings form just 8.1% of outstanding loan balances. Proposed microfinance legislation will open the door to enable savings mobilisation for by societies, trusts and cooperatives, but not NBFCs and Section 25 (not-for-profit) companies, effectively excluding a large nearly 80% proportion of clients from saving with MFIs.

A substantial increase in the outreach of microfinance services in India has occurred, in recent years, partly because of the phenomenal growth of the bank-SHG linkage programme (promoted by the National Bank for Agriculture and Rural Development, NABARD), but also from the substantial growth of the MFI sector. Yet, the number and size of microfinance institutions in India is small in relation to the numbers of poor people in the country. MFIs in India (including Self Help Groups) cover no more than 15-20 million clients, at best, 25-30% of the 60-70 million poor families in the country.

As indicated in the previous section, there is significantly greater outreach of microfinance in the south of the country with over 70% of the national figure for microfinance clients concentrated in just three southern states, Andhra Pradesh, Tamil Nadu and Karnataka.¹ The main reasons for higher

¹ M-CRIL's estimate based on figures available from a large apex organization (SIDBI) and the M-CRIL database. This and the following paragraph have been adapted from Sinha, Sanjay and Rasmussen, Stephen, et al, 2006. *Towards Financial Inclusion for the Poor*. Washington DC: The World Bank.

microfinance outreach in southern India include

- The origination of the bank-SHG linkage programme in Karnataka largely through the initiatives of the NGO, MYRADA, and the consequent greater participation of Karnataka based banks such as Syndicate Bank and Canara Bank in the programme.
- Better governance that has enabled the development of a large number of good quality NGOs that in turn have spawned MFIs.
- More vibrant local economies in the southern states as compared to the less developed states in the north and east.
- Higher literacy and participation rates of women in the local economy making them more suitable clients for MFIs.

In the southern states, in particular, there is some overlap between the members of different MFIs and SHGs. There is substantial competition between MFIs in areas such as around Guntur and West Godavari region of coastal Andhra Pradesh and the Thiruchirapalli-Madurai region of Tamil Nadu resulting in membership overlap. Further, all microfinance clients are not necessarily poor. An extensive impact study undertaken across 20 NGO MFIs operating in different parts of India in 2003 and 2004 found that, typically, only 35% of MFI clients in the country can strictly be classified as poor.² This leads to an even lower (8-10%) outreach of microfinance services to the poor than that indicated above. Much of the microfinance outreach in India is concentrated in rural areas where MFIs and SHGs tend to operate, though there has been increasing interest in urban areas in recent years.

2.1 Membership

—growing fast especially with non-bank finance companies using the Grameen model

Overall the institutions sampled provide financial services – either loans or thrift deposit facilities – to nearly 5.6 million clients (often referred to as members). 73% (over 4.06 million) of whom are in the southern part of India as shown by the regional distribution in **Exhibit 2.1**. The largest MFIs (all based in South India) are now expanding into states in other parts of the country. As a result, it is no longer strictly correct to include all of the members and borrowers of these MFIs into the total for the southern region. As the number of clients covered by all-India MFIs grows, this Review will (in future) separate intra-MFI client information regionally. MIX data for March 2007 data for 37 MFIs show even greater outreach to 6.6 million borrowers with a similar regional distribution as M-CRIL's sample though it is even more focussed on the south (83.5% of all clients). The Top10 MFIs identified for this analysis serve some 3.31 million members, around 54% of the total.

Exhibit 2.1
Model-wise distribution of
MFI clients in India

Models	M-CRIL sample	
	million	%
Grameen	3.00	53.7
Individual Banking	0.77	13.8
SHG	1.82	32.5
M-CRIL India	5.59	100.0
Top 10	3.31	54.2

Regional client distribution

Region	M-CRIL		MIX	
	million	%	million	%
South	4.06	72.6	5.03	76.2
East/NE	1.30	23.2	1.37	20.7
West	0.02	0.4	0.001	0.0
North	0.21	3.8	0.20	3.1
Total	5.59	100.0	6.60	100.0

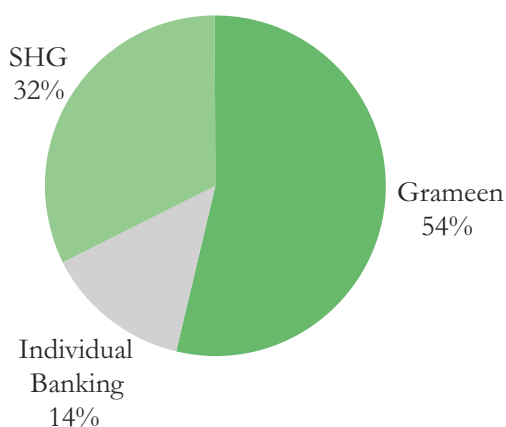
² EDA, 2004. *The Maturing of Indian Microfinance: A impact assessment of 20 Indian MFIs*. Sponsored by SIDBI. Gurgaon, India: EDA Rural Systems Private Limited.

The importance of SHG programmes in the sample has declined from 47% of membership in the 2005 Review to just 32% now (**Exhibit 2.2a**). In recent years, most government initiatives in the country have been through groups – whether it is bank linkages with the support of NABARD, women's development schemes, Velugu in Andhra Pradesh or other rural development programmes such as the Swarnajayanti Gram Swarozgar Yojana (SGSY golden jubilee village self-employment programme). Due to this government support, a number of MFIs, especially those that started as multi-service organisations, adopted the SHG model and the number of SHG MFIs in the sample is significant.

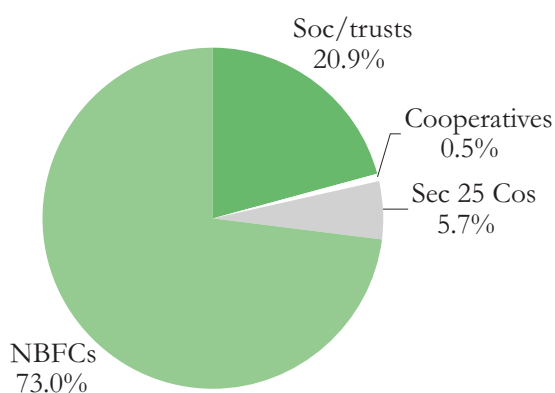
Conversely, the Grameen organisations tend to have a much larger number of members (average membership ~130,000, **Exhibit 2.3**) and thus provide 54% of total membership though the number of organisations in the sample is just 23 (36%).

Exhibit 2.2
Membership of sample MFIs

(a) ...by microfinance methodology



(b) ...by legal form



The increase in the number of Grameen-inspired programmes is the result of a number of SHG-based programmes having switched to the Grameen model to accelerate their progress to sustainability. As indicated in the **Appendix 1**, to eliminate the ambiguous “mixed” category of earlier Reviews, MFIs have now been classified to the three main categories based on the principal methodology used by them.

Though there are many MFIs in India using traditional cooperative principles – particularly the Mutually Aided Cooperative Societies (MACS) of the state of Andhra Pradesh– the coverage of individual banking organisations in M-CRIL's rating has been relatively low resulting in a small base in the sample. This is largely because cooperative organisations tend to be savings-based and not significant net borrowers from external sources while rating – as a tool – is intended to facilitate borrowing from banks or investment by others. As a result, rating is not necessary for many cooperative-based MFIs. At the same time, two of the institutions classified as individual banking are traditional Non-Bank Finance Companies (NBFCs) engaged in lending and leasing to small businesses but also now downscaling into lower segments of the market. Since there are not many such NBFCs yet, this factor has also limited the base of individual banking institutions in the sample. Another reason for the small number of such MFIs in the sample is that– in contrast to Grameen MFIs – the individual banking methodology is relatively risky so development (as opposed

to commercial) institutions using this methodology expand cautiously. Similarly the sample does not include many cooperative institutions because these tend to be small, local organisations relatively unconnected with the national and international mainstream.

In the context of the current proposal to bring societies, trusts and cooperative MFIs under a separate regulatory framework from that of NBFCs and Section 25 companies, the information in **Exhibit 2.2b** needs consideration. It shows that as much as 78.7% of the total number of MFI clients in India will be

excluded by the new regulatory regime. While MFIs registered as societies, trusts and cooperatives will be able to offer thrift services to their clients nearly 80% of the clients, those served by NBFCs and Section 25 companies, will not have such services available to them because of the restrictions of the rules applied by the Reserve Bank of India to all (non-MFI and MFI) NBFCs.

For many MFIs in the region, their development objectives mean thrift deposit services and empowerment through the promotion of governance capabilities are at least as important as lending to their members. This is particularly so for the SHG model with many programmes actually placing as much emphasis on social issues and developing governance capabilities as on providing financial services. For this reason, there is a significant difference between the membership of these institutions and the number of persons participating in their programmes as borrowers. **Exhibit 2.3** also provides a comparison between the average active borrowers and the average membership of MFIs in the sample following each methodology.

The ratio of active clients to total members, presented in **Exhibit 2.4**, is largely dependent on the extent of dormancy accepted within a methodology. For instance, Grameen organisations have a high average of 96% of members as active clients. This is because the conventional Grameen methodology does not allow a member to remain dormant for more than 2 weeks. Members who do not take the next cycle of loan must drop out of the programme. On the other hand,

SHG-based MFIs tend to have much lower active client to member ratios though this has risen (from 37% to 60%) with heightened interest in efficiency. In SHG MFIs the focus is on group solidarity and thrift so not all members need to be borrowers concurrently.

Overall, Indian MFIs serve an average of 64,000 active borrowers per MFI which is 20% lower than the MIX India benchmark of 82,562 active borrowers partly a reflection of the relatively large size of the institutions that are willing to participate in the MIX's self-reporting process. It is interesting to note the growth of the typical MFI in India. The average size of MFIs has increased from 21,000 for the 2005 sample and 117,000 for the Top10 to 88,000 and 268,000 respectively, indicating a growth rate of 80% per annum for the average MFI and 51% for the Top10 over the two years 2004 to 2006.

Exhibit 2.3

Average membership of MFIs in India

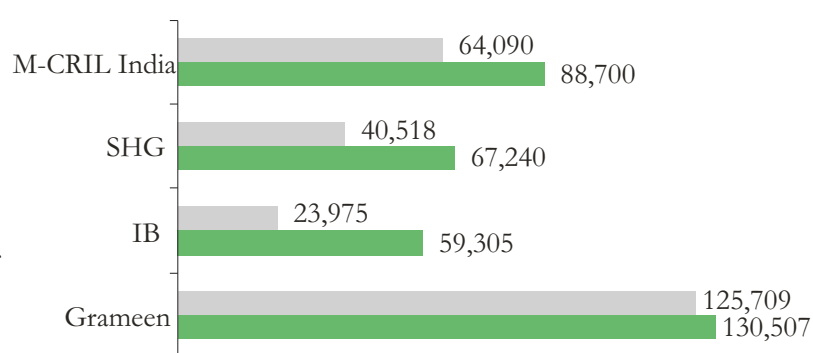


Exhibit 2.4

Average active borrowers and average membership

Model	Member* clients	Active borrowers	Borrower-member ratio (%)
Grameen	130,507	125,709	96
IB	59,305	23,975	40
SHG	67,240	40,518	60
M-CRIL India	88,700	64,090	72
Top 10	331,469	268,081	81
MIX India, median		82,562	
South Asia		44,647	
Global, large outreach		70,837	

* Members are all those who save with the organisation but do not necessarily borrow.

2.2 Loans Outstanding

–Grameen MFIs provide small loans to a large number of clients and Indian microfinance clients have minuscule loan balances compared to the international average

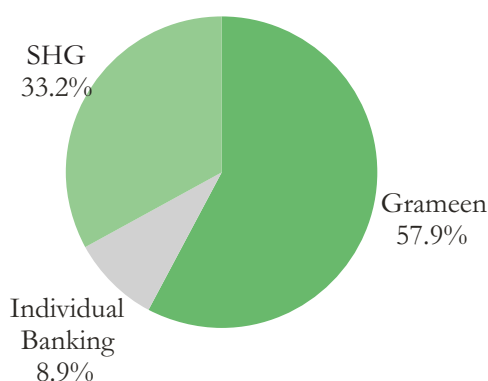
After excluding outliers in the database, the remaining 58 Indian MFIs rated during the reference period had a total portfolio outstanding of Rs1,453 crores (\$354million). The MIX dataset covers nearly twice the portfolio as it incorporates a set of larger MFIs and provides information for March 2007 (six months later than the median date for the M-CRIL data). About 53% of the sample's portfolio is with MFIs using the Grameen model (**Exhibit 2.5a**), while the SHGs represent 30% of the total portfolio though a single organisation contributes one-third of the SHG MFIs' share. Equally important, the Top10 MFIs own 63% of the total portfolio of sample MFIs (as well as serving 54% of the total number of borrowers served). While this is an indication of the polarised nature of the MFI sector in India in terms of size these proportions are lower than the two-thirds of portfolio as well as borrowers

Exhibit 2.5

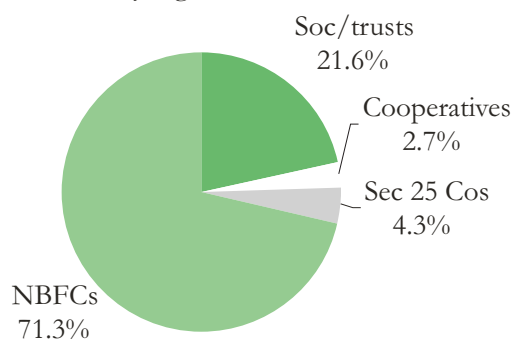
(a) Distribution of outstanding portfolio by microfinance model

Model	Outstanding portfolio		% of total
	Rs crore	US\$ million	
Grameen	770.8	188.0	53.0
Individual Banking	240.3	58.6	16.5
SHG	441.8	107.8	30.4
M-CRIL India	1452.9	354.4	100.0
Top 10	919.7	224.3	63.3
MIX India*	2,812.3	685.9	

*This includes loans under management under the partnership model



(b) Distribution of outstanding portfolio by legal status of MFI



covered by the Top10 in the 2005 sample. There is a small number of large MFIs that are very strong and expanding fast but the urge to grow fast is also now spreading to some of the medium sized institutions.

The distribution of outstanding portfolio among sample MFIs emphasises the point made in the above sub-section about the proposed regulatory framework for MFIs. The omission of nearly 79% of clients of the largest MFIs from the proposed regulatory framework for microfinance entails the exclusion of over 75% of the total outstanding portfolio. It is apparent that the issue of the exclusion of MFIs registered as companies from the framework needs further consideration.

Exhibit 2.6 provides a better understanding of the average portfolio across MFI models. The figure confirms that SHG model MFIs in India have relatively small portfolios (average Rs16.4 crores, \$4.0 million), around 70% of the country average (Rs23.1 crores, \$5.6 million). The average portfolio for the SHG models is restricted by the low active client-member ratio as well as by their small sizes of loans disbursed since this is a savings-led model with a number (8 out of 27) having average loans disbursed around \$100 or less. This is despite average SHG-MFI portfolios now being three times their size since 2005.

Exhibit 2.6
Average loan portfolios and loan size,US\$

Model	Average portfolio/MFI		Loans disbursed		Loan balance	
	Rs crore	\$ Million	Rupees	Dollars	Rupees	Dollars
Grameen	33.5	8.2	6,391	156	2,666	65
IB	30.0	7.3	13,100	320	7,710	188
SHG	16.4	4.0	5,631	137	4,039	99
M-CRIL India	23.1	5.6	6,684	163	3,381	82
Top 10	92.0	22.4	6,548	160	3,099	76
MIX, India*	74.2	18.1			4,346	106
Global	18.3	4.4			18,700	456

*This includes loans under management under the partnership model

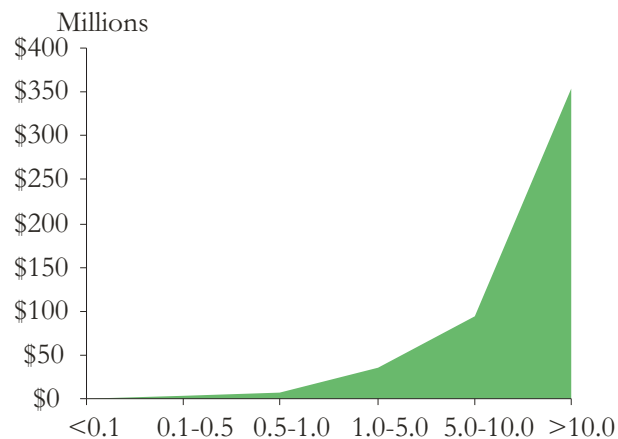
Exhibit 2.6 also shows that Grameen MFIs have the largest average portfolios of around Rs33.5 crores (\$8.2 million) but there is a wide range in the actual portfolio size within this category. The largest organisations now have portfolios in excess of Rs103 crores (\$25 million), but most have portfolios of Rs25-50 crores (\$6-12 million). Though the model has considerable capacity to be scaled-up, it is restricted by the small average loans disbursed (Rs6,400 or \$156); the large portfolios being mainly due to the large number of active clients (**Exhibit 2.4**). Since some of the individual banking programmes are actually constituted as cooperatives or commercial NBFCs with no specific microfinance mandate, their average loan sizes are significantly higher than those for the other categories on account of a mixed client base consisting of low and not-so-low income clients.

The \$456 average outstanding loan balance of the MFIs reporting internationally to the MIX is now more than 5.5 times the \$82 M-CRIL sample average and over six times the average loan outstanding with borrowers of the Top10 MFIs.

Exhibit 2.7 illustrates the extent of concentration of microfinance portfolios in India amongst the MFIs. Of the total of 58 MFIs in the sample, 49 (84%) service just 27% of the total MFI outstanding portfolio while the

Exhibit 2.7
Portfolio size distribution of MFIs

Portfolio		No of MFIs	Portfolio outstanding, \$ millions	
US\$ m	Rs crores		Total	Avg/ MFI
<0.1	(<0.41)	8	0.4	0.1
0.1-0.5	(0.41-2.05)	15	3.2	0.2
0.5-1.0	(2.05-4.1)	5	3.4	0.7
100-5.0	(4.1-20.5)	12	23.1	1.9
5.0- 10.0	(20.5-41.0)	9	48.8	5.4
>10.0	(>41.0)	9	213.1	23.7
		58	354.4	6.1



largest 9, with portfolios in excess of \$10 million (Rs41 crore) each, account for over 73% of the total. The average portfolio size of these MFIs is more than 4 times that of the next lower size class of MFIs and more than ten times the average for more than 80% of the sample. There is little change in this situation since the 2005 Review. The reasons for this situation are related to the efficiency and financial performance of different MFIs and are discussed later in this review.

It is apparent from **Exhibit 2.8**, however, that the longevity of operations (age) has relatively little direct relationship with portfolio size. The oldest MFIs (more than 10 years old by 2007) no longer have the

Exhibit 2.8
Relationship between portfolio outstanding and age

Age of MFIs	No of MFIs	Portfolio outstanding,		
		Total	Avg, cr Rs	Avg US\$
<3 years	13	179.6	13.8	3.4
3-5 years	4	42.8	10.7	2.6
5-7 years	6	48.1	8.0	2.0
7-10 years	17	684.1	40.2	9.8
>10 years	18	498.2	27.7	6.8
	58	1,452.9	25.1	6.1

largest average portfolios, with the “new age tigers” established in the late 1990s (7-10 years old) having clearly grown faster than some of the more conservative older institutions and have developed now much larger portfolios.

2.3 Growth of outreach

–is substantial though the average size of loan balances is stagnant

Since the samples for the 2005 and 2007 Reviews are not the same, a direct comparison of the two samples cannot be used for determining growth of outreach in Indian microfinance. However, the 28 MFIs in this sample that have recently had previous ratings as well (see **Section 1**) have grown rapidly in terms of outreach – both in the number of borrowers and of members.³ The number of borrowers has increased even more rapidly than before (84% per annum up from 41% annually in the previous period) than members (64% per annum up from 33% previously) resulting in a significant increase in the aggregate borrower-to-member ratio to 90% (**Exhibit 2.9**). As the MFIs grow they place greater emphasis on increasing portfolio concentration amongst their members – an important measure of cost control enabling better progress towards sustainability. This high growth is equally pronounced in the case of the MIX dataset that has 27 MFIs common to both the 2005-06 and 2006-07 sets. For this set of 27 MFIs the growth in clients (defined as active borrowers) for financial year 2006-07 is 58%.

As **Exhibit 2.10** shows, the aggregate loan portfolio of these MFIs taken together has grown at about 40% per year while the average loan size (loans disbursed) has declined from Rs11,019 (\$239) to Rs8,540 (\$208), ~24 months later (an annual decline of around 7%) for the update sample though the average outstanding balance per loan client for the whole sample (not just MFIs with recent rating updates) has increased by a small amount to \$82 from \$77 for 2005. This increase is attributable to the change in exchange rate as the amount is stagnant at Rs3,400. India benchmarks also indicate stagnant loan balances as the increase in dollar value of the loan balance per borrower from \$101 in March 2006 to \$110 in March 2007 is wholly attributable to the change in the exchange rate. In practice, given an inflation rate of around 5% for the period, this means a decline in the real value of average outstanding loan balances. In a way this is the natural result of the high growth rate of Indian MFIs resulting in large numbers of new clients with very small “first cycle” loans. While this demonstrates that MFI

³ **Reminder:** Borrowers are those with outstanding loans; clients are those who participate in the programme– in any way saving with the MFI or MFI-formed group or even attending group meetings regularly

managements have an institutional commitment to their mission by providing small loans to a large number of low-income people the small loan size is also partly the result of an inflexible approach to lending that does not permit a significant increase in loan size with each loan cycle.

2.4 Depth of outreach

—substantial by international indicators

The size of the average loan balance held by borrowers of Indian MFIs as a proportion of Gross National Income (GNI) per capita was just 9.9% in 2006 (**Exhibit 2.11**). This is a quick indicator of depth of outreach employed by international donor and microfinance support organisations such as CGAP. This calculation uses India's GNI per capita in 2006 (\$830) available from the World Bank's website. The Top10 MFIs record a slightly lower loan size-GNI ratio of 9.2%. For the MIX India benchmarks show an equivalent ratio is 12.8% for a slightly later date. These are well below 40.3% median and 45.3% for fully sustainable (FSS) MFIs so, apparently, indicate an excellent depth of outreach.

Growth of...

Exhibit 2.9
...borrowers and members

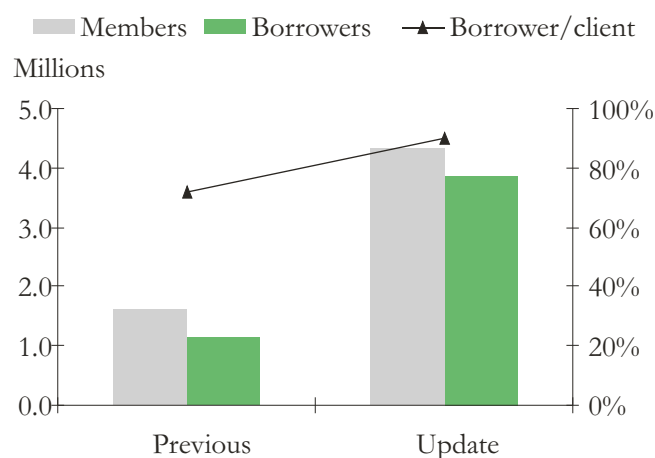


Exhibit 2.10

...loan size and portfolio

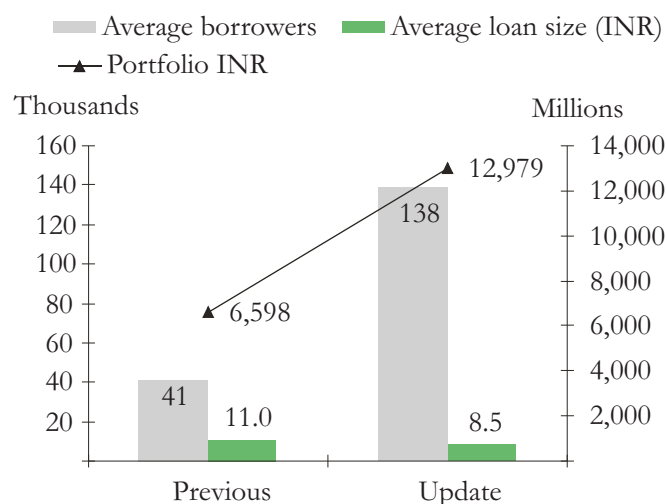
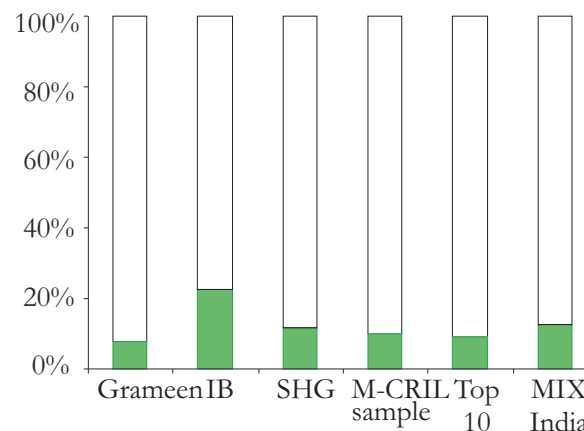


Exhibit 2.11

Average loan balance compared with GNI per capita

Model	Loan balance, US\$	Loan balance/GNI per capita (%)
Grameen	65	7.8
IB	188	22.7
SHG	99	11.9
M-CRIL India	82	9.9
Top 10	76	9.2
MIX, India	106	12.8
Asia	149	20.8
Global	456	40.3



However, the utility of the loan balance-GNI ratio as an indicator of depth of outreach is questionable. Field research in India shows that even middle class women often join microfinance groups for social reasons and will take quite small loans for minor activities in order to be able to participate in group activities. As discussed above, impact studies show that the proportion of MFI clients in India who have incomes below the poverty threshold is just 35%.⁴ Further researches since then on the SHG-bank linkage programme indicate that the poverty (depth of) outreach of that programme is no more than that of the MFIs.⁵

2.5 Thrift deposits

—are not always recorded by MFIs with SHG programmes; an appropriate regulatory framework for MFIs of all legal forms could enable microfinance to be undertaken largely with client savings

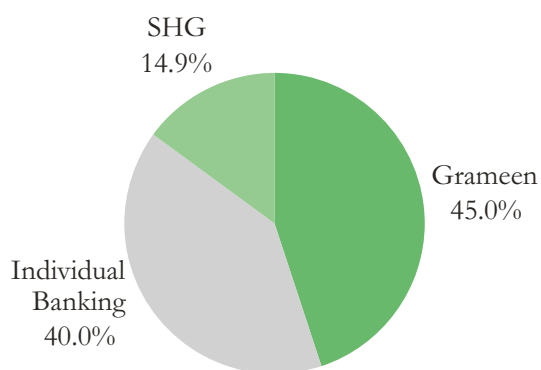
The full sample of 58 Indian MFIs had raised a total of Rs118 crores (\$28.8 million) in thrift deposits at the time of their latest ratings. These are the deposits accepted formally - and taken onto their balance sheets by the MFIs in the sample from their members.

