Chapter-6

DEVELOPMENT OF SELECTED MICROFINANCE INSTITUTES IN INDIA

The logic of commercialization is simple
“Banking for the poor cannot be poor Banking”.

Y S P Thorat, MD, NABARD

6.1 National Bank for Agriculture and Rural Development (NABARD) :

Since establishment, Reserve Bank of India has shown keen interest on agricultural credit. RBI has maintained a separate department in his organization for agricultural credit. This department of RBI extended short term seasonal credit as well as medium-term and long-term credit to agriculture through Cooperative Credit Institutions.

The RBI has also set up the Agricultural Refinance Development Corporation, to provide refinance facilities to the banks engaged in agricultural credit. With the widening of the role of bank credit from “agricultural development” to “rural development” the Government proposed to have a more broad based organization at the apex level to extend support and give guidance to credit institutions in matters related to the formulation and implementation of rural development Programmes.

The Reserve Bank of India, in consultation with the Government of India, set up a Committee to Review Arrangement for Institutional Credit for Agriculture and Rural Development (CRAFICARD) in 1979 under the
Chairmanship of Shri B. Shirvaraman. The CRAFICARD recommended in its report for setting up of National Bank for Agriculture and Rural Development (NABARD). The objective of NABARD is to give undivided attention to the problem of providing all types of production and investment credit to various rural sectors like agriculture, small scale and cottage industries, and also to handicrafts, to artisans and to other allied activities in an integrated manner. The basic idea was that there should be a “National Bank” to pay undivided attention to all regions of the country in the matter of rural credit and other needs related to agricultural and rural development and secondly, the problem of agricultural and rural development should be viewed in an integrated and comprehensive way instead of in a fragmented way by several financial institutions in an uncoordinated way as was happening till then. It was felt that if there is a banking institution at the national level, the above objective would be achieved.

The Government of India accepted the recommendation of CRAFICARD with some modifications. As a result of this acceptance, the National Bank for Agriculture and Rural Development Bill was passed by Parliament in December, 1981 and the National Bank for Agricultural and Rural Development (NABARD) came into existence in July, 1982.

The NABARD has taken over the entire agricultural refinancing functions of the Reserve Bank of India and the Agricultural Refinance and Development Corporation (ARDC) has been merged with the NABARD. The National Agricultural Credit (Long-term Operations) Fund of the Reserve Bank of India and also the National Agricultural Credit (Stabilisation) Fund stand
transferred to the NABARD and form part of National Rural Credit (Long-term Operations) Fund and National Rural (Stabilisation) Fund, respectively.

As discussed above, the entire refinancing work of the Reserve Bank to the State Cooperative Banks (the Apex Banks), the Regional Rural Banks and Central Land Development Banks has been transferred from the Reserve Bank to the NABARD. In the other sense, it means that the work of the Reserve Bank has come to be decentralized and the role of the Reserve Bank in the sphere of agricultural finance has been handed over to NABARD which is to give its undivided attention to the problems of agriculture and rural finance. The only link between the Reserve Bank and the NABARD is that at any time 50 per cent of the paid up capital of the NABARS will be subscribed by the Reserve Bank. The remaining 50% being subscribed by the Central Government.

**Functions of NABARD**

Under Section 21 of the Act, establishing the NABARD, the NABARD has to provide refinance assistance to the State Cooperative Banks (Apex Banks), the Regional Rural Banks or any other financial institutions approved by the RBI. The NABARD has a dual role to play as - an apex institution and as a refinance institution. It has inherited its apex role from RBI i.e. it is performing all the functions performed by RBI with regard to agricultural and rural credit. At the same time, the NABARD is performing the function of providing refinance facilities to all the banks and financial institutions lending to agricultural and rural development.

The main functions of NABARD are as follows:
(1) The NABARD works as an apex body to look after the credit requirements of the agriculture and rural sector.

(2) The NABARD services as a refinancing institution for all kinds of production and investment credit to agriculture, small scale industries, cottage and village industries, handicraft and rural artisans and other allied economic activities with a view to promote all over rural development.

(3) NABARD has the responsibility of coordinating the activities of Central and State Government the Planning Commission and other all-India and State level institutions entrusted with the development of small scale industries, village and cottage industries, rural crafts, industries in the tiny and decentralized sectors etc.

(4) In order to fulfill the financial needs of the rural sector, NABARD borrows funds from the Government of India. World Bank and other financial institutions. It borrows short term funds from Reserve Bank of India.

(5) It provides short term, medium term and long term credits to State Cooperative Bank, RRBs, Land Development Banks and other financial institutions approved by the Reserve Bank of India.