Exhibit 2.12 provides the distribution of aggregate deposits (member savings) across models for the sample MFIs. The low contribution of the SHG model, 15% of the total for the sample, is misleading. Savings form the crux of empowerment and are collected to give members the experience of financial transactions as a means of developing self-governance capabilities. However, this analysis heavily understates the amount of savings actually mobilised by SHGs promoted by MFIs since it does not include the amount that is retained by each self-help group for internal circulation and, therefore, not recorded by the MFI in its accounts. It is estimated that the actual level of savings by members of SHG

MFIs - both with the MFI and the SHG - is around three times the figure recorded in the MFI's accounts. This would increase the total savings of members of MFIs in the sample to Rs150 crores (\$37 million).

Exhibit 2.12
Distribution of thrift deposits of members

Model	Rs crore	\$ millions	% of total
Grameen	53.1	12.9	45.0
Individual	47.2	11.5	40.0
SHG	17.6	4.3	14.9
M-CRIL India	117.9	28.8	100
Top 10	54.1	13.2	45.9



The magnitude of MFI thrift deposit services is, of course, limited by the fact that in India not all MFIs are able to offer deposit services. Organisations registered as non-bank finance companies (NBFCs) that are regulated by the central bank, the Reserve Bank of India, may offer such services only after obtaining an investment grade rating from a recognised corporate rating agency. Only two NBFC MFIs have been able to get such ratings so far and even these can only accept deposits under highly restrictive conditions. In addition, a number of other MFIs - 22 of the 58 in the sample (even some of those registered as societies and trusts) - do not provide thrift deposit facilities to their members since such services are technically illegal under the RBI Act, unless specifically permitted by the central bank. As a result, the Rs117.9 crores (\$28.8 million) of savings formally mobilised by the MFIs in the

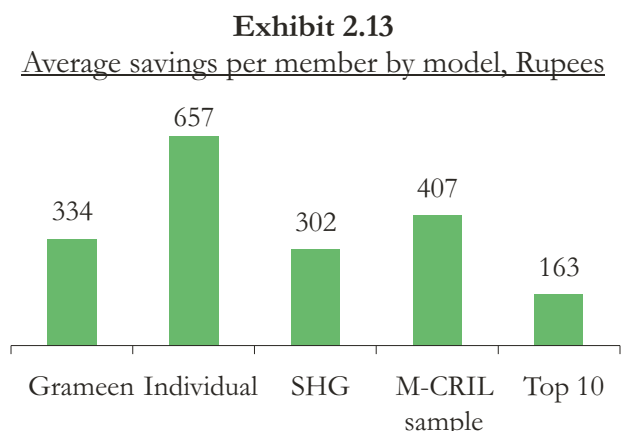
⁴ EDA, 2004. *The Maturing of Indian Microfinance: Impact Monitoring & Assessment Report for the Small Industries Development Bank of India*, Lucknow.

⁵ EDA, 2006. *Self Help Groups: The light and dark sides*. Study for Catholic Relief Services and others.

sample amount to just 8.1% of the total amount outstanding to loan clients. This represents a decline in the savings to portfolio ratio from the 11.5% of the 2005 sample and indicates the effect of regulatory pressure on the willingness of MFIs to offer deposit services to low income clients. Conversely, the high deposits mobilised by the individual banking model are related to the legal basis of such MFIs as cooperatives or rated NBFCs that are specifically permitted to offer deposit services to their members.

As **Exhibit 2.13** indicates, all the methodologies have low average savings per member except for the individual banking model. Each of the bars reflects the nature of the methodologies and the legal framework in which the organisations operate.

SHG programmes, usually have voluntary deposit schemes in which the members themselves determine the amount of the recurring savings deposit. Since disposition of this amount is determined by the group rather than by the individual saver, this often results in minimalist norms and leads to deposits that are far lower than the members' savings potential. Deposits form just 4.0% of the average SHG MFIs' portfolio, though (as indicated earlier) this excludes the far larger amounts revolved internally by SHG members⁶.



In the case of the Grameen organisations, on the other hand, the limited savings per member is due to the credit-led nature of the model. This leads Grameen MFIs to fix relatively small (5-20%) proportions of loan amounts as compulsory deposits by borrowers. Interestingly, for the individual banking model, the average savings per member is high on account of the cooperative institutions. These organisations are able to offer a set of savings products and the collection of deposits is an integral part of their business model. This provides a pointer to the likely impact of a facilitative regulatory framework on the financing of microfinance in the country; such a framework could enable client savings to form the bulk of funds deployed in microfinance. Average deposits of Rs407 (\$10) per MFI client in India are minuscule when compared with the global benchmark of \$251 for the universe of MFIs reporting globally to the MIX. The deposits collected by the Top 10 are even lower at Rs163 (\$4.00) per member, a negligible fraction of the global benchmark of \$388 for financially sustainable institutions. The low savings orientation of the Top10 results from their registration as NBFCs that are not allowed by the RBI to raise deposits. The amounts still carried by these companies on their balance sheets are made up of limited amounts of cash security against advances. As in the case of average loan balance, these small numbers are partly also an indication of the low levels of income of Indian MFI clients in nominal dollar terms.

The growth of outreach discussed in this section inevitably affects the operating costs and portfolio performance of MFIs. These issues are discussed in the next section.

⁶ Issues of deposit orientation of MFI models and their relationship with regulation and resource mobilisation are discussed in **Section 4**.

Section 3

Operating Efficiency and Portfolio Quality

—over the past few years the structural shift in Indian microfinance has given way to a push for growth; Indian MFIs are now amongst the fastest growing as well as the most efficient internationally

The Indian MFI sector performs far better than other markets in productivity and efficiency. With 326 staff members each, the sample Indian institutions serve 231 borrowers per staff member two-thirds more than their South Asian peers that have historically been regarded as more productive. On account of their streamlined activities, Grameen MFIs lead the field and continue to be the most innovative in this area, though productivity gains appear to be decreasing.

This high productivity results in some of the lowest servicing costs for Indian MFIs. Both Grameen and SHG MFIs record average servicing costs of the order of Rs400(\$10) per borrower one third the amount spent by the typical Asian MFI. As institutions have grown and staff productivity has increased over the years, servicing costs have come down even in nominal terms. With an inflation rate averaging 5% per annum in the mid-2000s, this has resulted in a decline of around 9% per annum in the cost of servicing borrowers.

Over the past year, expansion of the leading MFIs into less developed parts of the country has resulted in some loss of efficiency. The typical Indian MFI's operating expense ratio rose from 18.5% to 20.7% even as competition and political pressure pushed down portfolio yields, from 27.3% in 2005 to 24.0% - not significantly different from the rates charged by commercial banks on consumer finance. New institutions recorded high deficits in their operations, but yields improve and operating expense ratios decline as MFIs begin to benefit from economies of scale, which are significant up to a portfolio size of Rs2.5 crores (\$600,000).

While efficiency is important, it would be counter-productive if MFIs reduced the follow up of clients in order to save cost, especially since MFIs that are able to control their portfolio qualities are those that also have the competence to grow. Partly due to official action that undermined the credit culture in some districts, the weighted average PAR has declined from 4.7% in 2005 to 6.0% now, with leading MFIs particularly affected. The sector has been historically reluctant to write off bad loans and appropriately provision for eventual loan loss, though this is decreasingly so as the prudential implications of writing off unrecoverable loans have become better understood.

3.1 Cost efficiency

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

3.1.1 Staff Productivity

—staff productivity in India is now higher than in any other major region offering microfinance

The 58 MFIs in the sample have a staff strength ranging from 7 to 2,397. The average number of staff in the sample is 326 per MFI, which is greater than the global benchmark of 94. Overall, as **Exhibit 3.1**

shows, it is the Grameen organisations that have large complements of staff with an overall average of 460, but this is inevitable given that they are also the largest MFIs by numbers of clients.

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

Staff productivity by models is depicted in **Exhibit 3.2**. While individual banking programmes are the most efficient in terms of average portfolio per staff member, Rs12.5 lakhs (~\$30,600), it is the Grameen model in which the staff service the largest number of borrowers (273) but, as discussed above, for much smaller loans. Staff productivities in India are now much higher than the Asian benchmark, despite a preponderance of group lending across the region.

Grameen institutions have, as a group, shown the greatest concern for efficiency and become the most competitive MFIs in India today with staff productivity increasing from 146 in 2003. The low client productivity of the individual banking MFIs (~163) results from the large difference between the number of loan clients and the number of members. These institutions serve 295 client members per member of staff and this is now close to the 300 members served per staff member of the sample for this review. Deposit services to non-borrowing members of individual banking organisations are provided directly by staff, thus reducing the number of loan clients they are able to work with.

SHG MFIs, as a group, emerge as relatively inefficient serving just 179 borrowers per staff member who services a portfolio of Rs7.2 lakhs (\$17,600). At 297, average staff productivity of SHG programmes is much higher in terms of client members served.

Exhibit 3.1

Average staff employed by sample MFIs

Model	Average number of staff members
Grameen	460
IB	274
SHG	226
M-CRIL India	326
Top 10	1,079
MIX India	303
Asia	135
Global	94

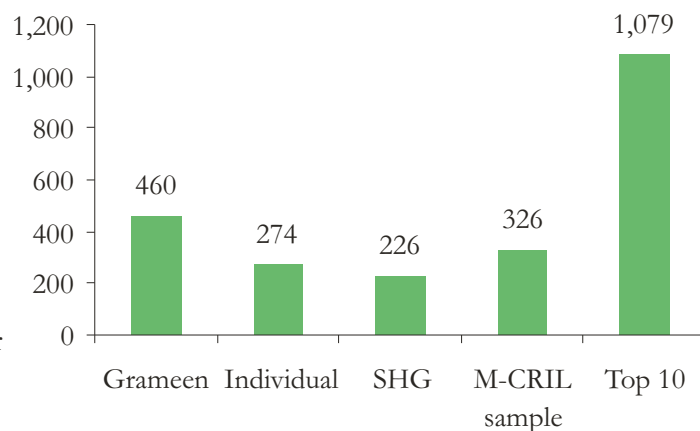


Exhibit 3.2

Staff productivity

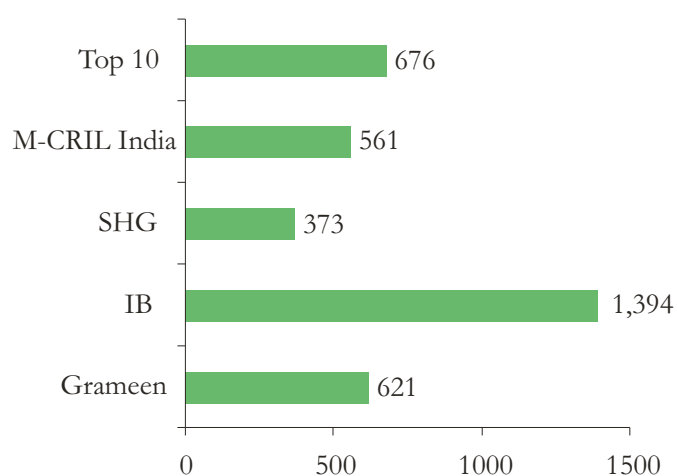
Model	Borrowers/member of staff	Portfolio serviced	
		Rs lakh	US\$ '000
Grameen	273	7.3	17.8
IB	163	12.5	30.6
SHG	179	7.2	30.6
M-CRIL India	231	7.8	19.0
Top 10	275	8.5	20.8
MIX India	255		
Asia	125		
Global	112		

This figure incorporates not only large numbers of clients who are savers and, therefore, receive a useful service but also, unfortunately, an at least equally large number of dormant clients and is, therefore, questionable. The relatively low productivity of the SHG model is largely on account of the intensive staff inputs required in the initial years of developing the self-governance capabilities of client groups. While this is understandable, it is also an important factor affecting the cost efficiency of SHG MFIs.

The sample average of 231 borrowers per staff member is somewhat lower than the Top10 average of 275 borrowers per staff member though the averages for the number of members served are roughly the same at 300 and 307 respectively. The portfolio serviced by average MFI staff is Rs7.8 lakhs (\$19,000), some 10% lower than the Rs8.5 lakhs (\$20,800) per staff member of the Top10. The borrowers per staff member average of the sample for India compares very well with the global benchmark of 112 borrowers per staff member and the Top10 average of 275 borrowers is more than twice the median of 116 reported for fully sustainable institutions. The India average of 231 is a lot better than the South Asia median of 160 borrowers per staff member with Bangladesh reporting 146 borrowers per staff member and even further ahead of the Asia figure of 126.

Exhibit 3.3
Cost per borrower (Rs)

Model	Cost per borrower, Rs			US\$
	2003	2005	2007	
Grameen	621	590	425	10.4
IB	1394	2,407	1,460	35.6
SHG	373	360	386	9.4
M-CRIL India	561	581	504	12.3
Top 10	676	500	473	11.5
2006 benchmarks				
MIX India				11
B' desh				11
Nepal				13
MIX Asia				38
Global				108



These productivity numbers for the current review represent significant improvements over the 2005 productivities with Grameen MFIs showing the greatest improvements but productivity growth of 5-10% per annum taking place in the SHG MFIs as well. This represents a significant decline in the rate of growth of productivity and suggests that the scope for further productivity growth may now be limited.

3.1.2 Cost per borrower

—of Indian MFIs has declined in nominal as well as real terms indicating the significant economies of scale in the delivery of microfinance services

The cost of loan servicing by Indian MFIs is very low in comparison with the global benchmark of \$111. Even when compared with other Asian MFIs, the cost per borrower amounts to less than one-third of the Asian median of \$38 and is similarly lower than the median for low end MFIs internationally (\$48). The average cost per borrower for the different MFI models is depicted in

Exhibit 3.3. The cost of delivering the bulk of micro-loans in India is of the order of Rs500 (\$12.3) per borrower per annum. This is the upper end of the cost incurred across 50 of the 58 MFIs serving nearly 86% of clients that make up the Grameen and SHG-based service providers. It is greater than the average cost incurred by the Top10 institutions. The Indian numbers make international microfinance seem highly extravagant with only Bangladesh and Nepal at comparable levels. These figures, however, are expressed in absolute terms and do not take into account differences in standards of living across the region.

Since the cost per borrower reported in the 2003 and 2005 Reviews Rs561 and Rs581 respectively, this represents a decrease in the average cost of servicing Indian MFI clients (despite an inflation rate of the order of 5% during this period). Indeed, in the case of Grameen clients these numbers represent a significant *decline even in the nominal cost of serving them*. Since the Grameen MFIs are the largest and fastest growing in India, this is a clear indication of the economies of scale in microfinance.

The cost per borrower in the case of IB in India is higher, as it requires better contact with clients on account of significantly larger average loan size and no group security. More stringent loan appraisal and frequent visits (particularly to delinquent clients) add to the cost of servicing such loans though, even so, the average cost of less than \$36 is lower than the \$38 Asian median.

3.2 Operating efficiency

3.2.1 Operating expense ratio

–has not changed much as Indian MFIs have focussed on growth but are still amongst the most efficient in the world

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

The average Indian microfinance client was being served in 2006 by MFIs that were more efficient than those internationally. The weighted average OER for sample MFIs is 15.9% (slightly higher than the 15.6% of the 2005 M-CRIL sample) and that for the Top10 MFIs in the sample has risen to 13.1% (from 10.8%). However, these expense ratios are well below the global median of 20.1%. The MIX data, with

Exhibit 3.4

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

Model	Weighted Avge (%)	Typical MFI (%)	Operating expense ratio				Total no. of MFIs
			<10%	10-15%	15-25%	>25%	
G	16.7	16.4	4	8	6	3	21
IB	20.5	24.5	2	1	4	1	8
SHG	11.2	23.2	7	4	7	7	25
M-CRIL,2007	15.9	20.7	13	13	17	11	54
2005	15.6	18.5	25	19	23	16	83
2003	20.5	36.5		23	21	46	90
Top 10	13.1	11.6	4	4	2	0	10
MIX	India	Bangladesh	Nepal	South Asia	Global	Asia	
	10.4	14.2	11.2	14.3	21.5	17.2	

only the more efficient MFIs reporting, shows how the median for India (10.4%) is better not only than the Asia and South Asia median ratios but also better than Bangladesh and Nepal (**Exhibit 3.4**).

The typical Indian MFI— as measured by the simple average across MFIs — had an OER of 20.7% . This performance represents a levelling off of the improvement in efficiency of Indian MFIs reported in the 2005 Review over 2003 when the weighted average was 20.5% for the India sample and the typical MFI incurred as much as 36.5% cost in servicing the portfolio. While the earlier improvement was attributable to the progress made by Grameen MFIs as they had a high OER of 25.2% in the 2003 Review, which was reduced to 16.3% in 2005, it is the same category that has slipped slightly this time. This levelling off of operating efficiency is reflected in the similar distribution of MFI OERs across the performance categories for the current sample to that in the 2005 Review.

This levelling off in efficiency has occurred despite an improvement in staff productivity (discussed in the previous section) and a reduction in cost per borrower (shown above). It is directly related to the push for growth in outreach that has occurred over the past two years, resulting in growth rates in excess of 80% per annum in the number of borrowers served. Relatively little of this growth has been in contiguous areas as the leading MFIs have competed to be seen in the less developed parts of the country. This trend to reach the under-served areas has resulted in increased outreach but with some loss of efficiency. The increase in the OER of the Top10 is also partly attributable to the growth of MFIs that are more focussed either on livelihoods promotion or on social welfare products (like insurance and pensions) rather than merely on credit delivery. While the pursuit of such strategies is laudable from a development perspective, the short term impact on efficiency has been negative as these add-on activities are yet to find viable business models.

Amongst the MFI models, typical Grameen MFIs are the most efficient on average in terms of operating expenses. The low weighted average for SHG MFIs results from the apparently more efficient ones externalising their promotional costs. Thus their self help group promotion costs are incurred by other organisations the government or NGOs while only the portfolio servicing costs are accounted for by the MFI. This anomaly of the Indian microfinance system is common to both the MFI sub-sector and the bank-SHG linkage programme and is yet to be resolved.

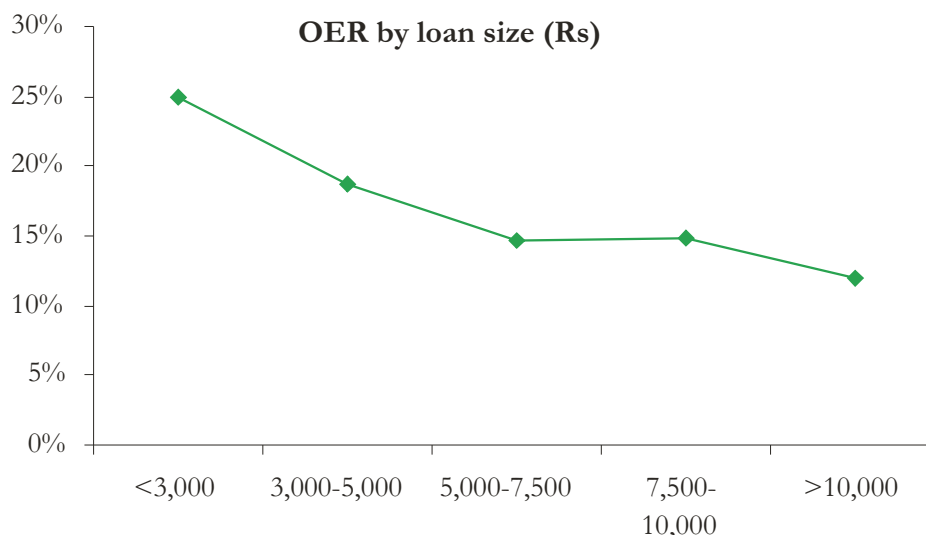
It is apparent that even the 13.1% operating expense ratio for the Top10 is within the “best practice” range for microfinance where transaction costs relative to loan sizes are well known to be substantially higher than the 3.0-4.0% (of advances) reported as operating expenses by the commercial banking sector in the country. These far lower average expense ratios typical of the formal banks mean they are able to limit their interest rates on loans well below those of microfinance. The lower interest rates of the banking sector convey the impression that it ought to be cheaper for MFIs to service their loans as well. However, the average size of a commercial bank loan is several multiples (8-10 times) the Rs5-6,000 (\$70-80) loan balance typically serviced by Indian MFIs. The efficiency of Indian MFIs relative to benchmarks presented above should dispel the popular impression of Indian MFIs as being “too costly”.

Indeed the fact that loan size is a key determinant of operating expense ratios is apparent even from the data for the sample. It shows that **loan size** (the size of loan disbursed in **Exhibit 3.5**) shows a very clear downward trend in OER as the loan size increases. MFIs with the smallest size of loan disbursed (less than Rs3,000, \$75) record typical OERs of 25% whereas larger categories reduce to 15% and even 12% for the largest, above Rs10,000 (\$250), category. There is, of course, some correlation with the age of an MFI here since the newer MFIs tend to have smaller loan sizes but an even stronger correlation with the fast growing institutions that both incur higher costs when they are in their growth phase and have lower loan sizes on account of having large numbers of new clients.

Exhibit 3.5
Impact of size of loan on the OER of Indian MFIs

Average loan size, Rs	<3,000	3,000-5,000	5,000-7,500	7,500-10,000	>10,000
OER(%)	25.0	18.7	14.7	14.8	12.0

As MFIs stabilize in terms of growth and become older institutions, their OER declines as the costs of growth (training staff, opening new branches, reaching new geographical areas) are more limited while their average loan size increases as the number of clients getting the fourth or fifth repeat loan becomes quite high (perhaps 50-60%). Conversely, MFIs operating with larger loan sizes are able to limit their operating expense ratios partly on that account. Similarly, the “weaker sections” lending of the commercial banks (with average loan sizes almost four times those of MFIs) is, inevitably, substantially cheaper to service than that of MFIs and, thus, represents a different asset class altogether.



3.2.2 Composition of operating expenses

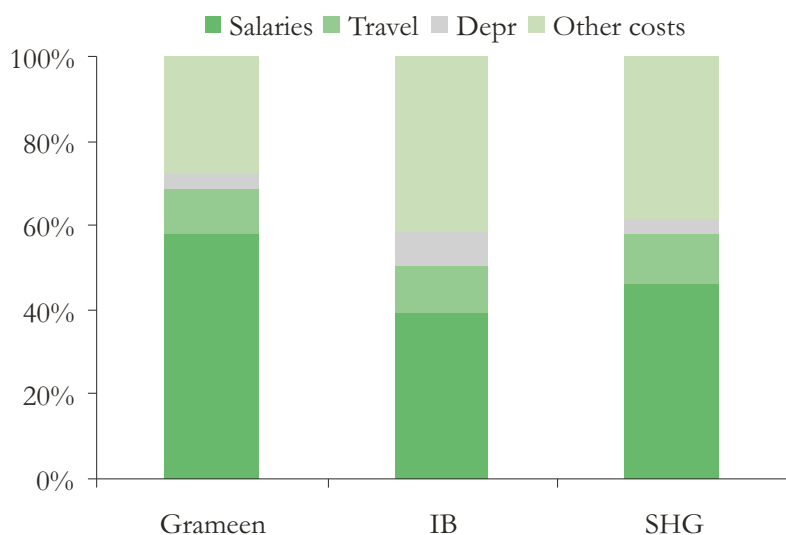
—conforms to international “best practice” norms for microfinance but travel costs take an increased proportion of the total as MFIs push for growth

Looking at the four major components of operating expenses indicated above while SHG and Grameen models incur around half their operating expenses on staff, individual banking programmes incur a much lower 40%. This is because individual banking is focussed purely on the delivery of financial services to individual clients. It does not form groups and the time the staff member spends with the client is limited to transaction time. In Grameen and SHG programmes, by contrast, staff spends time forming and attending group meetings as well. This cost break-up is presented in **Exhibit 3.6**. The Indian MFIs' salary allocation of 40-60% is well within the global best practice range (Asia, 57.1%; global, 55.8%).

For MFIs, travel is also a significant expenditure contributing as much as 12.0% of total expenses in the case of SHGs and 10.7% in the case of Grameen MFIs. This ratio for the sample has increased to 11% from 9% in 2005 and for the Top10 it has gone up even more from 9.7% to 12.2%. This is largely a reflection of the increased costs incurred as the large MFIs push for growth in less developed parts of the country.

Exhibit 3.6
Cost distribution and operating expense ratio (% of total)

Model	Salaries (%)	Travel (%)	Depreciation (%)	Other Admin costs (%)
Grameen	57.8	10.7	3.7	27.7
IB	39.6	11.1	7.8	41.5
SHG	46.0	12.0	3.6	38.4
M-CRIL sample	51.5	11.0	4.6	32.9
Top 10	55.3	12.2	3.0	29.6
MIX India	51.0		49.0	
Asia	57.1		42.9	



Grameen MFIs incur other administrative costs of ~28% (about the same level as in the 2005 Review). The Grameen organisations always tend to have low proportionate expenditure on administration as their standardised recording systems reduce paperwork, and well-defined servicing strategies reduce travel costs.