(6) It gives long term loans (up to 20 years) to State Government to enable term to subscribe to the share capital of cooperative credit societies.

(7) It gives long term loans to any institution approved by the Central Government or contribute to the share capital or invest in securities of any institution concerned with agriculture and rural development.

(8) It maintains a Research and Development Fund to promote research in agriculture and rural development, to formulate and design project and
Programmes to suit the requirements of different areas and to cover special activities.

(9) It has been entrusted with the responsibility of inspecting District and State Cooperative Banks and Regional Rural Banks. The inspection of Central land development banks and other cooperative institutions is undertaken on voluntary basis.

(10) It has authority to oversee the functioning of the co-operative sector through its Agriculture Credit Department.

Management of NABARD
The management of the NABARD is entrusted to Board of Directors to be appointed by the Government of India in consultation with the Reserve Bank of India. In the Board of directors there is a Chairman and a Managing Director and 13 other directors. Of the 13 directors appointed in the Board of Directors; 2 are to be experts in subject like rural economics, rural development and handicraft; 3 directors should have experience in the field of cooperative and commercial banking; 3 directors from among the directors of the Reserve Bank of India; 3 from among the official of the Government of India; and 2 directors from among the officials of the State Governments.

In addition there is an Advisory Council in the NABARD which consist of such directors of the NABARD; there is an Advisory Council in the NABARD which consist of such directors of the NABARD and such other persons who in the opinion of the NABARD possess special knowledge on subjects with which the NABARD is concerned. The Advisory Council
gives advice on matters referred to it by NABARD are carry out other
functions entrusted to it by the NABARD.

Accordingly the amendment of 2000, in NABARD Act, 1981, the number of
State Government representatives has increased from 2 to 4 in the board of
directors of NABARD. As per the amendment other shareholder’s
representation in board of directors may up to 4 directors. Now, NABARD
enjoys the statue of “Development Bank”. NABARD can grant loans in
foreign currency facilities. NABARD can also grant loan to persons and
institutions for infrastructural facilities. Also, NABARD has empowered to
establish subsidiaries. Private participation up to 49% of the share capital is
also allowed in recent amendments.

The Chairman and Managing Director of NABARD have been appointed for
a term of five years and other members of the board of directors for a period
of three years. As Executive Committee is formed for day to day operations.
The executive committee works under the directors of the Board of
Directors. Apart form the Executive Committee, Advisory Council also
works to advise the matters referred by the Board of Directors.

**Financial Resources of NABARD**

(1) **Share Capital:** Initially, the paid up capital of the NABARD was ₹ 100
crore which is equally shared by Central Government and Reserve Bank of
India. As per the Section 4 (1) of the NABARD Act, authorized capital can
be raised up to ₹500 Crore. This limit has been further raised, as per the
amendment in December, 2000, to ₹5000 Crores. The paid up capital of
NABARD was raised from ₹100 crore to ₹500 crore and the to ₹2000 crores by the year 1999, the Government of India and the Reserve Bank of India have contributed ₹1450 crore and ₹550 crore respectively in the paid up capital. To meet its loan requirements, the NABAD draws funds from the Government of India, the World Bank and other financial institutions and also raised funds from the open marked. NABARD also uses the resources of the National Agricultural (long-term operations and stabilization) funds which stand transferred to the NABARD. As regards short term credit and working capital requirements, NABARD depends upon Reserve Bank of India. World Bank and International Development Association (IDA) have been providing funds to NABARD (National Bank) for implementation of the projects financed by them.

(2) Reserves and Surplus: NABARD get 3% of the total resources for its reserves and surplus. The reserves of NABARD have been increasing continuously. It has been raised to ₹4028 crore in March 2002 from ₹122 crore in June, 1983.

(3) Special Loan Funds: NABARD has setup two special loan funds. The first one is “national Rural Credit (Long-term operations) Fund” and the second is “National Rural Credit (Stabilisation) Fund”. An amount of ₹56500 crore was deposited in both the funds in 1989-90 which has raised to ₹13975 crore in 2001-02. The Reserve Bank of India also contributed in these funds. Apart from the RBI contribution, a part of the profit of NABAD is also transferred in these funds. The RBI has contributed ₹5884 crore in 1999-2000 to the general credit scheme of NABARD.

(4) Deposits: NABARD accepts deposits from the Commercial Banks, persons and institutions. In the year 1982-83 its deposits were ₹11 crore
which increased to ₹24 crore in 1998-85. In the year 1999-2000, its deposits were ₹5717 crore which have raised to ₹9835 crore in 2001-02. The amounts of deposits are low as compared to the total recourses of the NABARD.