3.2.3 Comparison with portfolio yield

–the effective interest rate paid by the average Indian microfinance borrower is no more than 25%, not significantly different from the ~24% charged by commercial banks on consumer finance

Besides looking at the contribution of various components to an MFI's operating expenses it is also instructive to compare OER the cost incurred on servicing loans with the yield (interest income earned from the portfolio outstanding for a given period) to ascertain the margin earned albeit before accounting for the cost of funds or for loan losses. The typical yield at 24.0% (compared to 27.3% in the 2005 Review) has declined. The improvement in the yield-OER performance of Grameen MFIs is attributable to improvement in OER from 33.4% in the 2003 Review to 21.1% in 2005 and even further to 16.4% now. Most Grameen MFIs incur high operating expenses till they reach maturity and, in recent months, increasing numbers have done so. **Exhibits 3.7 and 3.8** compare the OER to the portfolio yield across the various types and ages of MFIs.

In order to neutralise for the dominance of a few well-run, large MFIs, the information in the above figure relies on *typical MFI* (simple averages of individual MFI ratios) rather than on weighted averages. Grameen MFIs continue to cover their operating expenses through their earnings on portfolio as they did in the 2005 sample.

Exhibit 3.7

Typical operating expenses in relation to portfolio yield...

Models	OER (%)	Yield (%)	Wtd ave Yield (%)
Grameen	16.4	24.0	27.6
IB	24.5	18.5	26.1
SHG	23.2	16.5	18.3
M-CRIL India	20.7	19.6	24.8
Top 10	11.6	22.7	24.4
MIX medians			
South Asia	14.3	23.3	
Asia	17.2	26.5	
India	10.4	21.7	
Global	20.1	30.2	

The SHG organisations continue to have the greatest adverse difference between expenses and income largely due to their social orientation and low interest rates. However, the difference between the yield (16.5%) and OER (23.2%) is significantly better than the yield (12.6%) and OER (63.8%) respectively of the 2003 sample but has not improved over that achieved in 2005. While the improvement in yield indicates that even these MFIs are acquiring a more sustainability focussed orientation and charging more realistic interest rates the increase in OERs points partly to the fact that some of the MFIs in this category have, in fact, converted to the Grameen model in the process.

Equally importantly, in the context of recent events in the Indian microfinance sector, it is also worth taking a careful look at the weighted average yield. This ratio indicates the **effective interest rate paid by the average Indian microfinance borrower** for her loans. This ranges from 27.6% paid by Grameen clients to 18.3% paid by the average client of SHG-based MFIs. Clients of the Top10 pay around 24%. When compared with the 26.5% median for Asia and 30.2% global median, moneylender rates of 30-72% in different parts of India and consumer finance rates of around 24% charged even by established commercial banks for much larger loans, it is apparent that the Indian MFI rates are not exorbitant. There has, indeed, been a marginal decline in average yield from 25.2% reported by the 2005 Review to 24.8% now.

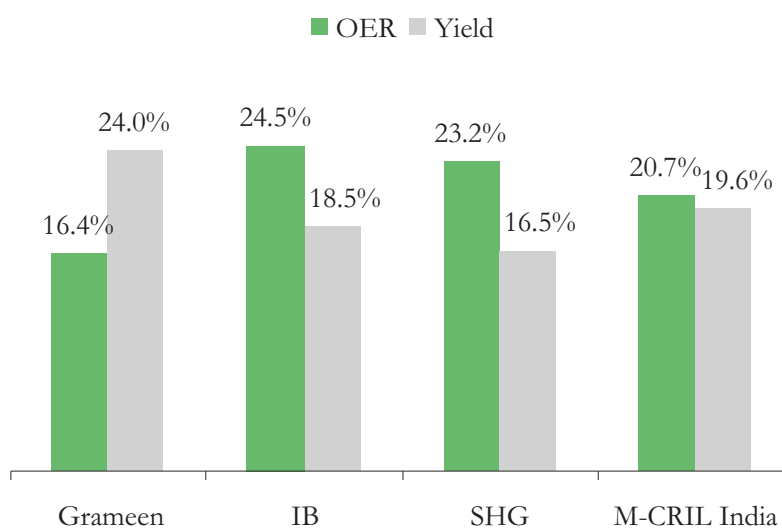
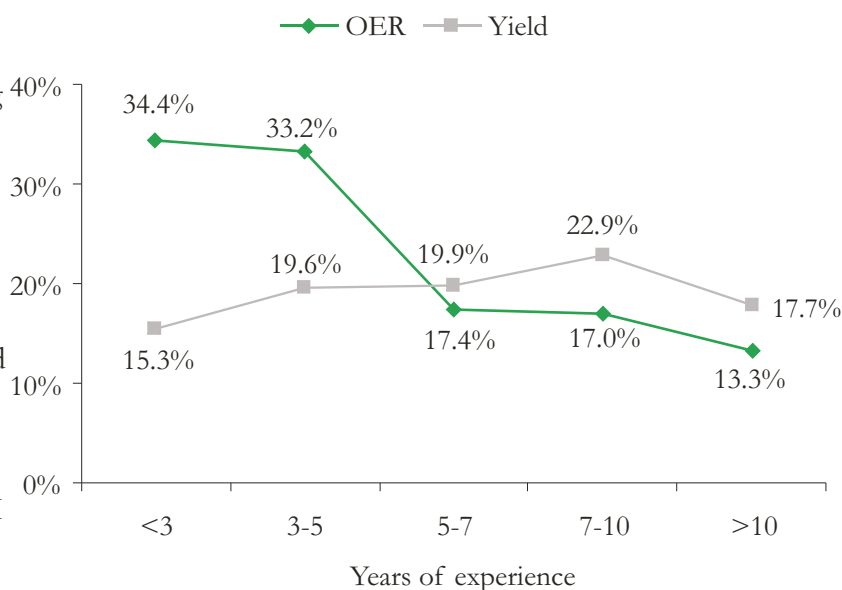


Exhibit 3.8
Operating expenses and portfolio yield by age of MFI

Age, years	OER (%)	Yield (%)
<3	34.4	15.3
3-5	33.2	19.6
5-7	17.4	19.9
7-10	17.0	22.9
>10	13.3	17.7
M-CRIL India	20.7	19.6
Top 10	11.6	22.7
MIX Global	15.3	30.2

The trend in OER and yield by age, **Exhibit 3.8**, shows that relatively new institutions have a low average yield (15%) and high OER (34%) so they record huge deficits in their operations. Since these MFIs are new, staff productivity is low and they must put significant effort into mobilising and educating clients. At the same time, loan sizes are small relative to the expenses incurred. The adverse difference in yield and OER declines substantially when MFIs start expanding their operations from their third year.

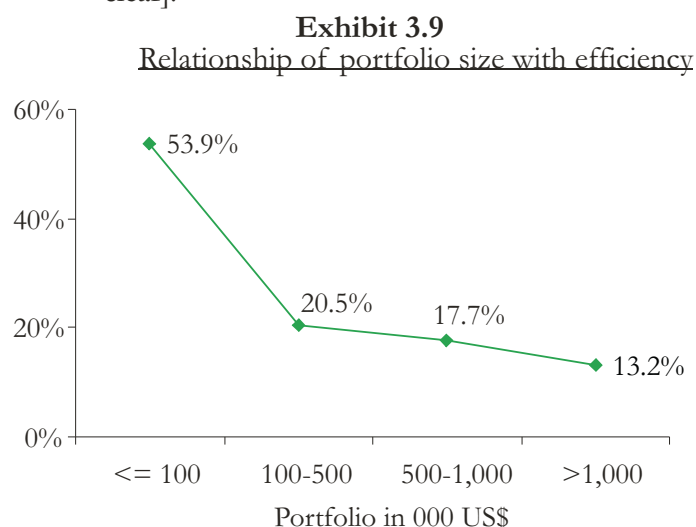
Gradually the OER improves as MFIs achieve economies of scale. As the figure shows, the decline in the OER is dramatic during the Years 3-5 and improves further to the seventh year and even further beyond that. There is, however, no discernible correlation between the age of an MFI and yield. This is due to the fact that while an MFI has significant control over expenses, its pricing of loans is affected by external factors such as competition (with other MFIs, with moneylenders and with government programmes) and, more recently, the prevailing political environment in its operational area.



3.2.4 Economies of scale

—are evident, particularly up to a portfolio size of Rs2.5 crores (\$600,000)

Since economies of scale are generally expected in any economic activity, the relationship between the operating expense ratio and overall portfolio size of individual MFIs is illustrated in **Exhibit 3.9**. Though the correlation is not perfect, a rough inverse relationship between portfolio size and operating expense ratio emerges from the sample information. However, the inverse correlation is stronger for growth on very small outstanding portfolios up to around Rs82 lakhs (\$200,000) in India when the OER is around 12-14% after which it stabilises. It goes down further to a range of 5-10% as the portfolio goes beyond around Rs20-25 crores (\$4-5 million). However, this also depends on the methodology adopted by the MFI and is related to the concern of the management for achieving sustainability. [There is a high variation in OERs for MFIs of every size class but the broad trend is clear].



Overall, across methodologies, MFIs have shown substantial improvement in the management of operating expenses. As these models scale up further, some further improvement in the OER can be expected though these gains will depend on the rate of growth of the MFI since high rates of growth result in higher average costs and also on the economies of scale available at the relatively small average sizes of loan provided by Indian MFIs.

3.3 Portfolio quality

—has deteriorated overall as official action, not entirely justified, has undermined the credit culture in some areas

While efficiency is important, it would be counter-productive if MFIs reduced the follow up of clients in order to save cost since this would result in a decline in portfolio quality and a consequent increase in loan losses. Database analysis indicates that the Grameen organisations in India have been the best performers with a typical Portfolio at Risk (PAR₆₀) of just 0.9% in the 2005 Review (**Exhibit 3.10**) and 9 of the 19 MFIs with less than 1% PAR₆₀. This performance is attributed to a small 5-member group structure and to better group discipline maintained through deployment of significant resources by the MFI and strong delinquency management efforts. Hence, this good portfolio quality was often maintained at high cost (typical OER 21%). Over the past two years, however, some of the Grameen MFIs operating in south India suffered a setback on account of government concerns about consumer protection issues. As a result of local government actions, clients in one of the most microfinance intensive districts of Andhra Pradesh stopped paying their dues and the repayment culture in other districts was also affected. As a result, the PAR of two of the largest MFIs in the country increased to high levels increasing the overall PAR of Grameen MFIs to over 8%, affecting the country average too —up from 4.7% in 2005.

Though overall SHG MFI performance on portfolio quality remains relatively poor, they have improved considerably over the past few years as the PAR₆₀ has reduced from 8.6% for the typical MFI. Though the weighted average for SHG MFIs has come down to just 1.1% this is largely on account of the exemplary performance of one large SHG facilitator in Tamil Nadu.

The Top10 average PAR₆₀ of 4.6% has also suffered on account of the problem in Andhra Pradesh and, as a result, Indian PAR ratios are not as good as those reported globally. Indian benchmarks display better results, but portfolio quality benchmarks may be significantly overestimated since self-reporting is subject to misunderstanding and variations in interpretation. Benchmarks results moreover correct for loans overdue by more than 365 days, and these are written-off from MFI portfolio in the adjustments. Overall, while M-CRIL PAR ratios for Indian MFIs seem high by international standards, the situation is far from alarming.

Exhibit 3.10
Portfolio at risk (>60 days), by microfinance model

Model	PAR ₆₀ (Wtd aveg) (%)	PAR (Typical) (%)
Grameen	8.4	8.1
IB	6.0	14.1
SHG	1.1	8.6
M-CRIL India	6.0	9.8
Top 10	4.6	2.2
MIX PAR₃₀		
India		0.8
Bangladesh		1.1
Nepal		4.7
South Asia		1.2
Asia		2.1
Global PAR₃₀		2.8

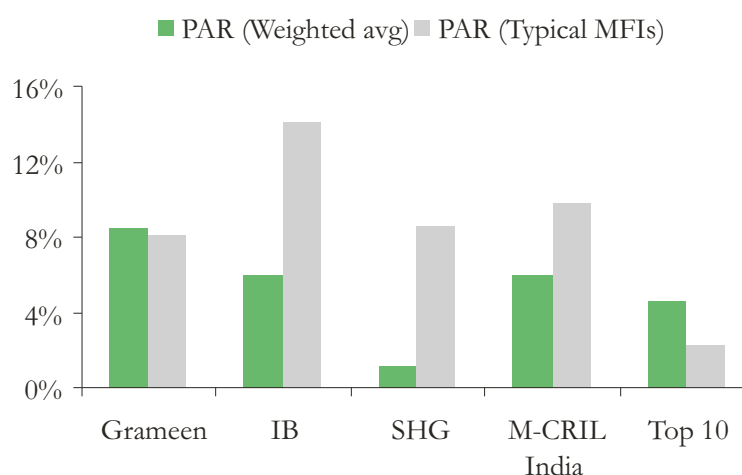


Exhibit 3.11 presents a cross-sectional analysis of the trend in PAR with growth in portfolio size. While methodology is also an important factor, the data confirms the expectation that it is the organisations that are able to control their portfolio qualities that also have the competence to grow. Portfolio sizes of Rs5 crore (\$1.2 million) and above are only achieved by organisations that have the ability to develop appropriate systems and keep portfolio quality under control.¹

However, a similar relationship is not discernible between good portfolio quality and an MFI's experience in terms of years of existence. **Exhibit 3.12** shows PAR₆₀ of typical MFIs with experience ranging between less than 3 years to greater than ten years. The PAR₆₀ of the youngest MFIs is quite good in

Exhibit 3.11
...and by portfolio size

Portfolio		PAR	
Rs crores	US\$ mill	Typical MFI(%)	Weighted average (%)
<0.5	<0.12	17.7	21.1
0.5-2.5	0.12-0.61	14.4	13.2
2.5-5.0	0.61-1.2	10.3	8.5
5.0-10.0	1.2-2.4	5.5	3.5
10.0-25.0	2.4-6.1	4.9	4.7
>25.0	>6.0	3.9	6.2
M-CRIL India		9.8	6.0

¹ Two outliers in the Rs10-25 crore portfolio category have been excluded, one managed by a temple trust and the other an urban traders' cooperative each its own special case.

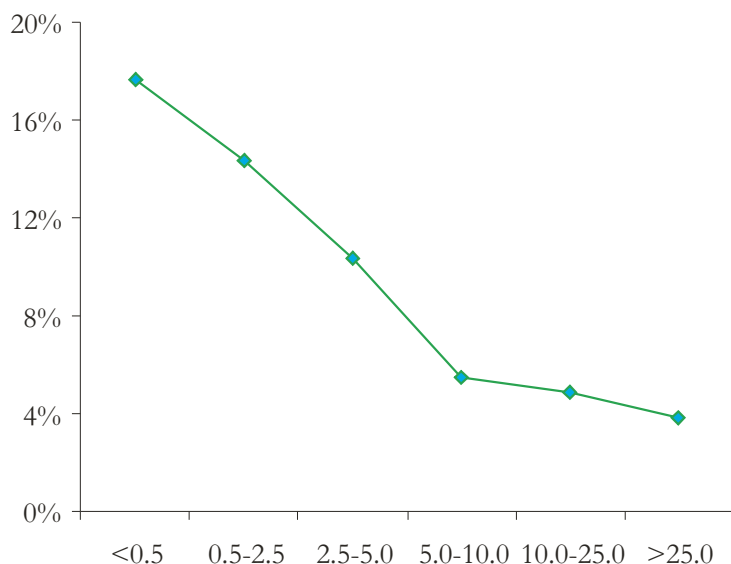
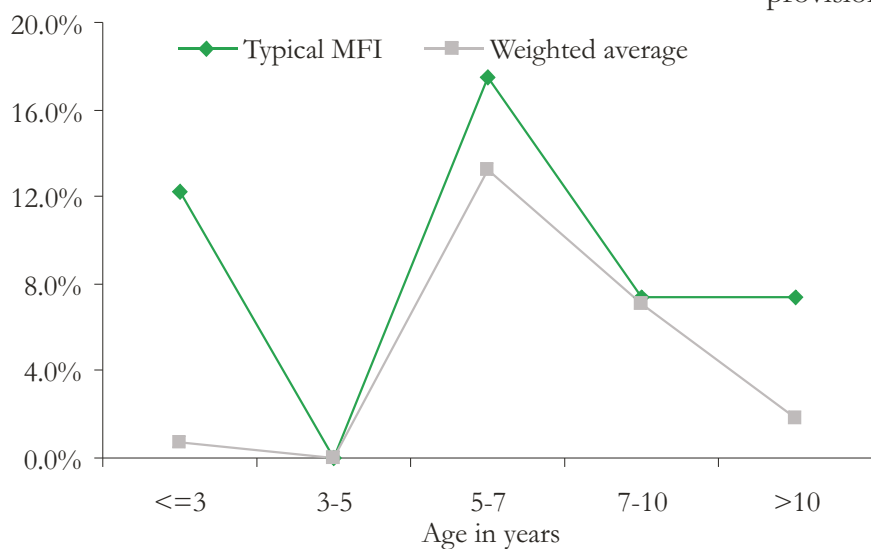


Exhibit 3.12
...and by MFI age

Age Years	PAR	
	Typical (%)	Wtd average (%)
<3	12.2	0.7
3-5	0.0	0.0
5-7	17.5	13.2
7-10	7.4	7.1
>10	7.4	17.7
Sample	9.8	6.0



terms of weighted average. The apparent anomaly of the youngest having good portfolios is explained by a number of recent start-ups having been established by professionals (rather than development practitioners) and, therefore, following best practice principles from the start. The PAR ratio for the over 10 year category here is skewed by a few large institutions that have become entrenched for reasons other than microfinance but are able to continue operations on account of their work in client welfare that is supported by donors despite carrying high levels of risk and being basically unsustainable.

In spite of the increased consciousness of portfolio quality and higher PAR ratios than the international average, several MFIs in the sample do not make adequate provisions for loan losses. As a result, adjustments are made to existing balance sheets in order to determine appropriate loan loss reserves for both rated and self-reporting MFIs.

While Grameen MFIs have generally had a low PAR₆₀, they have continued to make annual provisions as a proportion (often 2%) of total

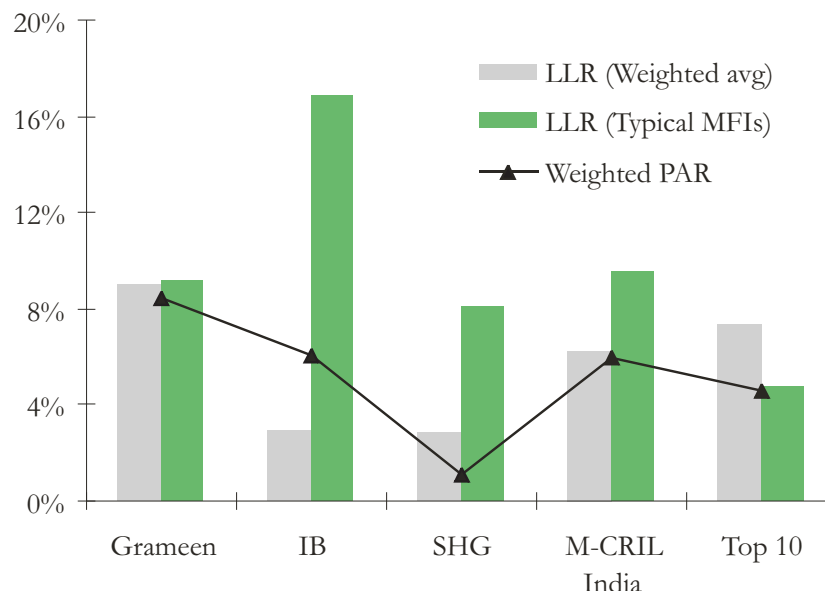
portfolio *a la* Grameen Bank – as a matter of prudence. More recently, on account of the official action in Andhra Pradesh loan loss reserves have had to be increased considerably and, as a result, **Exhibit 3.13** shows that Grameen MFIs have average reserve rates of around 9%, actually slightly higher than their typical PAR₆₀ (8.1%). Based on extensive MFI experience over the past ten years, the rule of thumb employed by M-CRIL is that the loan loss reserve rate should be about 50% of the PAR₆₀. However, due to the political difficulties of

recent times this relationship has broken down. In terms of what is appropriate as a loan loss reserve, relative to the rule the thumb can be flexed according to the history of recovery of overdues, substitute collateral and any other measures that reduce the risk.

Part of the reason for high PAR and low loan loss reserve ratios has been the historical reluctance of MFIs in India to write off unrecoverable loans for fear that clients/members would get the impression that loans remaining unpaid for extended periods of time would simply not be followed up by the organisation. Their concern not entirely unjustified was that both field staff and members would regard written off loans as a dole and that this perception would lead to their portfolio quality deteriorating further as more clients would stop repaying loans in the hope that these too would be written off. As a result, MFIs with relatively poor portfolio quality would allow their PAR ratios to increase without making any attempt to obtain a realistic picture of their asset profile. This confused the impression given by their balance sheets, which as indicated above sometimes did not include loan loss reserves at all and this, inevitably, affected the quality of management decision making. This is decreasingly so as most MFI managements have become more professional over time and the prudential implications of writing off unrecoverable loans have become better understood.

Exhibit 3.13
Loan loss reserve ratios

Model	LLR typical (%)	PAR typical (%)	LLR wtd avg (%)	Weighted PAR (%)
Grameen	9.2	8.1	9.0	8.4
IB	16.8	14.1	2.9	6.0
SHG	8.1	8.6	2.9	1.1
M-CRIL India	9.6	9.8	6.2	6.0
Top 10	4.8	2.2	7.4	4.6



The following section examines the financing of microfinance sources of funds and the efficacy of fund utilization by MFIs providing financial services to low income clients.

Section 4

Portfolio Financing

—the dependence of Indian MFIs on commercial debt as a source of funds is overwhelming, resulting in a low capital adequacy and high debt-equity ratios

The structural shift indicated by an increase in debt financing among Indian MFIs has continued while net worth as a proportion of the total has been reduced as current surpluses and a very limited flow of grants have failed to keep pace with growth. Borrowings have reached three-quarters of total liabilities on MFI balance sheets as funds have been readily available from both private and public commercial banks. Even small institutions with relatively low exposure to financial markets have succeeded in sourcing half of their liabilities through bank borrowings, bringing over 60% of MFIs under the 15% suggested capital adequacy ratio. The trend towards commercialization becomes even stronger in the context of off-balance sheet financing under the partnership model, which accounts for an additional 44% of the overall portfolio in the sector. When managed loans are added back to the balance sheets of a subset of leading Indian MFIs, The leverage ratio jumps from 10.7 to 11.9, far exceeding the regional median of 6:1.

While a limited amount of debt continues to be available at concessional rates, much of it is contracted at commercial rates in the range of 10-14% per annum. With such financing accounting for four-fifths of the portfolio of leading MFIs, the commercialization of the Indian sector far exceeds that of other important markets in the region, such as Bangladesh, where institutions source less than one-tenth of their portfolios from commercial funds.

Indeed, Indian MFIs are increasingly turning to the banking sector as their access to grants and customer deposits continues to diminish. The share of grants dropped from one third of the balance sheet in 2003 to just 3% in 2006, barely covering cumulative losses among smaller institutions. With the ability to raise equity capital limited to just a few legal entities, reliance on net worth fell to 10%, less than one-third of that in 2003. Bank borrowings have also had to fill in for customer deposits, which amounted to one-fourth of MFI resources in 2003 and are now under one-tenth of the balance sheet. Concerns over the legality of savings mobilization combined with increasing transformation to NBFCs have phased savings out of MFI balance sheets. And mostly confined these to community-based institutions such as SHGs and cooperatives.

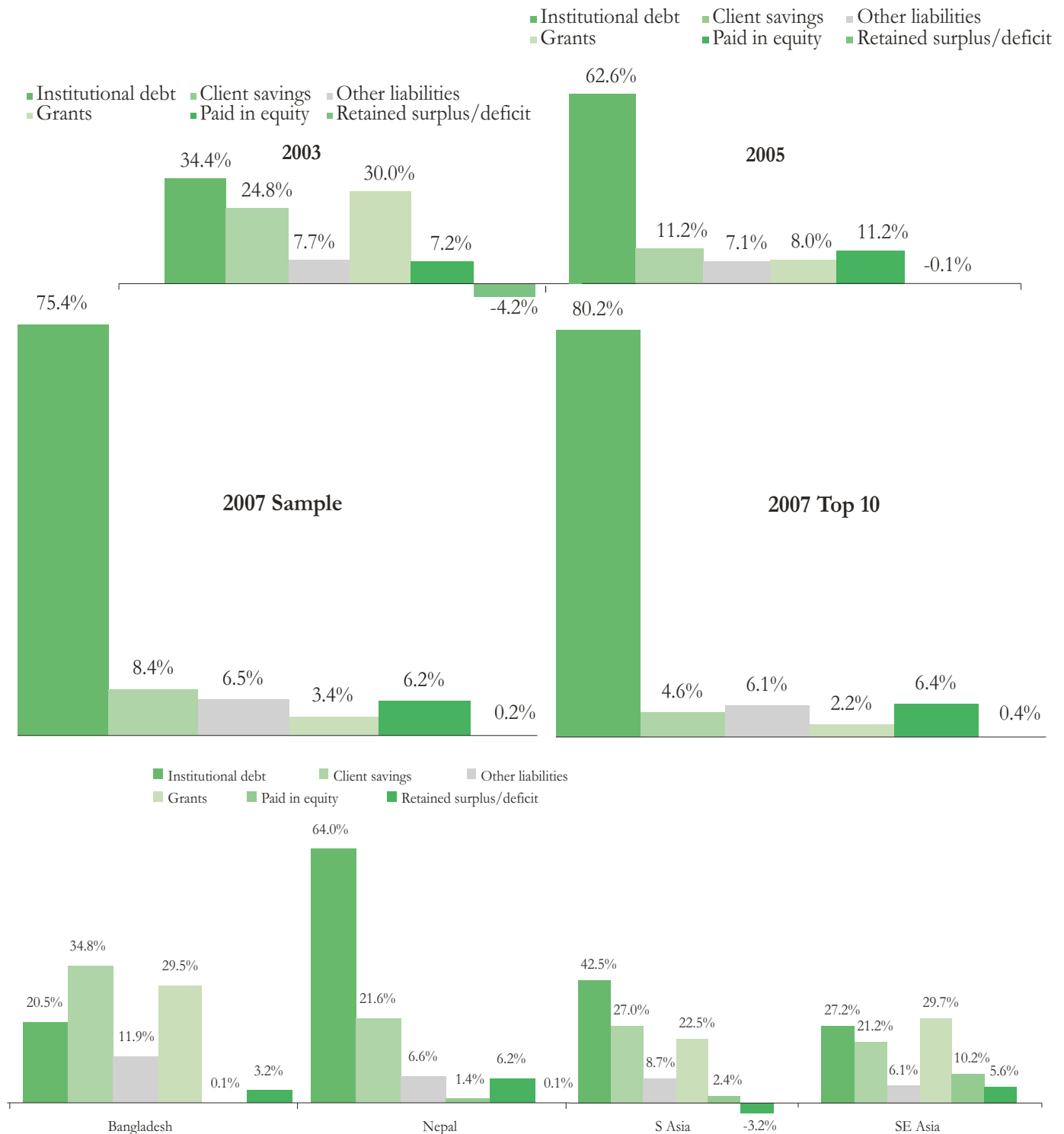
Indian financing patterns, however, could look quite different in the next few years. Under proposed legislation, societies, trusts and cooperatives will be able to offer thrift services. While companies are excluded from this proposed regulatory regime, a number of these have recently announced large investments by private equity funds. With the Top10 accounting for two-thirds of the financing, debt may be ceding some of its share to equity capital.

4.1 Sources of funds for microfinance

—debt has become dominant; grants have faded; regulations have alienated Indian microfinance from the saving power of its clients

The major shift in the financing pattern of microfinance in India during 2003-05 has continued to strengthen during the current period. The distribution of sources of funds for microfinance, presented in **Exhibit 4.1**, based on a consolidation of information for the rating sample, shows that the share of debt in MFI finances has climbed sharply from 34% (out of total liabilities or Rs375 crores, \$83 million) in the 2003 sample to nearly 63% (of Rs786 crores, \$176 million) in 2005 and now to 75.4% (of Rs1,713 crores, \$418 million).

Exhibit 4.1
Sources of funds for microfinance operations



Commercial debt funding for microfinance in India was initially promoted in a big way by the Small Industries Development Bank of India (SIDBI) beginning in the late-1990s but over the past five years has been enthusiastically taken up not only by ICICI Bank – the second largest commercial bank in the country – but also by a range of other new generation commercial banks including HDFC Bank, Axis Bank as well as foreign commercial banks like ABN Amro and Citibank. More recently, public sector commercial banks like the State Bank of India and Bank of India have also started to take a more active interest in the activity.

The debt (and equity) focus of Indian microfinance funding is placed in further perspective by the information for other Asian countries emerging from M-CRIL's international ratings over the past few years.¹ As in other aspects of microfinance performance, the Nepali MFIs seem very similar to the Indian ones – but for different reasons.² In Bangladesh, by contrast, debt funding is only 20.5% of microfinance funds while client savings account for nearly 35%. Even in Nepal, where rated institutions have 'limited banking licenses' allowing them to raise deposits from members, client savings account for some 21.6% of total funds. In South Asia generally (excluding India) and in Southeast Asia also client savings are 27% and 21% of total funds. The alienation of microfinance from the saving power of its own clients is unique to the Indian situation.

The extent to which commercial debt has come to dominate the financing of Indian micro-finance over the past few years is apparent from **Exhibit 4.1**. Indeed, the domination of commercial funds in Indian microfinance is under-played by the above information since it excludes the off-balance sheet financing of the “partnership model” heavily promoted by ICICI Bank – the second largest commercial bank in the country. A separate compilation of the portfolio managed by MFIs for others – partnership or securitised portfolios that are not on MFI balance sheets – shows that the amount is Rs596 crores (\$145.4 million), an additional 44.3% of the portfolio on the MFIs' balance sheets. As discussed in Section 2, this results in a total portfolio of Rs1,941 crores (\$473.5 million) serviced by MFIs in the sample. When managed loans are added back to the balance sheets of benchmarked MFIs, the leverage ratio jumps to 11.9, far exceeding the global median of 2.6.

The share of net worth (grants + paid in equity + retained surplus/deficit) on MFI balance sheets has declined from 33% in 2003 to 19% in 2005 to just 9.8% in 2007. This results from the combined effect of accumulated losses over the years, 4.2% of total liabilities in the 2003 sample to marginal accumulated surpluses since 2005 – just 0.2% for the current sample. The effected is reinforced by the virtual halt in the flow of grants into Indian microfinance (with its share on MFI balance sheets declining from 30.0% in 2003 to 8.0% in 2005 and just 3.4% now).

Equally important, the share of client savings has declined considerably from 25% in 2003 to 11.2% in 2005 and 8.4% now as the larger MFIs have increasingly transformed into regulated entities (NBFCs) –as reported in **Section 1**, 9 of the top 10 MFIs in the country are either already “for profit” NBFCs or are in the process of transforming to this legal status – and have had to withdraw from offering thrift deposit facilities since these are both technically illegal and specifically prohibited for NBFCs that do not have an investment grade rating from a corporate rating agency. Given the increase in the number of corporate entities amongst the large MFIs it is not surprising that the role of equity in MFI financing increased significantly from 7% in 2003 to over 11% in 2005 but has now fallen back to 6.2% on account of the substantial growth of debt financing.

The Top10 in 2003-2005 accounted for 56% of the financing of the sample. This has now increased to as much as 65.7%. The share of institutional debt in the Top10 has also risen significantly from 70% to over 80% of the funding. Just 6.4% of Top10 funds are accounted for by equity while, as expected, client savings are a low 6% of the total.

In practice, concern about the legality of deposit services offered by MFIs (and gentle pressure from the banking services regulator, the Reserve Bank of India) has led to the service being segregated from lending activities. Deposit services are now confined to community-based institutions such as SHGs

¹ The data is mainly for the 2004-06 period.

² To be discussed in the international version of the Review to be published shortly.

and mutual benefit trusts while MFIs continue to offer credit and other services. The resulting substantial decline in the savings orientation of MFIs is common over both SHG and Grameen MFIs as is apparent from **Exhibit 4.2**. The high deposit orientation of the IB model is on account of the formal banking or cooperative mode of some of the MFIs which can legally raise deposits. The high savings orientation of cooperative MFIs continues to demonstrate the potential for providing deposit services to low income clients, but also shows that, if an appropriate regulatory framework were in place, microfinance could be undertaken to a large extent with resources raised from MFI clients.

The 10.8% savings orientation of the latest India sample is very low by global standards. The Top10 –more visible and, therefore, more vulnerable – have an even lower savings (to portfolio) orientation at 5.6%, similar to the 2005 figure and down substantially from the 23.7% of the 2003 sample.

The pattern of funding sources also varies with the size of the portfolio. **Exhibit 4.3** shows that as MFIs grow, they capitalise on economies of scale and reduce their losses significantly. At the time of the rating visit, 19 of the 35 MFIs with portfolio greater than Rs2.5 crores (\$0.61 million) had recovered cumulative losses while 21 were earning current profits.

Exhibit 4.3 also shows that the high (37%) grant orientation of small MFIs is used mainly to cover their losses. It is interesting that even such MFIs now have significant (47%) institutional debt. The very low (1.3%) grant orientation of the 16 largest MFIs indicates their level of sustainability. As noted earlier, their equity orientation has actually declined though this is likely to be reversed with the large investments announced since March 2007 by private equity funds in some of the largest MFIs in India.

It is apparent that the importance of donor funds in Indian microfinance has declined as MFI managements have increasingly been able to obtain more resources from various types of institutional lenders even as regulatory concerns have reduced their ability to raise client deposits. While some institutional debt is still available at concessional rates – partly because banks are able to classify such lending as 'priority sector' directed credit – much of this debt is at commercial rates in the range 10-14% per annum for wholesale lending.

Exhibit 4.2
Savings-portfolio ratios (%)

Model	Client saving as % of portfolio		
	2005	2007 sample	
	all MFIs (%)	all MFIs (%)	only MFIs with deposit services (%)
Grameen	6.3	6.9	12.1
IB	43.1	21.9	30.1
SHG	11.0	5.4	16.7
M-CRIL India	14.6	10.6	18.2
Top 10	5.7	5.6	10.8
Global ave			29.6

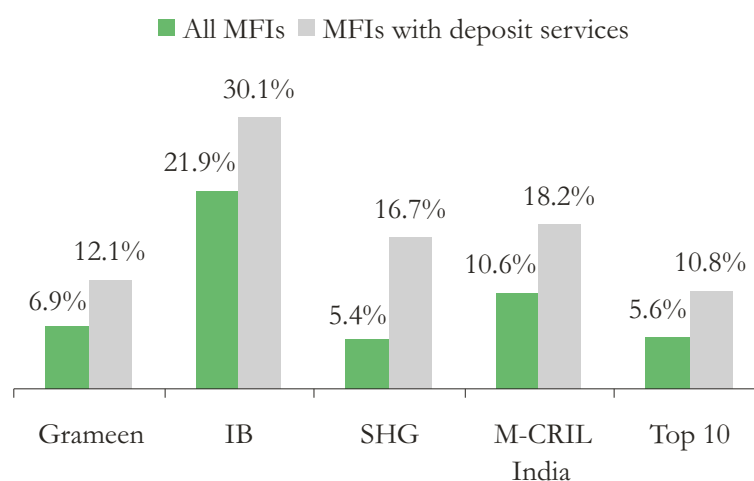
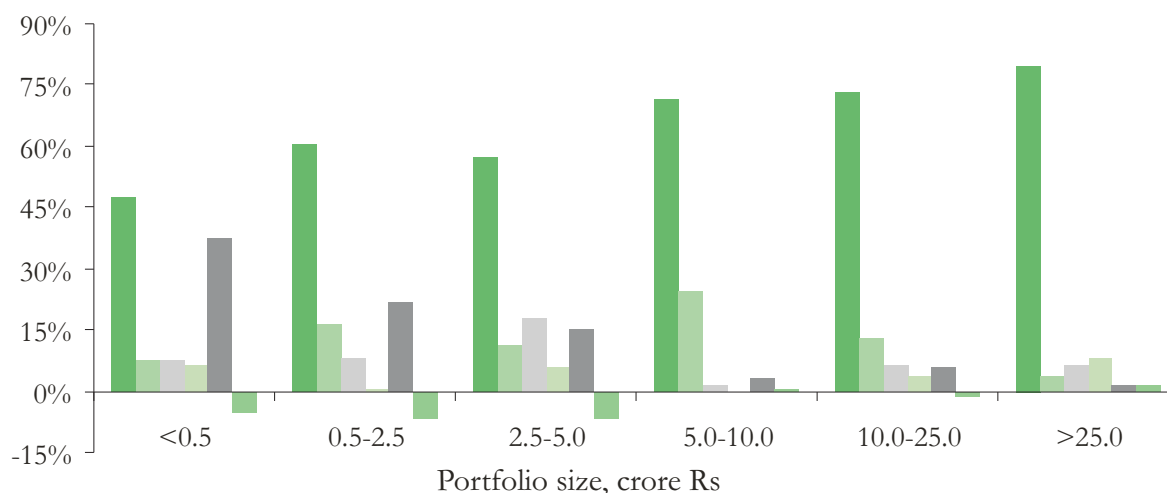


Exhibit 4.3

Funding pattern by portfolio size (%)

■ Institutional debt ■ Savings ■ Other liabilities ■ Paid in equity ■ Grants ■ Retained earnings/losses

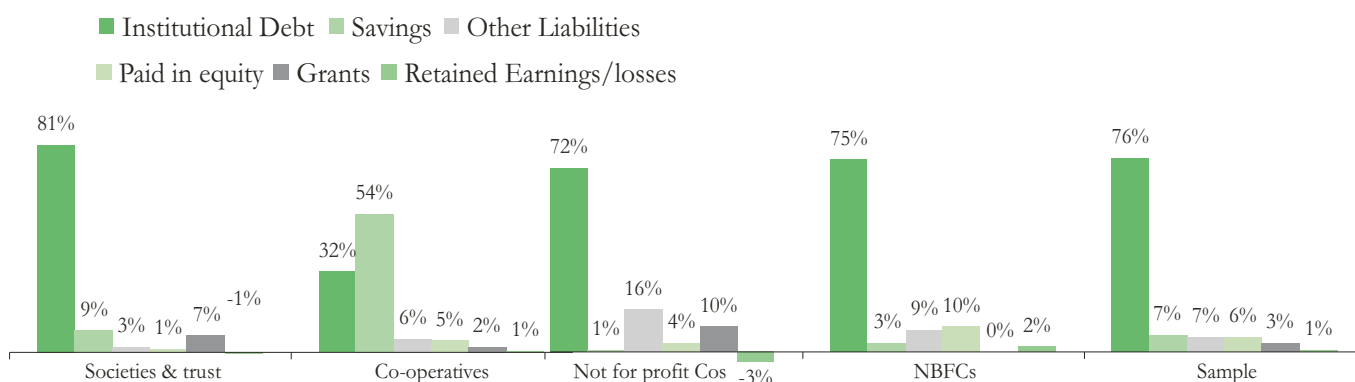


Portfolio size (Rs crores)	Portfolio size (US\$mill)	Institutional debt (%)	Savings (%)	Other liab (%)	Paid in equity (%)	Grants (%)	Retained earnings/losses (%)	Total (%)
<0.5	<0.12	47.3	7.2	7.4	6.1	37.4	-5.4	100
0.5-2.5	0.12-0.61	60.4	16.4	8.2	0.2	21.5	-6.7	100
2.5-5.0	0.61-1.2	57.4	11.4	17.7	5.6	14.9	-7.0	100
5.0-10.0	1.2-2.4	71.3	24.3	1.3	0.0	2.9	0.2	100
10.0-25.0	2.4-6.1	73.2	12.9	6.1	3.4	5.8	-1.4	100
>25.0	>6.1	79.5	3.8	6.3	7.7	1.3	1.3	100
M-CRIL India		76.6	7.0	6.5	6.3	3.4	0.2	100
Top 10		80.2	4.6	6.1	6.4	2.2	0.4	100

The extent to which legal recognition of deposit taking makes a difference to the fund mobilisation of MFIs is apparent also from the funding pattern depicted in **Exhibit 4.4** classified by form of legal registration. The cooperative MFIs in the sample generate over 50% of their funds from member savings while deposits in the “for profit” NBFCs account for only 3% of their total funds since, as noted, there are extensive restrictions on their freedom to raise deposits. To the extent that deposits figure at all on their balance sheets this consists mainly of cash security on loans given to clients. Apart from cooperatives, the financing of activities of all types of institutions is dominated by institutional debt though grants still figure significantly on the balance sheets of both the societies/trusts and “not for profit companies” in the sample.

In the matter of generating surpluses, the difference in the commercial (for-profit) orientation of NBFCs and cooperatives relative to the development orientation of societies and trusts is apparent. Despite improvements in performance, the not-for-profit societies and trusts together still have accumulated losses (though this is down from nearly 9% reported in the 2005 Review) while the for-profit cooperatives and NBFCs have accumulated profits. To be fair, there is also an element of adverse selection in the institutional framework since the better performing (and larger) MFIs have transformed or, as noted earlier, are transforming into NBFCs.

Exhibit 4.4
Funding pattern by form of MFI registration



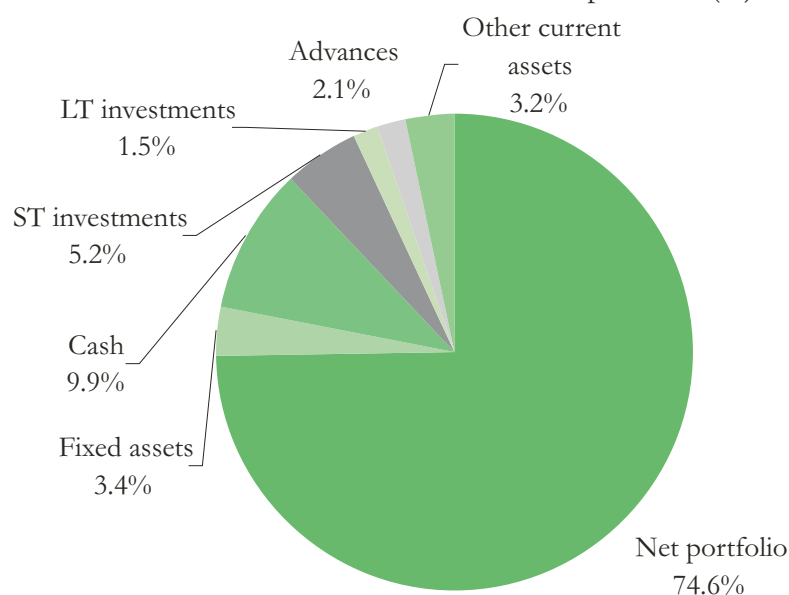
4.2 Uses of funds

- effective deployment of funds in loan portfolio
- capital adequacy is becoming a major concern

The allocation of funds by Indian MFIs, conforms fairly well to international best practice norms. Of the total resources of Rs1,713 crores (\$418 million) deployed in microfinance by the sample MFIs, nearly 75% is deployed in loans to clients (**Exhibit 4.5**). This is a fairly productive asset utilisation level being just below the MIX international median of 77.9%. Other allocations also conform fairly well to international norms. The Indian Top10 record a good performance with asset deployment in portfolio being 78.5% compared to the global 80.4% median for fully sustainable MFIs. The Top10 cash holdings at around 6% seem to be at a high level of efficiency though the fixed asset level at 1.8% is quite low by international standards.

As discussed earlier, MFIs in the sample included in the current Review also manage portfolios for others so the total portfolio serviced by these MFIs amounts to Rs1,874 crores (\$457 million) compared to the combined loan portfolio of Rs891 crores (\$199 million) of the 84 MFIs in the 2005 sample. This indicates a doubling of portfolio and very high annual growth rate of over 40% over a 2 year period (September 2004 to September 2006). As the update sample of 29 MFIs shows, assets on the balance sheet have gone up 2.5 times during this 2 year period.

Exhibit 4.5
Utilisation of funds for microfinance operations (%)



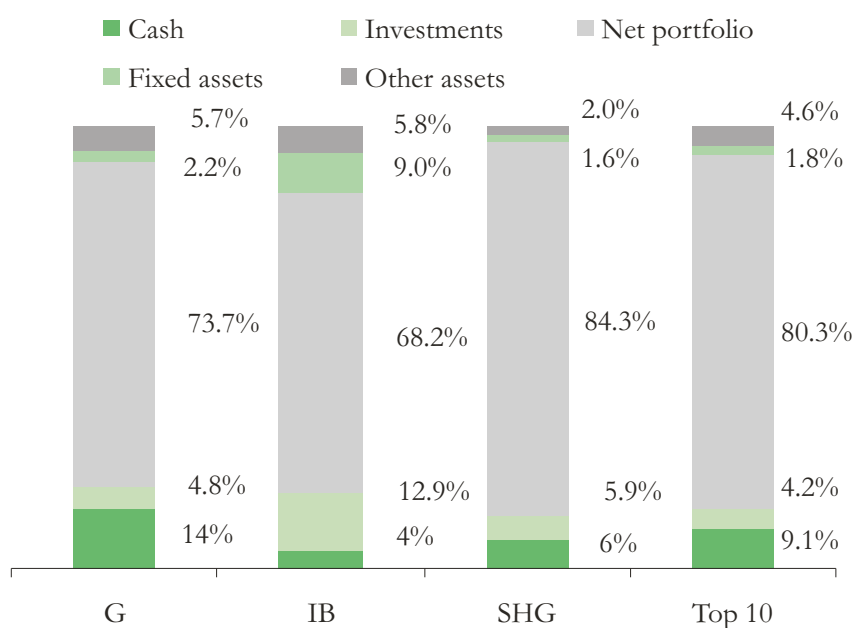
Allocations	Amount, Rs cr	%	Top 10
Net Portfolio	1,278.3	74.6	78.5
Fixed assets	58.7	3.4	1.8
Cash	169.7	9.9	8.7
ST investments	88.6	5.2	4.4
LT investments	25.6	1.5	0.3
Advances	36.7	2.1	2.2
Other current assets	55.3	3.2	4.1
Total sample	1,712.9	100.0	100.0

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

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

The allocation of assets has changed significantly between MFIs following different microfinance models (**Exhibit 4.6**). Individual banking MFIs still maintain the lowest cash holdings (4.0%), much lower than the 9.1% maintained by the Top10. The requirements of high growth and increasingly dispersed geographical location of the Grameen organisations, however, has resulted in an increase in their cash balances to 13.5% from 6.7%, with a lower proportion of funds allocated to portfolio (now 74%). The political risk faced by some of these MFIs has also been a factor, at least temporarily, in restraining disbursements leading to an accumulation of liquid funds. The highest proportion of resources deployed in loans to clients is by SHG MFIs (84%), though this is largely the result of a couple of the largest of these joining the quest for sustainability. The rest of this sub-sector of microfinance continues to conform to the familiar pattern of financial inefficiency relative to the rest of Indian microfinance.

Exhibit 4.6
Asset allocation (%)



Another aspect of good financial management is that of asset-liability matching. An analysis of the sample indicates the huge difference between the long term and short term sources and uses of funds. **Exhibit 4.7** depicts this matching for the overall sample.

Most MFIs aim to mobilize long term sources of funds such as long-term loans (repayable in 3-5 years), locked member savings and grants in order to finance their portfolios. On the other hand, the loans they extend are, usually for a period of one year, sometimes less, thus

becoming short-term assets. As in the figure, this translates into short term assets which account for 95% of the total while 92% of the liabilities are long-term. This is an area in which traditional MFI fund management is highly appropriate to their financing structure and has contributed to the relative stability of microfinance in India. This is in contrast to the asset-liability management of MFIs in some other Asian countries – a factor that is discussed in an Asian Microfinance Review to be published in the near future.

For ensuring prudential management, banks in India are expected to maintain Capital Adequacy Ratios (CAR - net worth as a proportion of risk weighted assets) of 9% and NBFCs of 12%. The relative lack of financial management experience of MFI managers, however, means that, for microfinance, a minimum 15% ratio is generally regarded as more appropriate. **Exhibit 4.8** provides information on the prudential management of sample MFIs.

Until now, with substantial historical grant funding and more recent operating surpluses accompanied by relatively small portfolios, the Indian microfinance sector has been well provided for in terms of owned funds. Now, the growth aspirations of MFI managements, competition and the relative paucity of grant funds, on the one hand, and the availability of liberal commercial debt funds, on the other, have taken their toll. The aggregate figures suggest that capital adequacy is now an issue as even the Top10 MFIs fail to register the 15% norm suggested above, though it is not alarming yet. The debt-equity ratios emerging from the two samples used here are far higher than the 5:1 norm in such lending by commercial banks. However, as noted earlier, the advent of social investment and private equity funds into microfinance – since March 2007 – has already started to correct this situation for the leading MFIs. For the time being, the growth of the smaller MFIs will depend, in the short term, on the indulgence of bankers, to provide them funds and on the ability of managements, in the long term, to shape up operations and generate adequate surpluses to attract further financing.

Before the private equity funds, a number of microfinance focused social investment funds– Bellwether, Lok Capital, Unitus and others – had already made some investments in the Indian

microfinance sector. Even the International Finance Corporation (IFC) has taken an interest. As a result, the equity constraint had already eased somewhat –particularly for start-up MFIs established by professionals. However, the institutional framework and the minimum capital requirements for transformation – continue to be a problem and this, naturally, limits the extent to which MFIs can raise equity as only those registered as companies can do so.³ Overall, as the figure in **Exhibit 4.9** shows, some 62% of the MFIs in the sample (36) have CARs less than the appropriate 15% level and 10 have negative net worth meaning that their current losses are actually eating into their borrowed funds.

Exhibit 4.7
Asset-liability matching

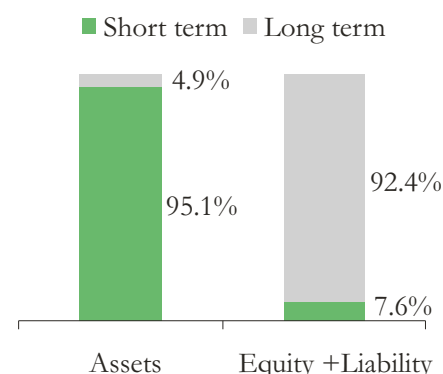
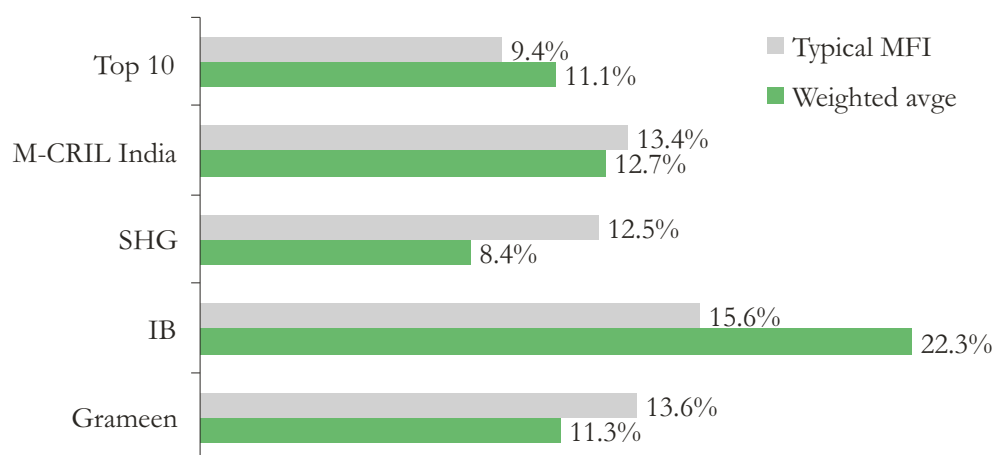


Exhibit 4.8
Capital adequacy ratios of Indian MFIs

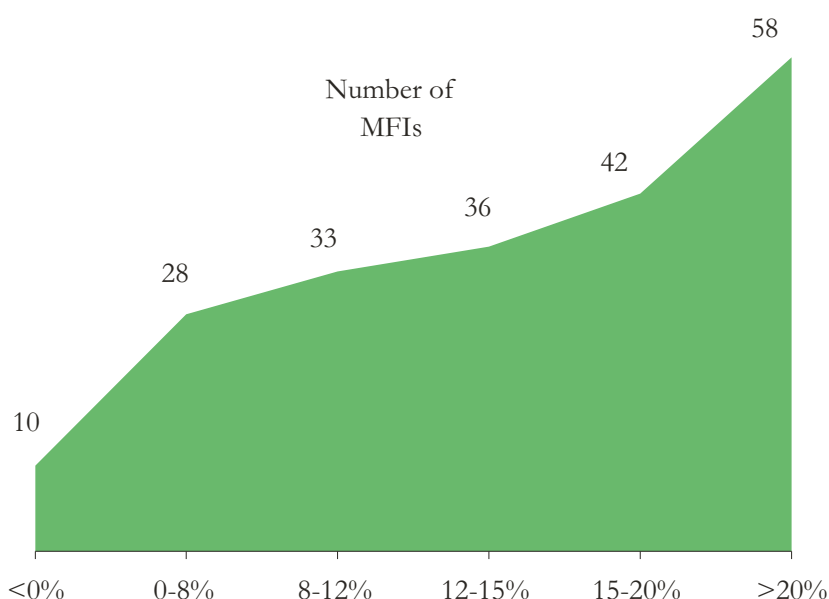
Model	Weighted CAR (%)	Typical MFI (%)
Grameen	11.3	13.6
IB	22.3	15.6
SHG	8.4	12.5
M-CRIL India	12.7	13.4
Top 10	11.1	9.4
<u>Debt-equity ratios</u>		
M-CRIL India	7.2	14.2
Top 10	8.6	10.5
MIX India		11.9



³ Even cooperatives are limited to raising share capital from their members alone.