(5) Bonds and Debenture: To fulfill the financial needs for rural credit NABARD issues bonds and debentures. NABARD has issued 8.25% bonds at par with in a period of 12 years. If had collected ₹400 crore in 1982-83, ₹436 crore in 1983-84 and ₹478 crore in 1985-86 through bonds. NABARD has collected ₹2141 crore in 1999-2000 and ₹6079 crore in 2001-02 through this item.

(6) Borrowing: NABARD borrows funds from the Government of India, RBI, the World Bank, International Development Agency and other financial institutions. On March 2002 the NABARD borrowed ₹7582 crore of which ₹832 crore were borrowed from Government of India and ₹6500 crore from Reserve Bank of India. NABARD also borrowed funds from the Government of India under foreign projects. The amount is funded by foreign agencies through Government of India.

Loan Operations of NABARD
NABARD is an apex institution in the field of agriculture and rural credit. It performs all matters relating to policy, planning and operational aspect in the flow of credit for the promotion of agriculture, small scale industries, cottage and village industries, handicraft and other rural craft and other allied economic activities in rural areas. Thus, it is the single integrated agency for meeting the credit needs of all type of agricultural and rural development activities. The main function of NABARD is to provide refinance facilities
to the State Cooperative Banks, Commercial Banks, Regional Rural Banks and State Cooperative Agricultural and Rural Development Banks (formerly known as LDBs) etc.

Loan operation of NABARD is as follow:

(1) **Short term Loans:** A major part of NABARD’s short-term credit support is disbursed for financing seasonal agricultural operations. It sanctioned short-term credit limits worth ₹8,160 crore during 1999-2000 for financial seasonal agricultural operations at the concessional rate of 3% below the Bank rate. The NABARD has attempted to ensure the flow of credit to weaker sections of society under the New Twenty Point Programme by making it obligatory for banks to disburse a specified percentage of short term loans to small and marginal farmers and other economically weaker sections.

Agency – wise Ground Level Credit Disbursements for Agriculture and Allied Activities.

(2) **Medium term Loans:** NABARD has continued to follow the policy earlier laid down by the Reserve Bank in regard to sanction of medium credit limits for approved agricultural purposes. It provided refinance assistance for medium term to State Cooperative Banks and Regional Rural Banks NABARD provides refinance assistance for integrated rural development, animal husbandry, small irrigation, gobar gas plants etc. separately. The national bank has attempted ensure that at least 50% of its medium term credit flow to the marginal and small farmers. NABARD grants loans to the State Cooperative Banks and RRBs to convert short term
loans into medium term loans granted to farmers affected by droughts, foods and other natural calamities. It also grants assistance to State Governments to enable them to contribute in the share capital of cooperative institutions.

(3) Long-term Loans: National Banks grant refinance assistance to commercial banks and other rural credit agencies. It also grants long term credit to State Government for contribution to the share capital or cooperative credit institution. During 1999-2000, it extended medium term and long term credit worth `200 crores. During 1999-2000, NABARD has extended long term refinance to the tune of `90 crore. It’s refinance assistance under IRDP is specifically to help weaker section of the rural community for minor irrigation, dairy development, sheep/goat/piggery/rearing, fisheries, small business etc. Land development command area development, plantations and horticulture, poultry; sheep breeding etc. are more important schemes which are finance by the Bank.

NABARD and Rural Infrastructure Development Fund
As envisaged in the Union Budget 1995-95, a Rural Infrastructure Development Fund (RIDF) was set up within NABARD for facilitating quicker completion of ongoing rural infrastructure projects. This scheme has been continued on a annual basis. However, as state earlier, the level or utilization the corpus of RIDFs is very low excepting RIDF -1. For instance, the corpus of RIDF-iii (year 1997-98) was `2,500 crore and sanction of loans by NABARD was `2,690 crore while disbursement was merely `2,180 crore. The corpus of RIDF-V (year 1999-2000) was `3,500 crore crore and sanction of loans by NABARD was `3,570 crore while disbursement was
merely ₹1,970 crore (just 55% of sanction). Under utilization of funds under RIDF was essentially due to the indifference and incompetence of State Government in getting various infrastructural projects prepared and in getting the necessary clearances in time.