Exhibit 4.9
Frequency distribution of MFIs by CAR

CAR (%)	No. of MFIs	% of total
<0	10	17.2
0-8	18	31.1
0-12	5	8.6
12-15	3	5.2
15-20	6	10.3
>20	16	27.6
Total	58	100.0



In the context of managed portfolios, of course, this analysis is misleadingly favourable to MFIs. The partnership model was devised for the purpose of avoiding the capital constraint. In some cases, the capital requirement related to risky “on-balance sheet” portfolios has been replaced in the partnership model by a “First Loss Deficiency Guarantee” (FLDG) secured by a fixed deposit or other investment instrument. However, for the purpose of CAR, even these security deposits with banks carry a 50% risk weight and, in any case, may not have been sourced from the MFI's own resources (since social investors will sometimes provide the necessary funds). In other cases, the FLDG may even have been provided to the MFI by the lending bank as an overdraft. In these situations, the MFI management's effective stake in the risk carried by their operations can go down to 5% and lower. While the partnership model may offer a short-term solution to the capital problem, it does not resolve the issue in the long term. Indeed, some of the ill effects of unrestrained growth made possible by this arrangement have already begun to show. A surfeit of lending funds leads MFIs to

- ⇒ induct clients without due care and relationship building
- ⇒ lend beyond the capabilities and means of their clients
- ⇒ resort to coercive practices when the clients' express an inability to pay.

The emergence of consumer issues and the related political risk in Andhra Pradesh and Karnataka (and, by extension, elsewhere in India) can, at least partly, be attributed to this phenomenon. In this context, the reduction in the proportion of the managed portfolio from 53% of the owned portfolio in the 2005 sample to 44% now is a welcome development. With the RBI's recent strictures on such arrangements, the proportion of funds allocated to managed portfolios is likely to reduce further⁴. This has led to an increase in MFIs applying to banks for commercial debt – as is apparent from the increase in demand from MFIs for independent ratings.

In this context, the next section undertakes a closer examination of the sector's profitability and sustainability.

⁴ The banks have been asked to follow “know your customer” norms for all segments of their portfolios, effectively making it more difficult to offer micro-loans through this route since each customer must now be fully identified and known to the bank.

Section 5

Financial Performance

–efficiency with growth remains the overall mantra of the Indian MFI sector though financial performance has deteriorated significantly as the constraints of the operating environment have taken their toll

The financial viability of microfinance institutions in India is under threat, despite improvements in the yield gap. The 2.1% weighted return on assets of the 2005 sample has been reduced to zero. While typical MFI returns are -9.8%, well behind Bangladeshi institutions reporting to MIX, which lead the region in profitability. Low portfolio yields, combined with poor portfolio quality and rising financial costs have reduced Indian MFI surpluses. Improvements in collection measures have boosted portfolio yields to 93% of the expected figure, up from 85% in 2005. Yields, however, remain low, with 43% of Indian MFIs earning less than 24% on their portfolios. In comparison with 36-50% real costs of bank loans and moneylender interest rates ranging from 36% to 120%, MFI average yields represent a substantial benefit for low income clients.

Nonetheless, these are not sufficient to cover rising costs brought on by ambitious growth plans, deteriorating portfolio quality and hardening of domestic interest rates on borrowings. Benchmarks for profitable Indian MFIs indicate that they charge more sustainable rates than their unprofitable peers and earn 24.8% on their portfolios as compared to 19.5%, but they also maintain tighter cost control. While both groups face similar financial costs, sustainable institutions benefit from lower provisioning expenses because of their superior portfolio quality. Moreover, they benefit from economies of scale as the typical sustainable MFI manages a much larger portfolio than an unsustainable institution. Indeed, the sample of 58 institutions shows a concentration of portfolio and borrowers among institutions that are at or near sustainability. Nearly 50% of borrowers are served by MFIs with operational self-sufficiency in excess of 90%. Since outreach has grown dramatically, the absolute numbers of clients served by sustainable institutions has actually increased by 35% over the past two years. Despite the sobering events of the past 18 months, the overall impression of an efficient MFI sector that is growing strongly remains unchanged.

5.1 Portfolio income

–interest charged by MFIs is under pressure but the yield gap has been reduced; two-thirds of clients pay <=24% interest to MFIs

The income earned by an organisation's major asset – in the case of MFIs, the outstanding portfolio – should be its main means of attaining viability. Portfolio yield measures the income actually earned by MFIs on their portfolios. It is apparent from **Exhibit 5.1** that this income is under pressure resulting in a decline in weighted average yield from 25.0% in 2005 to 24.2% for the current sample. As discussed in **Section 3**, these yields are amongst the lowest in the practice of microfinance internationally and the 24.2% average interest paid by Indian microfinance clients are comparable to those paid by users of consumer finance from commercial banks and other formal financial service providers.

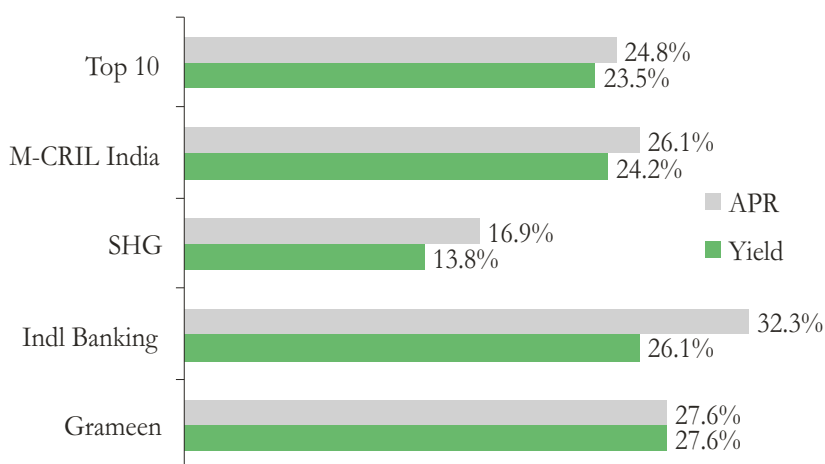
From the MFI perspective though, there has been a significant decline in weighted average APRs from 29.3% in 2005 to 26.1% now for the full sample and a similar 3% decline in the APR of the Top10 – a clear result of the political pressure there has been on MFIs over the past 18 months. The yields achieved are significantly different from the Annual Percentage Rates (APRs) – the expected interest rate – of MFIs in the region¹. A comparison of the APR and yield for the various microfinance models in the sample is presented in **Exhibit 5.1** as both weighted averages and for typical MFIs (simple averages).

¹ The APR is the highest income or yield that an organisation can earn from its portfolio based on the terms of its loans. The APR depends on the interest, fees and other charges, the loan term and the frequency of repayment.

Exhibit 5.1
Portfolio yield relative to APR

Weighted average

Models	Yield (%)	APR (%)	Yield/ APR (%)
Grameen	27.6	27.6	100.2
Incl Banking	26.1	32.3	80.7
SHG	13.8	16.9	81.5
M-CRIL India	24.2	26.1	92.8
Top 10	23.5	24.8	95.0
M-CRIL 2005	25.0	29.3	85.2
Top 10, 2005	23.9	27.8	86.0



Typical MFI

Models	Yield (%)	APR (%)	Yield/ APR (%)
Grameen	23.9	33.8	70.9
Incl Banking	18.5	25.5	72.5
SHG	16.5	20.4	80.8
M-CRIL India	19.7	26.5	74.3
Top 10	22.7	31.2	72.6
MIX India	21.7		
Asia	26.5		
Global	30.2		
FSS	31.0		

Frequency distribution: Number of MFIs

Interest (%)	APR	Yield	% of MFI borrowers served
< 12	2	7	7.5
12-18	8	19	34.7
18-24	14	17	27.9
24-30	15	7	21.7
>30	16	4	8.2
	55	54	100.0

The APR-yield mismatch is partly a reflection of rigidities in portfolio management and it is not surprising that, faced with pressure on their APRs, MFIs have, in fact, successfully reduced the yield gap from nearly 15% in 2005 to just over 7% now. For the Top10 the yield-gap² is now just 5%. The Grameen MFIs have been the most effective at this actually realising their full APRs from their portfolios (and even a little more through prepayment penalties) – the yield-APR ratio of the typical Grameen MFI is low (71%), however, and the apparent efficiency is attributable largely to the collection measures adopted by the Top10.³ Grameen's relatively rigid loan terms and high focus of the rated Grameen MFIs on collection of repayments enables the maximisation of portfolio productivity. On the other hand, SHG MFIs realise just about 80% of their planned interest income. This is both because of relatively poor portfolio quality, and ineffective/irregular collection systems of a number of MFIs following this model.

Compared to the 36-50% real costs of bank loans and moneylender interest rates ranging from 36% to 120% in various parts of the country, average yields of the order of 24% represent a substantial benefit for low income MFI clients. In the sample, 26 (42%) of MFIs have yields that are less than 18% and 43 (70%) have yields less than 24%. This is significant in the context of the recent debate in India about the suitability of interest rates charged by MFIs. These MFIs serve two-thirds of the 4.25 million active borrowers in the sample. Inclusive of these, 90% of borrowers pay less than 30% per annum for their loans from MFIs.

² Measured as One minus Yield divided by the APR (1-Yield/APR).

³ In some cases this could also be due to very rapid portfolio growth of MFIs charging interest on a flat basis since the interest component of an early instalment would represent a lower yield than interest on a later payment.

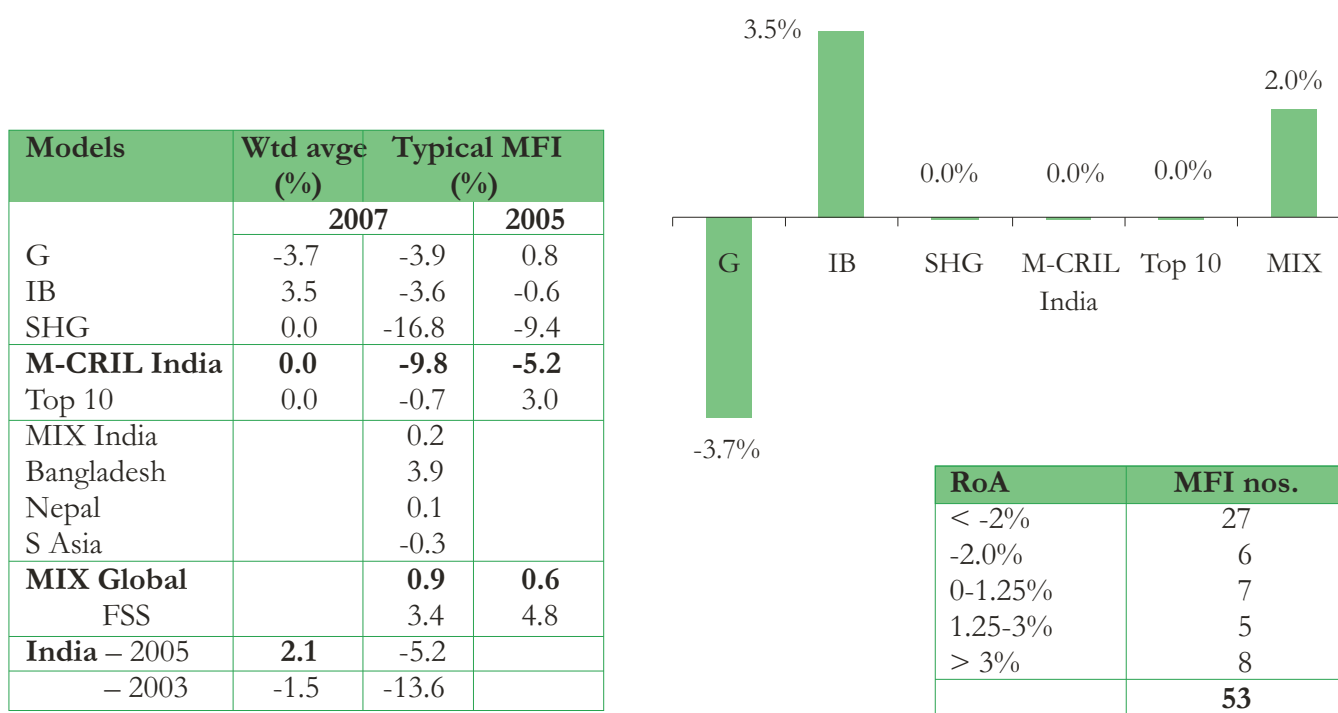
5.2 Returns to microfinance

—have deteriorated significantly since the 2005 Review with an increase in both the operating expense ratios and overall deterioration in portfolio quality

The financial viability of rated microfinance institutions in India, apparent in the 2005 Review, is under threat. This becomes clear in considering the returns they earn net of all costs – operating and financial. **Exhibit 5.2** provides a good indication of the situation. Across the sample, typically all types of MFIs including the generally efficient Grameen MFIs register losses. The 2.1% weighted average of the 2005 sample has now been reduced to zero, less than the 0.8-1.2% returns on assets reported by the commercial banks in the country.⁴ The Top10 in the sample now just break-even collectively well behind the 3.9% median return on assets of Bangladeshi institutions that lead in regional profitability.

As the information for *typical* MFIs indicates here, there are a large number of loss making organisations and relatively few, if large, viable ones. The disaggregated information in the following table shows that only 20 of the 58 MFIs (38%) are making profits and just 8 of these (15%) have returns greater than 3% of their assets. Essentially, while the microfinance sector generally improved its performance from a typical loss of 13% in 2003 to a typical loss of 5% in 2005 this has now deteriorated again to a loss of around 10%.

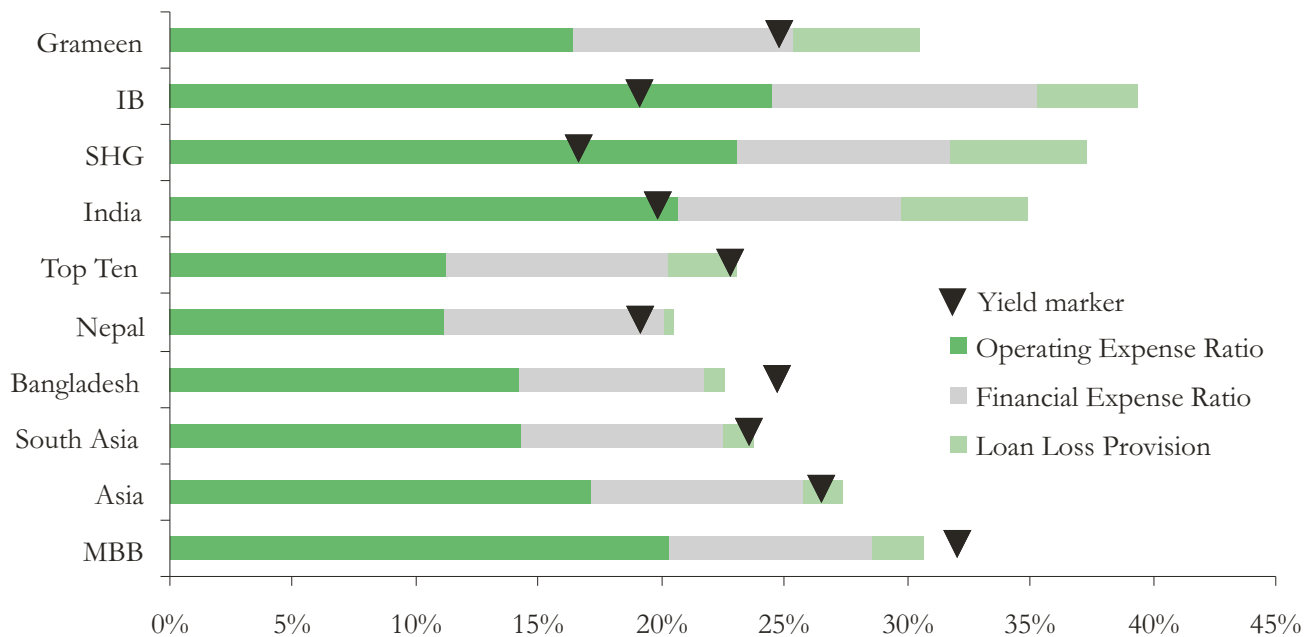
Exhibit 5.2
Return on total assets of MFIs



The profitability performance of Indian MFIs needs to be seen in the context of their much lower (24.0%) yield relative to global benchmark (30.2%) globally. Indeed, to the extent that the international yield is 1.26 times that of Indian MFIs it is laudable that the weighted average RoA of Indian MFIs is still just positive (though near zero). The relative efficiency (low OER) of Indian MFIs plays the key role in this. **Exhibit 5.3** shows that the financial expenses incurred by Indian MFIs are the same as global norm but the loan loss provisioning necessary is now higher and so is the operating expense ratio.

⁴ Bandopadhyay, T, 2006. “Our pygmy banks”, **Business Standard**, 21 September

Exhibit 5.3
Expenses and revenue realisation of Indian MFIs



Models	Operating expense ratio (%)	Financial expense ratio (%)	Loan loss provision (%)	Total expense ratio (%)	Yield (%)	Yield minus total expense ratio (%)
G	16.4	9.0	5.1	31.2	24.0	-7.2
IB	24.5	10.7	4.2	42.7	18.5	-24.2
SHG	23.1	8.7	5.5	38.4	16.5	16.1
M-CRIL India	20.7	9.1	5.2	36.0	19.6	-16.4
Top 10	11.3	9.0	2.8	23.1	22.7	-0.4
Bangladesh	14.2	7.5	0.9	22.6	24.3	1.7
Nepal	11.2	8.9	0.4	20.5	18.3	-2.2
Asia	17.2	8.6	1.6	27.4	26.5	-0.9
MIX Global	20.3	8.3	1.4	24.6	30.2	5.6

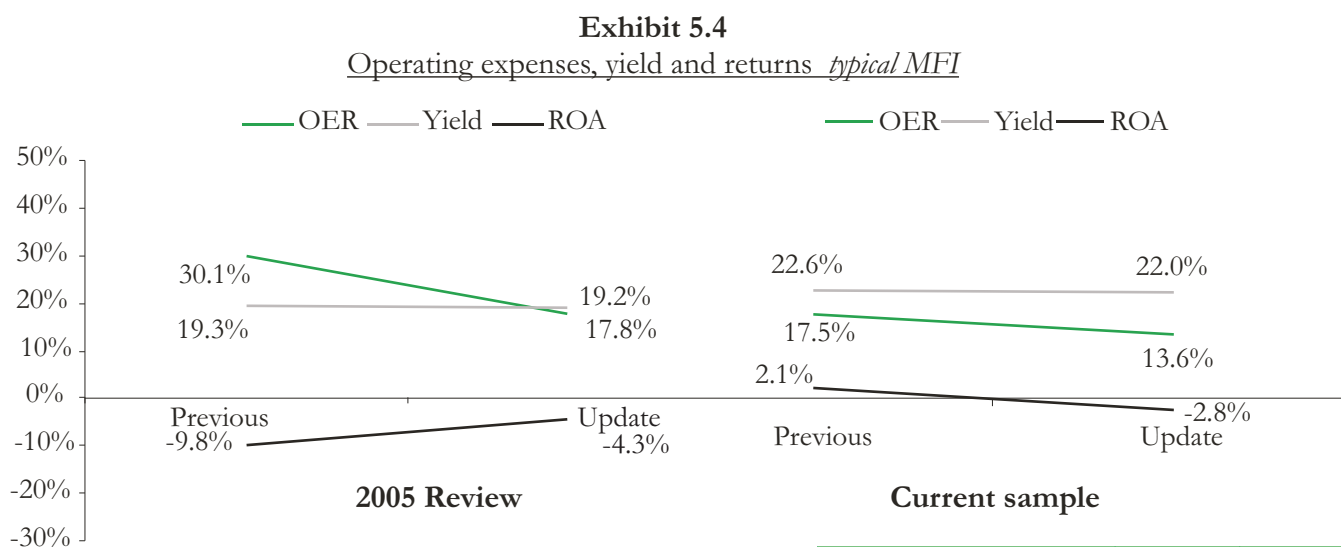
So, the weighted average typical expenses of Indian MFIs (36.0% of portfolio) are now much higher than the global median (24.6%) and the yield-total expenses deficit of Indian MFIs is quite high. Thus, while Indian MFIs deliver microfinance to low income clients at a lower cost than the typical international MFI, political and competitive pressures have resulted in a deterioration of portfolio quality and, as discussed earlier, the expansion strategies of the largest MFIs have put pressure on costs. As a result, even the Top10 Indian MFIs (that serve around 54% of clients) barely break-even.

5.3 Costs and returns: a review of trends

—while OERs of the MFIs with updates continues its trend decline it has been accompanied by an increase in other costs resulting in a decline in the return on assets

A review of trends in the performance of Indian MFIs as seen through rating updates confirms the finding of a small (but significant) reversal. Unlike the dramatic effect on OER that occurred between the 2003 and 2005 reviews, the current sample shows a small decline in yields of MFIs with rating updates, down from 22.6% at the time of the previous rating to 22.0%. Though the operating expense

ratio has continued a trend decline (in the case of MFIs in the sample with updates), it has been accompanied by increases in other costs largely a reflection of the decline in portfolio quality and also an increase in borrowing costs resulting from a hardening of interest rates over the past 12 months. The net result is a decline in the return on assets from 2.1% to (-)2.8% - **Exhibit 5.4**.



The concentration of yields in the 15-25% range and the substantial lowering of OER –with its obvious implications for improved sustainability – is apparent from the frequency tables in **Exhibit 5.4**. This holds promise for the future since an improvement in the political climate would help to improve portfolio quality. At the same time, the easing of the rate of inflation in recent months should see a softening of interest rates, lowering costs of borrowing from banks and leading to improved MFI profitability and sustainability.

5.4 Dependence on subsidies

– again below the international average

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

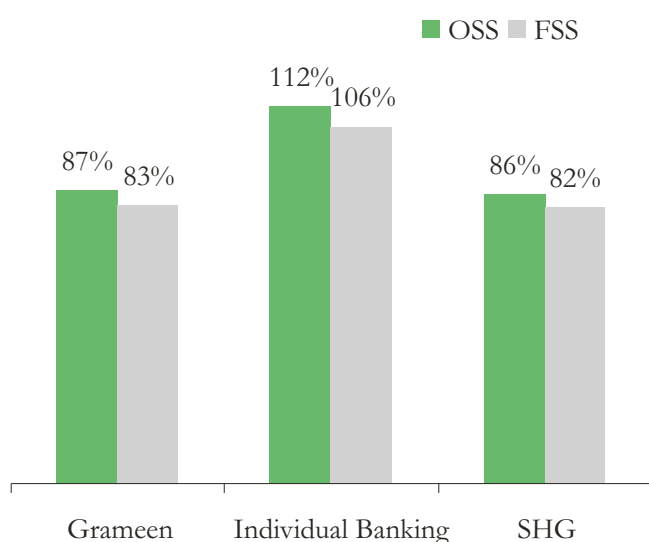
Return on Assets (%)	Previous	Update
>3	7	5
0-3	9	9
-2 to 0	2	5
<-2	10	9
Total	28	28

Yield (%)	Previous	Update
>3	5	3
15-25	11	17
25-35	11	5
<35	1	3
Total	28	28

OER (%)	Previous	Update
>15	13	17
15-25	8	9
25-35	5	2
<35	2	0
Total	28	28

The sustainability of Indian MFIs is now below par. As expected from the above discussion, **Exhibit 5.5** shows that the individual banking MFIs as a group are operationally self-sufficient. Though the weighted average OSS does represent the trend that the sustainability ratios are taking, the *typical* MFI figures are representative of the current status of most of the MFIs in the sample. Typically, individual banking organisations are operationally sustainable mainly because of their high investment income made possible by substantial savings collections from members.

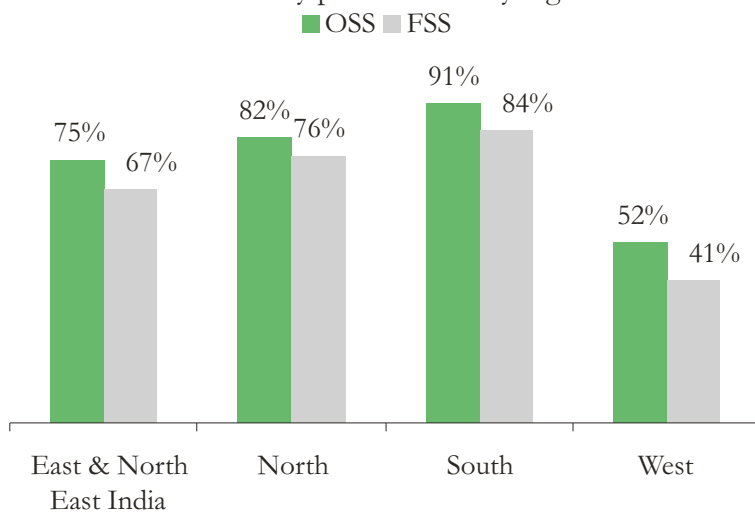
Exhibit 5.5
Sustainability performance by model



Models	Weighted average		Typical MFI	
	OSS (%)	FSS (%)	OSS (%)	FSS (%)
Grameen	87	83	94	84
Indl Banking	112	106	94	88
SHG	86	82	67	60
M-CRIL India	92	87	81	73
Top 10	89	85	103	95
MIX India			109.8	104.1

the performance of MFIs in North and East India is affected by issues with the organisational culture in those regions. The weighted averages for North India presented in the table are very different from the typical MFI figure (simple average) because the weighted average includes two large commercial NBFCs that are highly profitable institutions that are in the process of downscaling into microfinance operations while the MFIs perform poorly.

Exhibit 5.6
Sustainability performance by region



With the decline in grant funding of Indian microfinance (discussed in **Section 4**), there are no longer substantial differences between the OSS and FSS of Indian MFIs. The FSS ratio for the SHG model continues to be low; the 60% simple average indicating that without grants and subsidised funds, the organisations are effectively able to cover less than two-thirds of their costs though this is a significant improvement over the 42% OSS recorded in the 2003 Review. Following from the decline in profitability of the Top10 Indian MFIs, their sustainability ratios have also now dropped below global norms.

Exhibit 5.6 presents the regional variation in the sustainability of MFIs. For all practical purposes, this exhibit provides a good picture of the relative performance of MFIs in India by region. Thus, a number of MFIs in south India – some of the largest in the country – have achieved or are close to operational sustainability but, barring a few exceptions, those elsewhere are quite far from it. As discussed elsewhere in this review,

Comparing the trend of OSS and FSS across portfolio size – **Exhibit 5.7** – predictably shows that, as portfolio size increases, MFIs become more capable of covering their costs through revenues and their dependence on grants and other subsidies tends to decrease. This was discussed in **Section 4 (Exhibit 4.3)** which highlighted the changing sources of funds with the size of the portfolio.

Similarly, a positive correlation between sustainability and the age of the MFI (Exhibit 5.8) can be expected though the correlation here is

Regions	Number of MFIs	Weighted average		Typical MFI	
		OSS (%)	FSS (%)	OSS (%)	FSS (%)
East & North East India	18	92	87	75.1	66.9
North	8	101	103	82.2	76.2
South	26	90	87	91.3	83.5
West	5	91	54	51.6	41.2
M-CRIL India	57	92	87	81.4	73
Top 10	10	89	85	103	95

not perfect according to the figure. The reason for this has been discussed earlier; some MFI managements, being more development than sustainability-oriented, are able to keep their operations going either with direct subsidies or cross-subsidies from the other activities of their NGOs. As a result even some quite old and reasonably large MFIs are well below the sustainability threshold. However, increasingly, these tend to be exceptions as the overall acceptance of microfinance as a commercially viable activity has grown.

At the same time, in the context of the developmental mission of most MFIs, it has to be recognised that there is an inherent contradiction between the small size of loans generally appropriate for the poorest client groups and the achievement of sustainability at relatively low interest rates. It was emphasized in Section 3 that staff productivity is one of the most important contributors to MFI sustainability and the smaller the loan size, the more difficult it is to achieve sustainability. Economies of scale in relation to loan size are an important reason why the commercial banking system is unable and unwilling to provide microfinance services at its normal rates of interest.

Yet it is apparent from the cross-sectional analysis in Exhibit 5.9 that there are such economies even in the provision of microfinance services and in India it is the MFIs with average loan size of over 6,750 (\$170) per client that are able to achieve sustainability. MFIs with smaller loans may perhaps be reaching poorer clients⁵ but they have generally been unable to achieve sustainability – at the 18-24% APRs typically charged by such MFIs. This was also demonstrated by the inverse correlation between loan size and OER demonstrated in Exhibit 3.5.

⁵ As discussed in Section 2, this is also not necessarily the case.

Exhibit 5.7
Sustainability and portfolio size

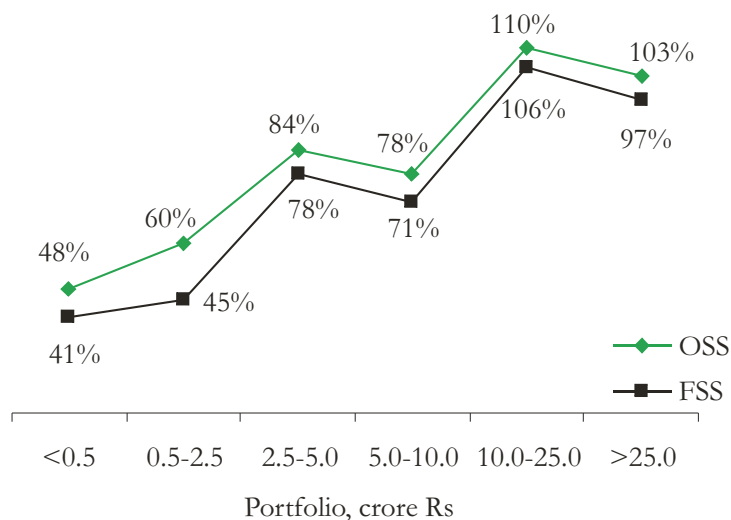
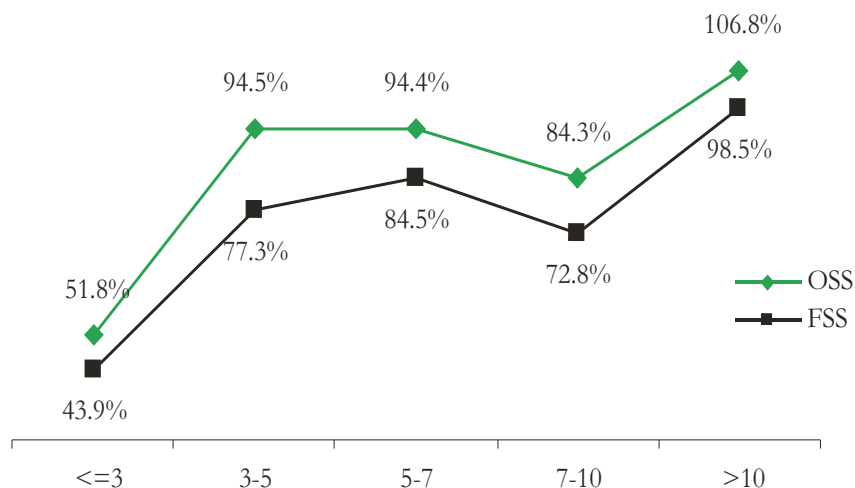


Exhibit 5.8
Relationship between age of MFI and sustainability



The discussion in this section shows that while the productivity and efficiency performance of Indian MFIs is good, the financial performance of MFIs in India is no longer comparable with global standards, excluding a group of leading institutions. The political and social (if not legal) restrictions on setting interest rates that have emerged over the past 18 months together with the enhanced costs resulting from the current high growth rates of Indian MFIs, have placed limitations on the overall sustainability performance of Indian microfinance and affected its financial performance.

Exhibit 5.9
Sustainability and loan size

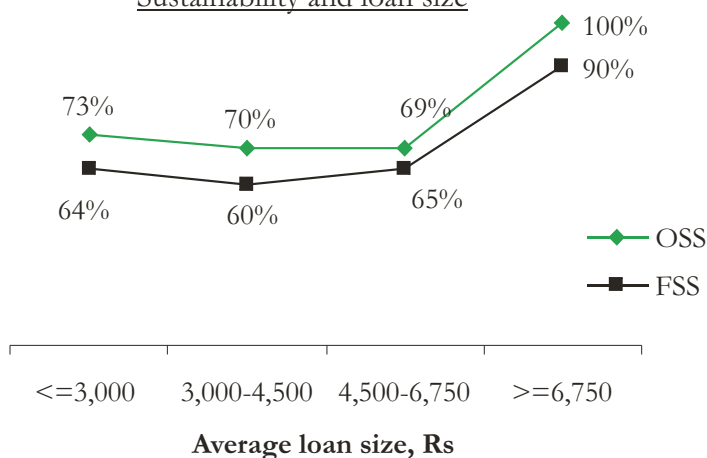
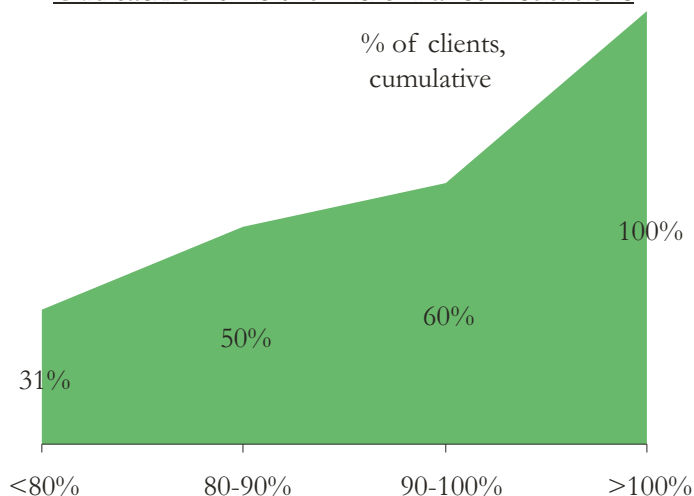


Exhibit 5.10
Outreach of efficient microfinance institutions



OSS (%)	Number	Proportion (%)
> 100	1,696,447	39.5
90-100	440,107	10.3
80-90	824,990	19.2
< 80	1,330,527	31.0
Total	4,292,071	100.0

Yet, the picture is not all grey. It is still the case that significant proportions of the 4.2 million borrowers covered by the MFIs in the sample are served by viable (and at least near sustainable) institutions. **Exhibit 5.10** shows that nearly 50% of borrowers are served by MFIs with OSS in excess of 90%. It is apparent that the outreach of MFIs functioning efficiently is still quite substantial in relation to the sector as a whole. Indeed, since outreach has grown dramatically over the past two years, the absolute numbers of those served by such “efficient” MFIs has actually grown by some 35% since the September 2004 median date of the previous sample. This is a positive outcome in that it has considerably enhanced the effective availability of microfinance for low income families. By the same token, the coverage of over 30% of borrowers by inefficient (<80% OSS) MFIs is a sobering feature that must be addressed urgently.

The next section discusses the social performance of Indian MFIs as a means of determining the relevance of microfinance initiatives in India to the needs of the low income families that are the target group.

Section 6

Assessing Social Performance of MFIs

—a substantial effort is still to be made by MFIs for clarifying social objectives, poverty targeting, product development and client orientation

Operating efficiency and financial performance tells only half the story of microfinance. As a social enterprise, an MFI must achieve goals of social as well as financial performance. M-CRIL's tool for social rating provides an assessment of an MFI's social performance.

Social performance assessments social ratings or (quicker) poverty audits are available from 12 MFIs in India covering the Grameen, SHG and individual banking models. These show that though MFIs specifically refer to the poor in their mission statements there is insufficient targeting in both client selection and product design for this to be translated into specific achievements. While official survey data shows that 39% of the population of India lives on less than \$1 a day, MFI coverage of such clients is only 30-35%. By and large, geographical area selection is a more popular approach for reaching the poor and disadvantaged than client targeting though relatively few MFIs work in the poorest districts of the country. This limits their real depth of outreach (to the poor), even though they may be serving broader goals of financial inclusion.

There are similar issues in relation to product design and the quality of services. Few clients are fully aware of the details and the cost and return implications of their products and an increase in the rate of exit from MFIs suggests a growing degree of dissatisfaction. Average exit rates have risen from 6-7% per annum in 2004 to around 11% now.

As the number of social ratings/poverty audits grows, a database of social indicators is developing, laying the foundation for comparison benchmarks on the double (if not triple) bottom line. Along with credit ratings, social ratings will assist donors and investors, as well as MFI managers, to make effective use of microfinance resources to achieve social/ethical goals in the same manner that credit rating has had a positive impact in enabling sustainability.

Operating efficiency and financial performance tells only half the story of microfinance. For most microfinance institutions (MFIs) and those that work with MFIs (banks, investors, donors) microfinance is a social enterprise. As an enterprise, the organisation is a business that aims to cover its costs and be financially sustainable. As a *social* enterprise, the business is a means to achieving social goals. Different organisations or models of microfinance may articulate slightly different social goals or mission statements. Nevertheless, there is agreement that social goals in microfinance generally include serving poor people, serving people otherwise excluded from formal financial services, providing appropriate financial services, contributing to employment, contributing to positive change for clients and their households, contributing to poverty reduction and ensuring social responsibility to clients, to staff, to communities and to the environment.

M-CRIL has taken the initiative to pioneer a tool for social rating to provide an assessment of the social performance of an MFI. The development of a social rating methodology has the potential to contribute to four important goals in microfinance:

- assist microfinance institutions to identify both whether they are achieving their social mission

- and the institutional factors that may be facilitating or hindering achieving this target;
- assist potential investors and donors in their review of microfinance institutions as part of their monitoring and due diligence processes;
- increase the transparency of the microfinance field; and
- if adopted widely, establish social performance as equally important as financial sustainability in microfinance.

6.1 Unpacking the concept of social performance

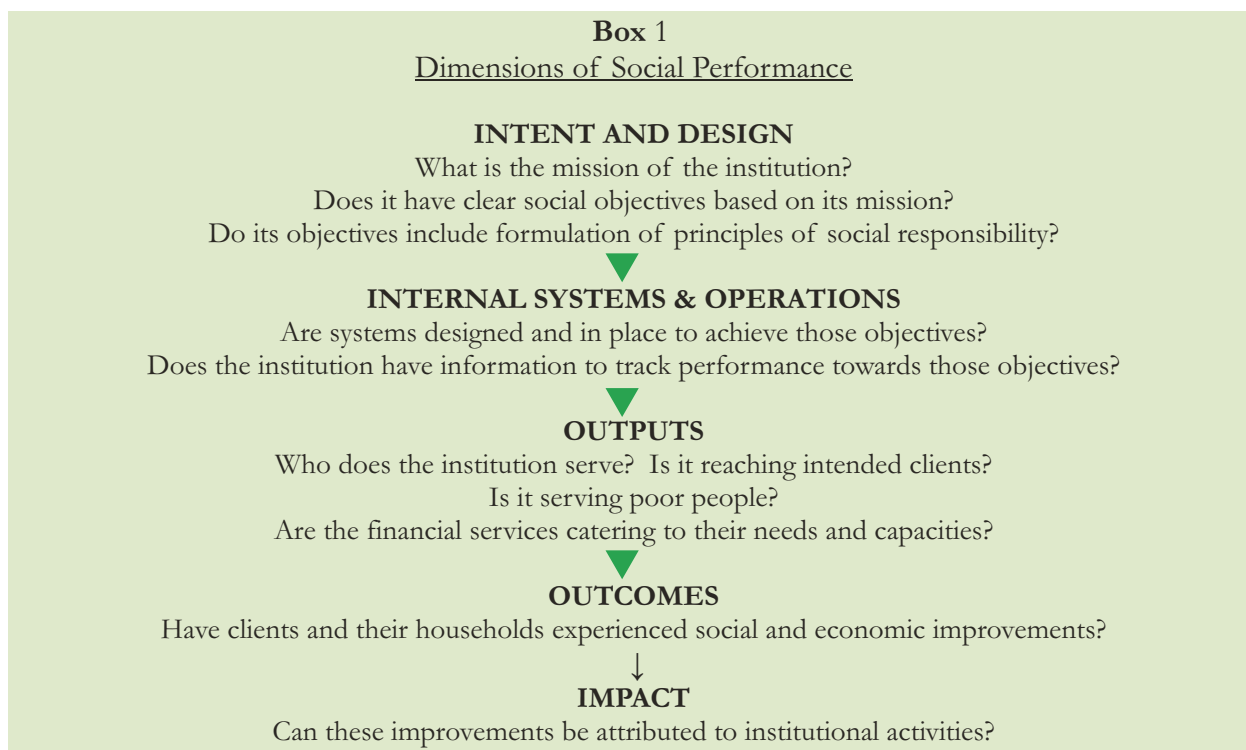
–it is important to take an interest not only in the end-result but the entire process of achieving that result

Social rating is part of a number of initiatives in the global microfinance industry, to build consensus around the meaning of social performance and develop appropriate tools to support, assess and report on social performance in microfinance. These developments are brought together in the Social Performance Task Force, an international group now involving over 150 microfinance networks and MFIs, as well as donors, investors and rating agencies.

The Social Performance Task Force has reached consensus on the following definition:

Social performance in microfinance is defined as:
the translation of mission into practice in line with accepted social goals.

Under this definition, social performance is not only the end result (or change), but the entire process of achieving that result. So, to assess social performance, we move away from focusing exclusively on trying to prove an end result (impact assessment) to looking at how to get there, and reporting on those steps that are likely to lead to positive social outcomes. These steps follow a logical organisational path, from intent/governance, through management/systems, to results. **Box 1** outlines the different steps involved.

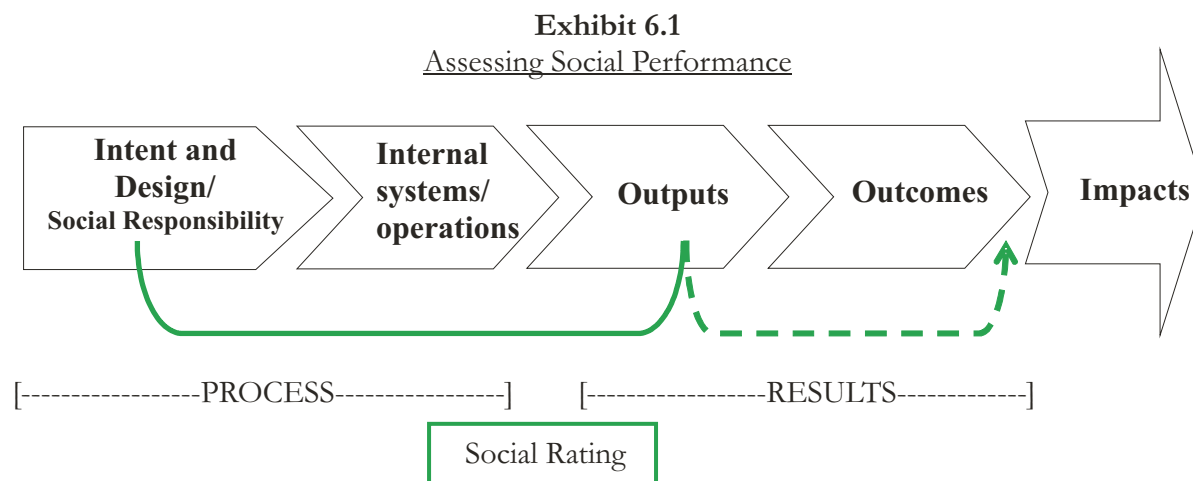


C-GAP, 2007 Focus Note Number 41, *Beyond Good Intentions: Measuring the Social Performance of Microfinance Institutions*, Washington DC, Sinha, Frances, 2006, *Social Rating and Social Performance Reporting in Microfinance: Towards a Common Framework*, SEEP Occasional Paper, Washington DC

6.2 Social rating as a new form of social assessment

Social Rating is an assessment of the likelihood of an MFI achieving social mission, in line with accepted social values

A social rating aims to be a relatively quick, low cost assessment, similar to credit rating. As in credit rating, the social rating uses information available with the MFI to the extent possible, drawing on available documentation and data, and discussions with staff at all levels. It covers both the process (intent, policies, design, systems) and part of the results (outreach and appropriate services) along the dimensions of social performance as outlined in **Exhibit 6.1**. A social rating is not an impact assessment. That is a more complex exercise. But if there is information on impact – or outcomes, and the information is robust, then the social rating can report on the impact findings.



How do we obtain information on the outputs to understand: who the clients are? Do they match the MFI's target group? Are the financial services appropriate? So as to obtain direct client-level information about outreach to target groups and feedback on services provided, the social rating exercise includes a small field survey, covering a sample of recent clients (to capture outreach profile on entry) and focus group discussions (FGDs) with older clients (for market feedback on MFI services). The field-work is undertaken in 3-5 clusters selected as representative of the MFI's current operations. The social rating sample covers a minimum of 127 clients from an average of four clusters. 127 is the minimum statistical level which gives a confidence level of 95% and precision of +/-10%. A larger sample size might be preferred, and can be done, but would take more time and cost more!

A social rating aims to cover all the social performance dimensions that come before outcomes/impact. It covers outcomes and impact information if this is available for the MFI and appears robust. In covering the steps of the process that lead to impact, the social rating can be seen as a good predictor of impact, an assessment of whether the MFI is on track to achieve its social goals. Or, in rating terminology, as assessment of the risk of non-achievement – or mission drift.

6.3 Findings so far

–there is systematic social performance data from 12 MFIs

M-CRIL has undertaken seven social ratings so far in India, with support from FWWB and the Ford Foundation. A few Poverty Audits have also been undertaken with support from SIDBI. The social

¹ See EDA technical note to explain the sampling formula. A larger sample of 340, or 510, would improve precision to +/- 5%.

² Also, the social rating sample of new clients can be used as a baseline for later follow-up on the same indicators.

rating exercise, including the field-work requires a team working up to 8-10 days with the MFI and in the field. The poverty audit was a quicker exercise, carried out over 3-5 days, focusing more on poverty related questions, with less detailed review of MFI systems, and a smaller sample for client profiling.

The scope of the social ratings has evolved as the tool has developed. Work is still in progress to build the data comparisons and derive appropriate benchmarks. The selected findings presented here are intended as an indication of the type of data and observations generated through a social rating. The data covers the period 2005-6. The findings are drawn from seven social ratings and five poverty audits and broadly follow the dimensions of social performance (as outlined in **Box 6.1**), covering process (intent and design, systems) and results (outputs – outreach and appropriate services).

<p>There is social performance data from twelve MFIs, eight from south India, four from the north. These MFIs are quite representative of MFIs in the country: five follow the Grameen model, three are SHG model, three are Cooperatives (MACTS) and one other follows individual banking. The data is mainly from 2006.</p> <p>The 12 MFIs together represented over 1 million microfinance clients at the time of the research –rating or audit.</p>	MFIs covered:	
	Social Rating	Poverty Audit
	<u>South</u>	<u>South</u>
	BWDA	ASA
	ASP	SKS
	BASIX	PWMACS
	AMMACTS	
	SWAWS	
	<u>North</u>	<u>North</u>
	Cashpor	RGVN
	Bandhan	NBJK

6.3.1 Institutional process as part of social performance

–though MFIs specifically refer to the poor in their mission statements there is insufficient targeting in both client selection and product design for this to be translated into achievement

Intent and Design: The mission statements of the twelve MFIs include references to

- ⇒ serving the poor and vulnerable (10 MFIs)
- ⇒ enhancing community capacities (4)
- ⇒ women's empowerment (4)
- ⇒ improved livelihoods (2)
- ⇒ poverty reduction (2)
- ⇒ quality services (2)

Whilst the overall orientation is usually clear, the meaning of key terms is not so clear and is not usually defined by the MFIs. For example, who is 'poor', in what way will community capacities be enhanced, what counts as women's 'empowerment' and what counts as poverty reduction? Accordingly, the mission is no more than a rhetorical statement or wish; it is not translated into social objectives, that are the first step to putting mission into practice, objectives that are SMART (specific, measurable, appropriate, realistic, time-bound) and strategic (what leads to what).

Out of the twelve MFIs, three had clear definitions of key terms (poor, vulnerable social groups, improved livelihoods). One of the three had gone further to develop SMART social objectives.

Governance appeared fairly well balanced in terms of financial and social experience and orientation, but reporting remains primarily financial – both within the organisation, and externally, in for example annual reports.

Services and access: The range of services includes general/enterprise loans starting at Rs2-5,000 (\$50-120), some larger (individual) loans (Rs15-30,000, \$375-750) including in the MACS and SHG model MFIs. Along with credit, Loan insurance and savings (or security deposits) are compulsory in 8 of the 12 MFIs. A few MFIs offer additional loans: education loan Rs1-10,000 (\$24-240), emergency loan Rs500-1,000 (\$12-24), and other insurance products (with linkages to formal sector insurance companies mainly for life and health). A few also offer non-financial services, directly, or through linkages to other providers – services such as agricultural/business development support, health and education as part of community development, gender training, even a school. Access to such services is quite low, usually to under 10% of clients (**Exhibit 6.2**).

Exhibit 6.2
MFI clients using products other than general/enterprise loans

Services	Number of MFIs providing	% clients accessing (prev yr)
Education loan	1	3
Emergency loan	1	<0.1
Life/medical other insurance	7	<20
Non-financial services	5	6-30

Internal systems: The conceptual framework for social performance includes an analysis of operational systems to see whether they support the mission – in particular, targeting strategy, staff training and incentives, and systems for MIS, monitoring and reporting.

In terms of targeting, the main approach is area targeting. MFIs may select less developed states and less developed regions within states and slum or low income areas in cities. One MFI also strategically targets poor clients and monitors poverty profile at entry. Another targets Scheduled Castes (SC), Scheduled Tribes (ST) and backward castes.² Some MFIs are beginning to cater to different market segments (with joint liability groups, often men, alongside women's SHGs, and at different income levels), though without specifically planning for what proportion of their clients (or portfolio) should be from different segments.

In relation to human resources – orientation and incentives – the mission and values are usually part of staff induction. But in practice, the main emphasis is on financial management and growth, as reflected in incentive systems that emphasise productivity (client numbers) and on-time repayment. Though one MFI includes an incentive linked to coverage of poorer clients.

In terms of monitoring and MIS, there is substantial scope for MFIs to strengthen their routine data collection and analysis of portfolio information from a social perspective. Many have interesting information fields relevant to client profiling in their loan appraisal formats but this is not being completed systematically or used for tracking outreach or market segments (except by one MFI). Portfolio information can be analysed not only to track growth and arrears, but to track client retention over time, how many stay for how many loan cycles, what is the drop-out rate, what differences are there for rural and urban clients, or for women and men clients (if an MFI has both). A few MFIs have started applying or have commissioned market research, though most rely on informal feedback from staff.

6.3.2 Financial inclusion

–it is only those who specifically target the poor and disadvantaged who make a real difference to financial inclusion

Areas: Information on outreach covers areas of operation, including rural/urban distribution and the

² Marginal communities in India's traditional and hierarchical social system based on caste

district (branch) distribution of clients with reference to development ranking of districts in the country. Based on data from the 2001 Census, the 593 districts in India are divided into development quintiles based on literacy rates, as a proxy for development level. Overall, in the sample, MFI outreach is more than proportionate (with 24% in the bottom district quintile, 56% in the lowest two district quintiles). The five-six MFIs with no clients in the lower district quintiles are located in the southern states. The majority of MFIs have mainly rural clients. Rural/urban classification is usually based on administrative definitions.

Exhibit 6.3
MFI outreach – rural and less developed districts

% of clients	0 %	<20%	21-55%	>55%	Average%
-in bottom district quintile	6	2	3	1	24
-in two lowest district quintiles	5		3	4	56
-rural	1		1	10	77

Beyond this broad (rural/urban) classification, it would be interesting to capture the extent of outreach in semi-urban/semi-rural areas. This would cover market town areas as a separate category (from rural) –with different implications for livelihoods, appropriate products and MFI costs of operations. However, such data is not easily available.

Reaching the unreached (financial inclusion): Secondly we seek information to understand whether the MFI is serving the poor and excluded. To obtain this information the social rating exercise includes a small field survey of recent clients (noted above), clients who have recently joined the MFI (within one year) so as to capture their profile on entry (before the likelihood of change). The sample size has averaged 152 per social rating and 48 per poverty audit. The total sample for 12 MFIs is 1,306.

To capture exclusion, the coverage of clients from vulnerable communities (such as SC/ST) or from households without alternative access to formal or semi-formal finance is analysed. From the rating sample, it emerges that most MFIs have a proportion of scheduled caste/tribe above the national average, reflecting substantial outreach to these communities. Interestingly, though, the data shows that not all client households have been excluded from formal financial services. On average 26% have a bank or post office savings account; 12% have had a bank loan in the previous three years (**Exhibit 6.4**). This compares with the 36% national figure. And 6% of client households have members in another MFI, or an SHG (with this figure higher for southern MFIs).

Exhibit 6.4
Reaching the unreached

% of recent client households:	Range%	Average %	All India population*%
SC/ST	15-57	33	25
With savings in bank or post office	19-39	26	36
With bank loan in previous 3 years	2-21	12	
With client in other MFIs or SHG	2-13	6	

Census of India, 2001, Population Tables, Government of India

A key question is poverty outreach. As we have seen, all the MFIs have a mission to serve the poor. How many clients are poor when they join? And how is poverty defined? A useful benchmark is the poverty line, the \$1 a day at purchasing power parity (PPP) which, currently at Rs17.5 per day or Rs524 per person per month is just above the Indian poverty line (Rs395 per person per month rural, Rs454 urban).⁴ The social rating questionnaire includes two pages to estimate client household income in

⁴ Updated to 2006 based on relevant CPIs agricultural labourers and industrial manual labourers, from World Bank estimates of purchasing power parity for the international poverty line (SEEP, Sillers Donald 2006), and the Deaton adjusted national poverty line, (in Schreiner, Mark, 2007 (next footnote)).

detail, from which the per capita per day figure can be calculated. Alternatively, and more easily, a poverty score card has now been developed for India.⁵ Both these methods have been used to find poverty levels mostly at or less than the estimated poverty rate in the country.

Outreach to those below \$1 a day varies substantially around the average which, at 30%, is slightly below the All India poverty incidence. Most of the MFIs rated are below the average. Just one MFI, with a strong strategic focus on poverty outreach, has 68% of its clients below the poverty line when they joined the programme (**Exhibit 6.5**).

Exhibit 6.5
Serving the poor

% of recent client households:	Range	Average	All India population*
<\$1/day at PPP	13%-68%	30%	39%

*NSSO, 2005.

These figures give pause for thought. Is this the depth of outreach intended for microfinance by MFIs whose stated mission is to serve the poor and contribute to poverty reduction? Are there elements in their operations which need strategic review to align with a deeper poverty focus? Including, defining more specifically who are the clients they intend to reach, how are the 'poor' identified.

Microfinance and women: The majority of MFI clients are women, with eight MFIs working only with women clients. The balance in staff is skewed to men, due partly to issues of field mobility, especially in the northern states. Two MFIs have less than 10% staff who are women, including one in the south (**Exhibit 6.6**).

Exhibit 6.6
Women as clients and staff of MFIs

Women as...	<50 %	51-99%	100%	Average
clients	1	3	8	86%
staff	10	2		32%

Gender related indicators, beyond the number of women (in **Exhibit 6.7**), relate to women's schooling at least up to completion of the primary level (which at 35% on average can affect awareness and understanding of MFI information and services), whether the household is woman headed (which is an indicator of poverty especially if there are no adult male earners in the family), and women clients'

Exhibit 6.7
Gender related indicators

% of recent women clients:	Range (%)	Average (%)
Have completed primary school or above	14-63	35
Are women heads of households with no adults male earner	3-10	4
Manage credit supported enterprise:		
Yes –by herself	12-72	22
Yes – jointly with husband/son	25-44	44
No – husband/son manages (loan pass)	3-45	38

involvement in managing an enterprise for which they have taken a loan. On average, just over one in five women clients manage by themselves the enterprise for which they take credit, another 40% manage jointly with a husband or son, and a similar proportion pass the loan to a male relative. This has implications for women's empowerment. In one MFI, working with urban women, women's independent enterprise activity was the highest (over 70%).

⁵ Schreiner, Mark, 2007. *Is one poverty score card enough for India?* Washington DC. See <http://www.microfinance.com/English/Papers/> The scorecard has 10 relatively simple questions which can be easily answered/observed about a household without much calculation or judgement. Indicators are: no of children under 17 years, whether house is *pucca*, whether own a TV, electric fans, *almirah*, sewing machine, pressure pan, land, primary energy source for cooking, no of acres of land, principal income source for the household. The answers to these questions are scored for their 'poverty probability', with the scores derived from statistical regression of NSSO data. The scores can be linked to any poverty line. For India, they are linked to the international poverty lines - \$1 and \$2/day. The poverty score card thus provides a simple but statistically robust method for measuring poverty levels.

Microfinance and employment (indirect outreach): Additional profile information from the rating survey relates to employment or 'indirect' outreach. The majority of enterprises supported by microfinance are usually family based micro-enterprises, providing self-employment to family members. If hired labour is employed in an enterprise, micro-credit can be seen to be supporting employment for others who are not direct MFI clients and may be of a lower income category. This is likely for larger

micro-enterprises or 'small enterprises'. In five MFIs for which we have this information, an average 8% of enterprises with credit have employed non-family labour, with an average employed of 2.4 (**Exhibit 6.8**).

Exhibit 6.8
Employment in credit supported enterprises

	Range (5 MFIs)	Average
% supported enterprises with hired (non-family) employees	3%-11%	8%
Average number of hired employees in such enterprises	1.6 -3.7	2.4

6.3.3 Appropriate Services

—few clients are fully aware of the details and implications of their products and an increase in the rate of exit from MFIs suggests a growing degree of dissatisfaction

The first set of questions under appropriate services, relates to client awareness of the financial products and terms of the MFI. This is a key element of social responsibility to clients, reflecting effective communication and transparency. These questions are covered as part of the rating survey, with reference to each MFI's specific services, and the responses are quantified. The findings are that

clients are mostly aware of the notional interest on loans and interest receivable on savings deposits (though in a couple of MFIs awareness is 60% or less). Few clients (around half on average as shown in **Exhibit 6.9**) are aware of the details of costs (interest on a declining balance basis, break-up of loan fees), and loan insurance.

Exhibit 6.9
Client awareness of financial services

% who know:	Range (%)	Average (%)
Notional interest on credit and repayment instalments	60- 98	78
Interest on savings deposits	55-91	77
More details of cost (EIR, declining interests break-up of loan fees)	31-90	52
Details of loan insurance	30-89	49

Client feedback is obtained through FGDs with older clients. This provides both positive feedback, and some suggestions to the MFI.

A strong indicator of client satisfaction or appropriateness of services is the rate of exit, particularly dropout. Of course, some clients who leave may be 'fly-outs' who no longer need microfinance, or may be able to graduate to a formal service. But many who leave (as studies have shown) do so because the microfinance services do not match their requirements, for reasons of dissatisfaction, problems with repayment, other financial difficulties. The annual dropout rate overall can be estimated from the loan portfolio, based on the number of clients at the end of the previous year, the number of new clients who joined during the year and the total number of clients at the end of the year.

The data shows higher rates of exit compared to figures from 2002-3 of around 4-6% (M-CRIL, 2004). Where MFIs are growing very fast, the large number of new clients in the year may mask the rate of dropout (just as a high disbursement of portfolio can mask the portfolio at risk, **Exhibit 6.10**).

⁶ M-CRIL applies the following formula:

$$\frac{\text{Number of clients at beginning of year} + \text{New clients during the year} - \text{Number of clients at end of year}}{\text{Number of clients at beginning of year} + \text{New clients during the year}}$$

A 'dropout' or client who exits is defined as: 'any client who has had not transaction with the MFI for the previous six months'. See M-CRIL Technical Note: Estimating Exit Rate

Box 6.2

Examples of client feedback on MFI services (from FGDs)

Clients like:

- ⇒ timely credit, without collateral
- ⇒ savings where available no other option for saving small amounts
- ⇒ discipline of weekly repayments (mainly non-farm enterprises, in market centres)
- ⇒ convenient repayment in instalments
- ⇒ grace period (1 MFI): 46 payments over one year
- ⇒ lower interest rate than moneylenders

Clients would like:

- loan products for other credit needs (education)
- larger loans, compare cost of dairy animal (Rs7-15,000); also demand from better-off clients (around 10% of clients interviewed), urban clients
- Monthly loan instalments rural
- Loan insurance to cover husband's death too (in case of women clients)
- Avoid high up-front security deposit.

Additional analysis would ideally include dropout rate by time with the MFI (or by loan cycle) and by other client characteristics (poverty, social group). In future, the social rating exercise will track client retention in terms of those who stay with the MFI for a certain period of time, say at least three years, or five years which may be the minimum time within which to achieve change, or sustainable impact. Less than this is probably not long enough for substantial change, at least in terms of poverty reduction (provided, that is, it is not the poorer clients who have dropped out of the programme)

Exhibit 6.10
Client exit

	Range	Average
Dropout rate	5%-17%	11%

6.4 Future directions

—a database of social indicators is developing as social ratings increasingly assist investors to achieve social/ethical goals in the same manner that credit rating has had a positive impact on sustainability.

The social rating tool has been under development for a couple of years. Its full form has now evolved in line with the understanding of what social performance is, and what the key indicators for achieving social performance are. It, therefore, now includes, for example, more details of social responsibility: whether MFIs are putting into practice key elements of the *Code of Conduct* towards clients, recently framed by Sa-Dhan.

As more social ratings are undertaken, M-CRIL is building a database on social indicators, so that a benchmark for comparison can be evolved. Alternative approaches to social rating may also be explored to cover detailed analysis of available portfolio information, without undertaking a field survey for client level findings. And, in MFIs where client level information is available (poverty profiling, market research) as part of their own system for social performance management, the social rating can be used to verify that information.

In future, the social rating may be offered as a stand-alone product, or alongside credit rating. This will contribute to greater transparency about what MFIs are achieving. When placed alongside a Credit

Rating, the Social Rating enables comparison of the social and financial performance of MFIs, providing an assessment of the double (if not triple) bottom line. It assists investors and donors in making effective use of microfinance resources to achieve social/ethical as well as financial goals. It can also assist MFIs to report on and improve their social performance, just as the Credit Rating has had a positive impact on the sustainability performance of MFIs.

Appendix 1

Microfinance Rating by M-CRIL

–M-CRIL's Sample of 58 rated Indian MFIs

From the commencement of operations in September 1998 until end-June 2007, M-CRIL had completed 428 MFI rating/assessment assignments covering Afghanistan, Azerbaijan, Bangladesh, Cambodia, East Timor, Georgia, India, Indonesia, Kazakhstan, Myanmar, Nepal, Pakistan, the Philippines, Russia, Samoa, Sri Lanka and Tajikistan. Two ratings were undertaken in Africa (Malawi and Morocco), jointly with MicroRate. **Exhibit A.1** provides an overview of the M-CRIL database and the set of MFIs rated by M-CRIL used for the analysis in this report.

This analysis covers ratings of Indian MFIs undertaken by M-CRIL during the period January 2006 to June 2007 the period after the previous report, M-CRIL Microfinance Review 2005. During this period, M-CRIL undertook 101 ratings of 94 MFIs, of which 22 were outside India. Of MFIs rated during this period, **Exhibit A.1** lists the number of times these have been rated over the years by M-CRIL.

Exhibit Table A.1
Overview of the M-CRIL sample

Sample details	Number rated	
	Overall	...during Jan 06-Jun 07
Rating in the database (including updates)	428	101
MFI's rated once	153	40
MFI's rated twice	62	25
Three times	18	10
Four times	15	11
Five times	5	5
Six times	2	3
Total number of MFIs rated	225	94
The M-CRIL sample- January 2006 to June 2007	All ratings	India
MFI's rated/ assessed once	39	19
MFI's with rating updates	44	39
Sample size for this report	83	58

From the 72 Indian MFIs rated during the reference period some have been excluded from the analysis as the data available from them was incomplete. FWWB and Trust Microfin Network have been left out as these are wholesale lenders to MFIs whose inclusion would result in double counting. Other rated institutions excluded from the analysis are micro-enterprise promoting NGOs that were assessed (but not awarded rating grades). This leaves usable data from 63 MFIs as M-CRIL's sample of the performance of microfinance institutions in India. Five of these are NBFCs (4) and a Local Area Bank (LAB) that mainly serve relatively large customers and do not strictly qualify as MFIs. Information on these has also been omitted in the following analysis resulting in an M-CRIL sample of 58 MFIs.

M-CRIL's revenue model for MFI ratings does not incorporate automatic updates; rather rating clients commission updates based on their needs. Generally, rating updates take place one year to 18 months after the previous rating. Rating updates are requested for MFIs usually at the initiative of their funders

but also, in a few cases, on their own. In order to avoid using out-of-date/irrelevant information, the sample for this report has been restricted to the latest ratings undertaken during the reference period indicated above. This is the period immediately succeeding the coverage of the M-CRIL Microfinance Review 2005.

While cross-sectional data for the 58 MFI covered does not relate to a fixed point of time, it serves the purpose of providing a comprehensive view of microfinance in India as seen through M-CRIL's rating activity. The median date for the rating information collected by M-CRIL and used for this analysis is 30 September 2006.

Disaggregation of the sample

–By *microfinance methodology used, age and legal status*

The analysis in this review uses a combination of the regional location, age of the organisation, legal status (or type of registration) and the methodology or model it adopts for implementing its microfinance programme.

Regional location: The state-wise coverage of the regional classification within India is provided in the box below.

Region	
⇒ South:	Andhra Pradesh, Karnataka, Kerala and Tamil Nadu
⇒ East:	Bihar, Chattisgarh, Jharkhand, Orissa & West Bengal
⇒ North-east:	Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Tripura
⇒ West:	Goa, Gujarat, Madhya Pradesh, Maharashtra
North:	Delhi, Haryana, Himachal Pradesh, Jammu & Kashmir, Punjab, Rajasthan Uttarakhand & Uttar Pradesh

Age: The second type of classification is the age of the microfinance programme. The classification used is

- ➔ **New** institutions - less than three years old
- ➔ **Young** institutions - 3-5 years old
- ➔ **Maturing** institutions - 5-7 years old, and
- ➔ **Mature** institutions - that have undertaken microfinance for 7-10 years
- ➔ **Rooted** institutions - more than 10 years old.

Legal status: The third type of institutional classification is the legal status, or form of registration. MFIs worldwide are registered in different legal forms depending on the regulatory framework in the country of operation. For the purpose of this analysis, sample MFIs have been classified into

- not-for-profit institutions - societies and trusts
- cooperative institutions - conventional cooperatives (usually apex rather than primary cooperatives), mutually aided credit societies (in India) and, even a few urban cooperative banks
- not-for-profit companies - registered under Section 25 of the Companies Act of India (elsewhere known as companies “limited by guarantee”)
- formal financial institutions - non-bank companies providing financial services (classified in India as non-bank finance companies or NBFCs).

Microfinance methodology: The models/methodologies are classified here as

- ➔ **Self-Help Group (SHG)** the dominant microfinance methodology in India which is a version of the **village banking model**. The operations of (mainly) 15-25 member SHGs are based on the principle of revolving the members' own savings. These resources are often augmented by funds borrowed from MFIs or banks. Savings thus precede borrowing by the members. In many SHG programmes, the volume of individual borrowing is determined either by the volume of member savings or by the savings of the group as a whole. Some charitable non-government organisations (NGOs) operate microfinance programmes by organizing federations of SHGs to act as the MFI which obtains external loan funds in bulk to be channelled to individuals via member SHGs.
- ➔ **Individual Banking** model (referred to here as IB) entailing the provision by MFIs of financial services to individual clients though they may sometimes be organised into joint liability groups, cooperatives or even SHGs. In the case of cooperatives, all borrowers are members of the organisation either directly, or indirectly by being members of primary cooperatives or associations which are members of the apex society. Creditworthiness and loan security are a function of cooperative membership within which member savings and peer pressure are assumed to be a key factor. Though the magnitude and timing of savings and loans are unrelated, in theory, a special effort is made to mobilize savings from members.
- ➔ **Grameen** model (coded as G) a model initially promoted by the Grameen Bank of Bangladesh and classified by the MIX as “**solidarity group lending**”. Grameen MFIs undertake individual lending but all borrowers are members of 5-member joint liability groups which, in turn, get together with 6-9 other such groups from the same village or neighbourhood to form a centre. Within each group and centre, peer pressure is said to be the key factor in ensuring repayment though maintaining credit-worthiness in order to qualify for a larger loan in the next cycle is an equally important factor. Savings are a compulsory component of the loan repayment schedule but does not determine the magnitude or timing of the loan.

The **mixed model** MFI, used as a category in earlier Reviews by M-CRIL, has been dropped this time. The category results in a varied (and not very significant) collection of MFIs with disparate characteristics so it is inappropriate to treat them as a group. Each MFI earlier classified as mixed has now been included in one of the above three categories depending on which methodology is used for outreach to the principal group of clients served by the MFIs.

Rating grades achieved by MFIs

—increasing numbers are now creditworthy enough to borrow significant sums of money

A description of the rating grades assigned by M-CRIL to individual MFIs is provided on the M-CRIL website. Grades are assigned to reflect the creditworthiness of the institution based on M-CRIL's rating methodology. The distribution of grades assigned to the rated Indian MFIs in the sample are presented in **Exhibit A.2**. The distribution here follows an approximate bell shape for normal distributions with the median grade as a low β + which is also the mode of the sample. This is a slight improvement from the median grade of β for the 2005 Review sample. It is a reflection of the improvements made by the large number of MFIs with rating updates and a continuation of the trend that sees most (but not all) MFIs making improvements in their operations based on the findings of the previous rating.

However, for the universe of MFIs in the region, it is likely that a larger sample would result in an increase in the bars at the lower end and a tendency towards a skewed distribution as the number of MFIs rated increases. A large proportion of MFIs, are unlikely to reach the minimum β grade required for them to be considered creditworthy. These MFIs are still not rated but there is a trend to increasing numbers asking for capacity assessments by M-CRIL.

Exhibit A.2
Distribution of rating grades across Indian MFIs by model

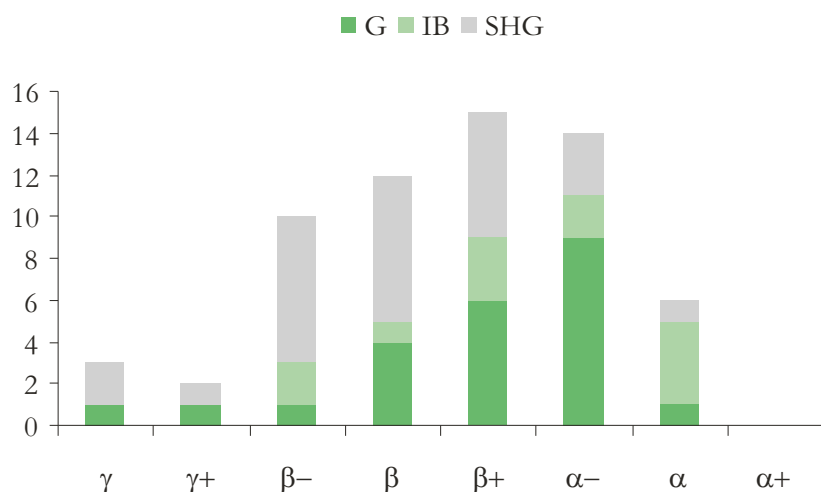
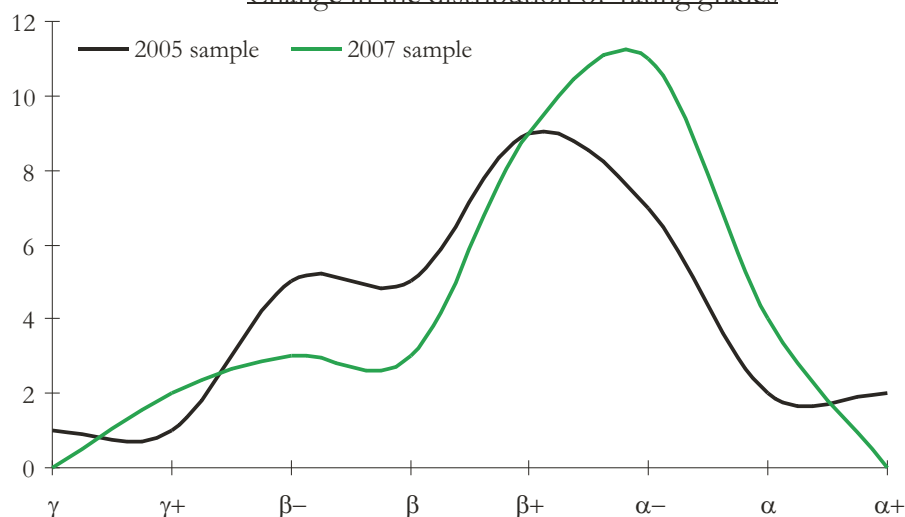


Exhibit A.2 also shows the distribution of rating grades across MFI types. The Grameen MFIs rated so far have been amongst the best of all the types with more than 80% being above or at the investment grade of β . Though the $\alpha+$ grade has not been achieved by MFIs operating with the individual lending model, these too have an overall trend similar to the Grameens. Some of the weakest organisations use the SHG model with 63% of MFIs in the investment grade though this is also a function of the relatively large number of SHG MFIs rated.

An analysis of the distribution of grades (**Exhibit A.3**) between the previous ratings and updates shows a shift in the curve, markedly for the better unlike in the 2005 Review. In the last review, the lack of a shift (from the previous period) resulted from M-CRIL's concern to keep up with the dynamics of the microfinance sector leading to a strengthening of its rating methodology and improvement in the minimum performance level on critical indicators for achieving particular grades. With better experience and stricter conditions applied in the update, ratings resulted in downgrades for a number of rated MFIs, sometimes *despite an improvement in their performance indicators*.

Exhibit A.3
Change in the distribution of rating grades



This time, no further change in the rating methodology has been necessary and the detailed analysis of the trends in performance ratios in this review shows the significant extent to which there have been improvements in the performance of the updated MFIs as indicated by the shift in the curve for the updated MFIs from the 2005 Review to the current sample.

The analysis in this report begins with a discussion of client outreach and productivity before going on to issues of efficiency, portfolio management and financial performance. Since the M-CRIL database has a substantial number of updates of rated MFIs (**Exhibit A.1**), comparative data for MFIs with rating updates has also been used throughout this document to assess the trends in growth and performance of microfinance institutions in the region.

Each section of this report analyses cross-sectional information but also looks at trends in the performance of the M-CRIL and MIX samples based on a comparison of the latest rating information with the sample averages of the previous (2005) and earlier Reviews and, where appropriate, with that of the update sample (rated MFIs that have had updates during the current period). Since the time between rating updates is usually about 15 months (average for the sample), all growth rates have been annualised. The MIX data sets for 2006-07 has been compared with that for 2005-06 where appropriate.

An international perspective has been provided by comparing sample averages with international benchmarks available from the MIX global database and also with information emerging from M-CRIL's international ratings. For this purpose, M-CRIL country averages for Bangladesh and Nepal and regional averages for South Asia (excluding India) and Southeast Asia (Cambodia, East Timor, Indonesia, Philippines) have been used along with MIX benchmarks for Asia.

Appendix 2

MIX Data and Data Preparation

For benchmarking purposes, MIX collects and prepares MFI financial and outreach data according to international microfinance reporting standards as applied in the *MicroBanking Bulletin*. Raw data are collected from the MFI, inputted into standard reporting formats and crosschecked with audited financial statements, ratings and other third party due diligence reports, as available. Performance results are then adjusted, using industry standard adjustments, to eliminate subsidy, guarantee minimal provisioning for risk and reflect the impact of inflation on institutional performance. This process increases comparability of performance results across institutions along a range of industry standard indicators. For an index of indicators, terms and ratios, see Methodology under www.mixmbb.org.

Peer Group	Description	Number
All MFIs	Global MFIs	704
Region		
Asia	Asia MFIs	184
South Asia	South Asia MFIs	83
Country		
India	India MFIs	37
Bangladesh	Bangladesh MFIs	10
Nepal	Nepal MFIs	9
Pakistan	Pakistan MFIs	11
Sustainability		
FSS	Global MFIs with Financial Self-sufficiency ratio > 100%	415
India FSS	India MFIs with Financial Self-sufficiency ratio > 100%	24
India Non FSS	India MFIs with Financial Self-sufficiency ratio ≤ 100%	13
Scale		
India Small	India MFIs with Loan Portfolio < USD 2 million	3
India Medium	India MFIs with Loan Portfolio ≥ USD 2 million and < USD 8 million	15
India Large	India MFIs with Loan Portfolio USD 8 million	19
Profit Status		
India For Profit	India MFIs with for profit status	13
India Non Profit	India MFIs with not-for-profit status	12

Appendix 3
List of Participating MFIs

	Microfinance Institutions	Rated by M-CRIL	Reporting to MIX
North India			
1	Cashpor Micro Credit, Uttar Pradesh	√	√
2	Disha Social Organisation, Uttar Pradesh	√	
3	Ishara Foundation for Finance and Rural Development, Uttar Pradesh	√	
4	Network of Entrepreneurship and Economic Development, Uttar Pradesh	√	
5	PAHAL, Uttaranchal	√	
6	Professional Assistance for Development Action, Delhi	√	
7	Satin Credit Care Network Limited, Delhi	√	
8	SE Investments Limited, Uttar Pradesh	√	
9	Sonata Finance, Uttar Pradesh	√	√
10	Trust Microfin Network, Uttar Pradesh	√	
East India			
1	All Backward Class Relief and Development Mission, West Bengal	√	√
2	ADHIKAR, Orissa	√	√
3	Asomi, Assam	√	√
4	ANG Resources Ltd, West Bengal	√	
5	Awareness, Orissa	√	√
6	BANDHAN, West Bengal	√	
7	Bharat Integrated Social Welfare Agency, Orissa		√
8	Gajapati Women Self Help Cooperative Ltd, Orissa	√	
9	Gramin, Assam	√	
10	Gram Utthan, Orissa		√
11	Kalighat Society for Development Facilitation, West Bengal	√	
12	KAS Foundation, Orissa	√	√
13	Kotalipara Development Society, West	√	√
14	Liberal Association for Movement of People, West Bengal	√	
15	Nav Bharat Jagriti Kendra, Jharkhand	√	
16	Network for Enterprise Enhancement and Development Support, Jharkhand	√	
17	Nidan, Bihar	√	
18	Project Nirdhan, Micofinance Programme of South Asia Research Society, West Bengal	√	

	Microfinance Institutions	Rated by M-CRIL	Reporting to MIX
19	Rashtriya Gramin Vikas Nidhi - Credit and Savings Programme, Assam	√	
20	Rashtriya Gramin Vikas Nidhi NGO MF Programme, Bihar and Orissa	√	
21	Sahara Uttarayan, West Bengal	√	
22	Sahara Utsarga Welfare Society, West Bengal	√	
23	Shrachi Infrastructure Finance Ltd, West Bengal	√	
24	Sreema Mahila Samity, West Bengal	√	√
25	SUPPORT, Jharkhand	√	
26	Village Welfare Society, West Bengal	√	√
West India			
1	Action for Social Advancement, Madhya Pradesh	√	
2	Arman Lease And Finance Ltd, Gujarat	√	
3	Bazaari Global Finance Ltd, Rajasthan	√	
4	Bhoruka Charitable Trust, Rajasthan	√	
5	Centre for Community Economics and Development Consultants Society, Rajasthan	√	
6	Development Initiative for Self Help and Awakening, Maharashtra	√	
7	Electronica Finance Ltd, Maharashtra	√	
8	Friends of Womens World Banking, Gujarat	√	
9	Indian Institute of Rural Development, Rajasthan	√	
10	Sakhi Samudaya Kosh, Maharashtra	√	
11	Swadhaar, Maharashtra	√	√
South India			
1	Activists for Social Alternatives (ASA), Tamil Nadu	√	√
2	Ankuram Sangamam Poram, Andhra Pradesh	√	
3	Asmitha Microfin Ltd, Andhra Pradesh		√
4	Bharathi Swamukti Samasthe, Karnataka	√	√
5	Bhartiya Samruddhi Finance Limited, Andhra Pradesh	√	√
6	Bullockcart Workers' Development Association, Tamil Nadu	√	√
7	Centre for Rural Reconstruction through Social Action, Andhra Pradesh	√	√
8	Coastal Local Area Bank, Andhra Pradesh	√	

	Microfinance Institutions	Rated by M-CRIL	Reporting to MIX
9	Evangelical Social Action Forum, Kerala	√	√
10	Grameen Koota, Karnataka	√	√
11	GUIDE, Andhra Pradesh	√	
12	Hand in Hand, Tamil Nadu	√	
13	Indian Association of Savings and Credit, Tamil Nad		√
14	Indur Intideepam Mutually Aided Thrift and Credit Cooperatives Federation Ltd, Andhra Pradesh	√	
15	Janalakshmi Social Services, Karnataka		√
16	Janodaya Micro Credit Programme, Karnataka	√	
17	Kanakamahalakshmi Cooperative Bank Ltd, Andhra Pradesh	√	
18	Karimangalam Onriya Pengal Semipu Amaippu Ltd, Tamil Nadu	√	
19	Krishna Bhima Samruddhi Local Area Bank Ltd, Karnataka		
20	KRUSHI, Andhra Pradesh		√
21	LEAD, Tamil Nadu	√	
22	Madura Microfinance Ltd, Tamil Nadu	√	√
23	Mahasemam Trust, Tamil Nadu	√	√
24	Payakaraopeta Women's Mutually Aided Cooperative Thrift and Credit Society, Andhra Pradesh	√	
25	Saadhana Microfin Society, Andhra Pradesh		√
26	Sanghamithra Rural Financial Services Ltd, Karnataka		√
27	Sarvodaya Nano Finance Ltd, Tamil Nadu		√
28	Sevashram, Kerala	√	
29	Sharda Women's Association for Weaker Sections, Andhra Pradesh	√	√
30	Share Microfin Ltd, Andhra Pradesh	√	√
31	Shree Kshetra Dharmasthala Rural Development Project, Karnataka	√	√
32	SKS Microfinance Pvt. Ltd, Andhra Pradesh	√	√
33	South Indian Federation of Fishermen Societies, Kerala	√	√
34	Spandana Spoorthy Microfinance Services Ltd, Andhra Pradeh	√	√
35	Star Microfin Service Society		√
36	Ujjivan Financial Services, Pvt. Ltd, Karnataka		√
37	Viswa Santhi Balaram Kendaram, Andhra Pradesh	√	

Glossary of Terms

Annual percentage rate (APR)	Expected earnings from a loan portfolio based on the stated terms of the financial institution's loan products
Financial spread	Portfolio yield minus financial costs (interest paid on borrowings, interest paid on deposits and loan loss provision expenses)
Loan loss provisioning ratio	Total loan loss provision expense for the year divided by the average portfolio
Operating expense ratio	Ratio of staff, travel, administration costs, other overheads and depreciation charges of the MFI (non- financial costs) to the average loan portfolio for the year
Operational Self-Sufficiency	Ratio of total income to total expenses for the year
Financial Self-Sufficiency	Ratio of total income to total adjusted expenses for the year. Adjustments are made for subsidised cost of funds (relative to market interest rate), equity (with respect to inflation) and in-kind donations
Portfolio at risk (≥ 60 days)	Ratio of the principal balance outstanding on all loans with overdues greater than or equal to 60 days to the total loans outstanding on a given date
Repayment rate (cumulative)	Ratio of cumulative principal recovered (net of pre-payments) to the cumulative principal due till the date of measurement
Yield on portfolio	Interest and fee income from loans to clients divided by the average loan portfolio for the year
Risk weighted capital adequacy ratio	Ratio of net worth to risk weighted assets (Risk weights: 100% for all assets except fixed assets & interest bearing deposits: 50%; cash 0%).

MIX Indicator Definitions

INSTITUTIONAL CHARACTERISTICS	
Age	Years functioning as an MFI
Total Assets	Total Assets, adjusted for inflation and standardized loan portfolio provisioning and write-offs
Offices	Number, including head office
Personnel	Total number of employees
FINANCING STRUCTURE	
Capital/ Asset Ratio	Adjusted Total Equity/ Adjusted Total Assets
Commercial Funding Liabilities Ratio	All liabilities with "market" price/ Adjusted Gross Loan Portfolio
Debt/ Equity Ratio	Adjusted Total Liabilities/ Adjusted Total Equity
Deposits to Loans	Voluntary Savings/ Adjusted Gross Loan Portfolio
Deposits to Total Assets	Voluntary Savings/ Total Assets, adjusted
Gross Loan Portfolio/ Total Assets	Adjusted Gross Loan Portfolio/ Adjusted Total Assets
OUTREACH INDICATORS	
Number of Active Borrowers	Number of borrowers with loans outstanding, adjusted for standardized write-offs
Percent of Women Borrowers	Number of active women borrowers/ Adjusted Number of Active Borrowers
Number of Loans Outstanding	Number of loans outstanding, adjusted for standardized write-offs
Gross Loan Portfolio	Gross Loan Portfolio, adjusted for standardized write-offs
Average Loan Balance per Borrower	Adjusted Gross Loan Portfolio/ Adjusted Number of Active Borrowers
Average Loan Balance per Borrower/ GNP per Capita	Adjusted Average Loan Balance per Borrower/ GNP per Capita
Average Outstanding Balance	Adjusted Gross Loan Portfolio/ Adjusted Number of Loans Outstanding
Average Outstanding Balance/ GNP per Capita	Adjusted Average Outstanding Balance/ GNP per Capita
Number of Voluntary Savers	Number of savers with voluntary savings demand deposit and time deposit accounts
Number of Voluntary Savings Accounts	Number of voluntary savings demand deposit and time deposit accounts
Voluntary Savings	Total value of voluntary savings demand deposit and time deposit accounts
Average Savings Balance per Saver	Voluntary Savings/ Number of Voluntary Savers
Average Savings Account Balance	Voluntary Savings/ Number of Voluntary Savings Accounts
OVERALL FINANCIAL PERFORMANCE	
Return on Assets	Adjusted Net Operating Income, and net of taxes/ Adjusted Average Total Assets
Return on Equity	Adjusted Net Operating Income, and net of taxes/ Adjusted Average Total Equity
Operational Self-Sufficiency	Financial Revenue/ (Financial Expense + Net Loan Loss Provision Expense + Operating Expense)
Financial Self-Sufficiency	Adjusted Financial Revenue/ Adjusted (Financial Expense + Net Loan Loss Provision Expense + Operating Expense)
REVENUES	
Financial Revenue Ratio	Adjusted Financial Revenue/ Adjusted Average Total Assets
Profit Margin	Adjusted Net Operating Income/ Adjusted Financial Revenue
Yield on Gross Portfolio (nominal)	Adjusted Financial Revenue from Loan Portfolio/ Adjusted Average Gross Loan Portfolio
Yield on Gross Portfolio (real)	(Yield on Gross Portfolio (nominal) - Inflation Rate)/ (1 + Inflation Rate)

MIX Indicator Definitions

EXPENSES

Total Expense Ratio	$\frac{\text{Adjusted (Financial Expense + Net Loan Loss Provision Expense + Operating Expense)}}{\text{Adjusted Average Total Assets}}$
Financial Expense Ratio	$\frac{\text{Adjusted Financial Expense}}{\text{Adjusted Average Total Assets}}$
Loan Loss Provision Expense Ratio	$\frac{\text{Adjusted Net Loan Loss Provision Expense}}{\text{Adjusted Average Total Assets}}$
Operating Expense Ratio	$\frac{\text{Adjusted Operating Expense}}{\text{Adjusted Average Total Assets}}$
Personnel Expense Ratio	$\frac{\text{Adjusted Personnel Expense}}{\text{Adjusted Average Total Assets}}$
Administrative Expense Ratio	$\frac{\text{Adjusted Administrative Expense}}{\text{Adjusted Average Total Assets}}$
Adjustment Expense Ratio	$\frac{\text{(Adjusted Net Operating Income - Unadjusted Net Operating Income)}}{\text{Adjusted Average Total Assets}}$

EFFICIENCY

Operating Expense/ Loan Portfolio	$\frac{\text{Adjusted Operating Expense}}{\text{Adjusted Average Gross Loan Portfolio}}$
Personnel Expense/ Loan Portfolio	$\frac{\text{Adjusted Personnel Expense}}{\text{Adjusted Average Gross Loan Portfolio}}$
Average Salary/ GNP per Capita	$\frac{\text{Adjusted Average Personnel Expense}}{\text{GNP per capita}}$
Cost per Borrower	$\frac{\text{Adjusted Operating Expense}}{\text{Adjusted Average Number of Active Borrowers}}$
Cost per Loan	$\frac{\text{Adjusted Operating Expense}}{\text{Adjusted Average Number of Loans}}$

PRODUCTIVITY

Borrowers per Staff Member	$\frac{\text{Adjusted Number of Active Borrowers}}{\text{Number of Personnel}}$
Loans per Staff Member	$\frac{\text{Adjusted Number of Loans Outstanding}}{\text{Number of Personnel}}$
Borrowers per Loan Officer	$\frac{\text{Adjusted Number of Active Borrowers}}{\text{Number of Loan Officers}}$
Loans per Loan Officer	$\frac{\text{Adjusted Number of Loans Outstanding}}{\text{Number of Loan Officers}}$
Voluntary Savers per Staff Member	$\frac{\text{Number of Voluntary Savers}}{\text{Number of Personnel}}$
Savings Accounts per Staff Member	$\frac{\text{Number of Saving Accounts}}{\text{Number of Personnel}}$

MIX Benchmarks 2006*

INSTITUTIONAL CHARACTERISTICS	India	Global	Global FSS	Asia***	South Asia***	Bangladesh	Nepal	Pakistan
Number of MFIs	37	704	415	184	83	10	9	11
Age	9	9	10	10	8	15.5	11	4
Total Assets	9,635,690	6,169,918	9,309,635	5,468,125	8,610,183	21,166,576	8,349,728	5,319,361
Offices	45	11	14	15	38	163	38	19
Personnel	303	94	128	135	248	1,419	194	195
FINANCIAL STRUCTURE								
Capital/ Asset Ratio	4.3%	25.4%	24.0%	17.5%	9.1%	28.7%	6.3%	42.0%
Commercial Funding Liabilities Ratio	81.1%	61.0%	71.0%	71.0%	63.4%	7.5%	147.1%	6.7%
Debt/ Equity Ratio	11.9	2.6	3.1	4.0	6.0	2.5	13.5	1.3
Gross Loan Portfolio/ Total Assets	83.4%	77.9%	80.4%	73.6%	78.5%	86.5%	53.9%	44.5%
OUTREACH INDICATORS								
Number of Active Borrowers	82,562	10,102	14,182	17,583	44,647	215,180	35,080	20,038
Percent of Women Borrowers	100%	66%	62%	99%	100%	100%	109%	51%
Gross Loan Portfolio**	8,648,133	4,438,677	7,392,137	3,434,180	6,478,902	18,879,279	4,236,905	2,779,661
Average Loan Balance per Borrower	106	456	572	149	120	85	137	149
Average Loan Balance per Borrower/ GNI per capita	14.5%	40.3%	45.3%	20.8%	18.1%	18.0%	50.9%	21.6%
OVERALL FINANCIAL PERFORMANCE								
Return on Assets	0.2%	0.9%	3.4%	0.1%	-0.3%	3.9%	0.1%	-10.1%
Return on Equity	18.4%	4.0%	13.3%	2.1%	0.6%	14.2%	-1.0%	-17.4%
Operational Self-Sufficiency	109.8%	115.4%	126.5%	113.3%	107.0%	129.7%	119.7%	69.5%
Financial Self-Sufficiency	104.1%	105.7%	117.3%	101.8%	101.0%	120.8%	102.3%	63.9%
REVENUES								
Financial Revenue Ratio	17.7%	24.7%	27.0%	20.8%	17.5%	22.6%	11.8%	17.4%
Profit Margin	4.0%	5.4%	14.7%	1.8%	1.0%	17.2%	2.3%	-56.4%
Yield on Gross Portfolio (nominal)	21.7%	30.2%	31.0%	26.5%	23.3%	24.3%	18.3%	25.3%
Yield on Gross Portfolio (real)	15.0%	22.3%	23.6%	19.1%	15.7%	16.4%	10.0%	16.1%
EXPENSES								
Total Expense Ratio	18.3%	24.6%	21.8%	22.0%	19.6%	19.4%	11.9%	27.1%
Financial Expense Ratio	6.7%	6.3%	6.2%	6.3%	6.4%	6.5%	4.8%	7.0%
Loan Loss Provision Expense Ratio	0.9%	1.4%	1.2%	1.2%	1.0%	0.8%	0.2%	1.1%
Operating Expense Ratio	8.8%	15.3%	13.5%	12.4%	10.4%	12.2%	6.2%	19.2%
Personnel Expense Ratio	4.6%	8.3%	7.5%	6.9%	5.9%	8.1%	5.0%	12.5%
Administrative Expense Ratio	4.1%	7.0%	6.2%	6.0%	4.5%	4.0%	1.3%	6.9%
Adjustment Expense Ratio	0.3%	1.6%	1.1%	1.6%	0.9%	2.0%	0.8%	2.4%
EFFICIENCY								
Operating Expense/ Loan Portfolio	10.4%	20.1%	17.3%	17.2%	14.3%	14.2%	11.2%	39.0%
Personnel Expense/ Loan Portfolio	5.3%	11.0%	9.4%	9.8%	8.6%	9.8%	8.8%	20.6%
Average Salary/ GNI per Capita	2.3	4.2	4.2	2.8	3.3	2.5	6.9	4.6
Cost per Borrower	11	108	111	39	16	11	13	68
PRODUCTIVITY								
Borrowers per Staff Member	255	112	116	125	160	146	162	99
Borrowers per Loan Officer	350	216	227	208	241	212	240	183
Personnel Allocation Ratio	72.8%	55.0%	55.6%	62.3%	67.0%	67.2%	65.3%	51.2%
RISK AND LIQUIDITY								
Portfolio at Risk > 30 days	0.8%	2.8%	2.3%	2.1%	1.2%	1.1%	4.7%	1.1%
Portfolio at Risk > 90 days	0.2%	1.4%	1.1%	1.2%	0.6%	0.6%	2.8%	0.4%
Write-off ratio	0.1%	1.1%	0.9%	0.7%	0.6%	0.9%	4.2%	0.6%
Loan Loss Rate	0.1%	0.9%	0.8%	0.7%	0.5%	0.9%	4.2%	0.6%
Risk Coverage	61.7%	90.1%	100.0%	86.7%	80.4%	164.7%	59.5%	111.9%
Non-earning Liquid Assets as % Total Assets	5.1%	6.5%	5.5%	6.1%	5.1%	4.8%	11.7%	2.5%

* FY 2006 data are data from institutions whose financial years close between July 1, 2006 and June 30, 2007.

** Measures of gross loan portfolio for India include managed loans.

*** Results are for preliminary 2006 benchmarks.

MIX Benchmarks 2006*

INSTITUTIONAL CHARACTERISTICS	India Small	India Medium	India Large	India FSS	India Non FSS	India For Profit	India Non Profit
Number of MFIs	3	15	19	24	13	12	25
Age	1	9	9	8	10	8.5	9
Total Assets	1,713,424	5,007,321	23,393,223	11,046,983	7,530,698	19,195,061	7,845,755
Offices	17	26	77	53	26	62	45
Personnel	171	152	1,105	391	197	831	207
FINANCIAL STRUCTURE							
Capital/ Asset Ratio	22.0%	3.5%	6.4%	4.6%	2.1%	10.3%	3.7%
Commercial Funding Liabilities Ratio	96.6%	92.8%	79.1%	72.1%	91.4%	85.6%	80.1%
Debt/ Equity Ratio	3.5	26.0	11.9	21.1	4.3	5.1	24.8
Gross Loan Portfolio/ Total Assets	65.7%	82.5%	87.8%	84.9%	82.8%	84.0%	83.4%
OUTREACH INDICATORS							
Number of Active Borrowers	11,393	39,541	197,676	83,510	41,353	166,668	72,396
Percent of Women Borrowers	100%	100%	100%	100%	100%	100%	100%
Gross Loan Portfolio**	1,126,242	3,805,668	21,294,940	9,588,303	6,478,902	16,238,473	6,902,406
Average Loan Balance per Borrower	98	110	107	106	109	108	106
Average Loan Balance per Borrower/ GNI per capita	13.4%	15.1%	14.7%	14.5%	15.0%	14.9%	14.5%
OVERALL FINANCIAL PERFORMANCE							
Return on Assets	-24.0%	0.2%	0.7%	1.3%	-3.9%	-1.3%	1.1%
Return on Equity	-56.8%	18.4%	19.0%	41.8%	-46.5%	-7.2%	45.4%
Operational Self-Sufficiency	44.5%	107.0%	115.7%	116.3%	97.3%	108.9%	110.0%
Financial Self-Sufficiency	41.6%	101.8%	106.9%	108.5%	84.2%	93.6%	106.9%
REVENUES							
Financial Revenue Ratio	17.1%	18.3%	16.2%	20.7%	15.0%	16.7%	19.5%
Profit Margin	-140.6%	1.8%	6.4%	7.8%	-18.7%	-7.1%	6.4%
Yield on Gross Portfolio (nominal)	24.6%	21.7%	16.0%	24.8%	19.5%	21.0%	21.7%
Yield on Gross Portfolio (real)	17.8%	15.0%	9.7%	17.9%	12.9%	14.3%	15.0%
EXPENSES							
Total Expense Ratio	41.2%	18.1%	18.3%	17.9%	20.5%	20.1%	17.6%
Financial Expense Ratio	5.2%	7.7%	6.6%	6.7%	6.7%	6.5%	7.0%
Loan Loss Provision Expense Ratio	0.0%	1.2%	0.9%	0.9%	1.6%	0.9%	1.1%
Operating Expense Ratio	35.9%	8.7%	8.6%	8.8%	9.8%	10.9%	8.5%
Personnel Expense Ratio	17.6%	4.3%	5.0%	4.6%	5.1%	6.0%	4.5%
Administrative Expense Ratio	18.3%	3.8%	3.8%	4.2%	3.8%	5.5%	3.7%
Adjustment Expense Ratio	0.6%	0.1%	0.4%	0.1%	1.2%	1.7%	0.1%
EFFICIENCY							
Operating Expense/ Loan Portfolio	59.3%	10.1%	10.2%	10.3%	10.9%	15.3%	9.0%
Personnel Expense/ Loan Portfolio	29.1%	4.9%	5.4%	5.3%	6.6%	7.8%	5.1%
Average Salary/ GNI per Capita	3.0	1.3	2.5	2.1	2.8	3.1	1.3
Cost per Borrower	58	11	11	11	18	19	10
PRODUCTIVITY							
Borrowers per Staff Member	67	234	264	258	207	274	246
Borrowers per Loan Officer	158	350	370	355	331	381	331
Personnel Allocation Ratio	42.1%	70.6%	77.0%	73.5%	72.0%	67.8%	74.2%
RISK AND LIQUIDITY							
Portfolio at Risk > 30 days	0.0%	0.9%	0.9%	0.6%	1.8%	2.0%	0.5%
Portfolio at Risk > 90 days	0.0%	0.2%	0.4%	0.1%	0.4%	0.8%	0.1%
Write-off ratio	0.1%	0.1%	0.1%	0.1%	1.7%	0.4%	0.0%
Loan Loss Rate	0.1%	0.1%	0.1%	0.0%	1.6%	0.3%	0.0%
Risk Coverage	2.7%	76.5%	65.4%	73.6%	44.4%	42.1%	95.0%
Non-earning Liquid Assets as % Total Assets	2.9%	7.1%	4.7%	4.9%	5.1%	4.9%	5.1%

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Introduction to M-CRIL and MIX

About Micro-Credit Ratings International Limited (M-CRIL)...

M-CRIL is the world leader in the rating of microfinance institutions (MFIs). By April 2007, M-CRIL had undertaken 430+ ratings or assessments covering 250+ microfinance institutions in 25 countries of Asia stretching from Georgia in the Caucasus to the Philippines in South-east Asia. M-CRIL's area of operations now includes Russia & the NIS as well as all of Asia. M-CRIL also works in Africa in association with MicroRate, USA as part of a global rating alliance known as MicroRating International. M-CRIL has a team of 12 analysts at various levels of expertise and experience for this purpose.

M-CRIL's offerings and other details are available at www.m-cril.com

M-CRIL's products include

Credit rating: M-CRIL pioneered the introduction of credit rating (rather than performance assessment) of MFIs. Our ratings include a risk assessment, projections of future performance and recommendations for investment in addition to a review of performance.

Quarterly monitoring: M-CRIL undertakes quarterly monitoring and semi-annual desk reviews of MFI performance when specifically contracted for this purpose.

Social Rating: M-CRIL has introduced social rating an assessment of systems, poverty outreach and client feedback to assess and compare the social performance of MFIs. M-CRIL is the world-wide pioneer of this product as a rating product, launched in 2005.

Sector Studies and Reviews: M-CRIL also undertakes studies of issues in the performance of the microfinance sector in its countries of operation. Such studies have covered aspects like microfinance policy, best practices in MF delivery, microinsurance and its role in meeting client needs and the microfinance market in a number of countries. Country evaluations of MFI performance have also been undertaken.

About Microfinance Information eXchange (MIX)...

The Microfinance Information eXchange (MIX) is the leading provider of comprehensive business information and data services for the microfinance industry. MIX is dedicated to strengthening the industry by increasing the flow of information, improving financial transparency and promoting the use of accepted business practices.

Extensive in coverage, MIX provides business information, in-depth analyses, and performance reporting through a variety of platforms: MIX Market (www.mixmarket.org) the online, interactive website with historical and current data on all segments of the industry, focusing on microfinance providers; The MicroBanking Bulletin, MIX's semi-annual industry journal featuring benchmarks, articles, case studies, and trends; industry, regional, and country reports, analyses and championship league tables, other publications and discussion papers, available at www.themix.org.



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