**Some Schemes of NABARD**

It is praiseworthy that Indian banking sector has achieved the target of agricultural credit during 2005-06 and the time is not far when this will also achieves the target to double the its achievement in the next two years if everything goes right. However, the word of caution given by Finance Minister, P Chidambaram 2006, held at Hyderabad, cleared that he is more inclined to provide quality credit than merely achieving the target. On the other hand, he also asked the banks to double the credit to Small and Medium Enterprises (SMEs) and Non-farming Sectors in the next five years. The question arises whether the Indian banking scenario is really ready for this and whether they have sufficient funds to finance SMEs and Non-farming Sectors in the long run, amidst tough competition with foreign banks. There is no doubt; banks are financing SMEs and non-farming sectors in one or the other, way. But as far as the magnitude of the funds is needed, they will surely make the bankers anxious in future. Thus, in a changing environment, banks need to diversify their role in non-farm sector in order to uplift the economy and rural sector.

Though all these developments are there in the urban areas, the lack of the same in the rural and semi-urban areas has been a cause of serious concern
among policy makers. Taking cognizance of this fact, the authorities have looked for effective measures to develop rural economy, without which the rapid growth would not be possible. Here "rural" does not strictly point to "agrarian". There is a considerable scope for other services to come up, provided the support credit facility comes up. The problem is that the rural people are not used to pay for such infrastructure. There are also a number of vested interests, which cannot be monitored in the same way as an urban municipality can. Therefore, it is clear that the implementing agency has to take up a large part of this burden, if the development of the rural areas is to take-off.

In this case, the solution is around us and it is none other than National Bank for Agriculture and Rural Development (NABARD), which is an apex body of promoting both agriculture and rural areas. Here some talks about some of the existing schemes, which will provide the solution to Indian banks. It is a win-win situation to Indian banks and NABARD. It will find wide number of customers by linking itself directly to banks and banks in turn will achieve the target. It is needless to say here that the main winner will be the rural community.

However, the word of caution here is that banks must identify the right ,set of people for financing them, as the attitude of rural people to depend on grants and subsidy are still their rights (they think so). It is after all the right attitude that needs to find among beneficiaries, which will develop the quality of life in the society and the economy of the society.
Constraints in SMEs and Non-farming sectors:

- Lack of entrepreneurship.
- Lack of latest technology and awareness.
- Lack of adequate training.
- Lack of proper infrastructure such as electricity, road and water, etc.

Some of the schemes of NABARD are discussed here, which promotes the SMEs and non-farming sectors.

**Rural Industrial Development Program (RIDP)**

The purpose of RIDP is to create the entrepreneurship among unemployed and uneducated rural people, which in turn may create the employment for others. It is one of the successful schemes of NABARD that is facilitated by Non-Government Organizations (NGOs). RIDP involves three phases i.e., pre-training phase, training phase and after-training phase.

Pre-training phase is basically the designing of survey, creating the awareness of the program and helping the banks, administrative, department and the organization of the selection committee.

The training phase involves eight weeks activity. The first four weeks is theoretical and the last four weeks involve the practical knowledge and visiting the project site. Sometimes, both the activities run side by side. The training contains a batch of 25-30 candidates. The training is basically an activity of involving the candidates in encasing the business opportunity and in the preparation of project report through practical exposure.
The last phase monitors the activities of both the trainees and the members of the project monitoring committee. NGO presents the project report before NABARD and NABARD sanctions the project after a thorough scrutiny.

**Assistance for Marketing of Non-farm Products of Rural Women (MAHIMA)**

It is a very successful scheme of NABARD, which assists the rural women to market their manufactured products. It happens by creating an environment by preliminary survey, capacity building, quality improvement, technological feasibility study, advertisement, branding, labeling, packaging, catalog preparation, exhibition participation, training and developing the right selling skills. In addition to this, NABARD also sanctions a grant up to ten lakhs based on case basis, subject to 25% of the sales turnover and loan assistance up to ten lakhs through commercial banks. However, in this case, ratio of refinance to grant as per the directive of NABARD should be in the ratio of 1:3.

**Assistance to Rural Women in Non-farm Sector Development (ARVIND)**

It is a very successful project of NABARD in Madhya Pradesh. It is slightly different from MAHIMA, where MAHIMA involves only marketing activity whereas ARVIND involves all the business activities starting from production to marketing and creating an overall entrepreneurship attitude among the beneficiaries. It is a holistic approach whereby the rural women are strengthened. The scheme is for individuals, SHGs and other types of
groups. In this program, each women of the group may take 50 lakhs loan from the bank and NABARD refinances the bank-up to 100%.

This program also supports in training, setting up the industry, skill development and in all other activities, as mentioned above, which are needed for the business development of rural industry. The main aim of the program is to promote rural industrialization and setting up of large units in rural areas. In this case, satellite units are set up which supply the ancillary material to mother units. Mother units buy at least 50% of the produce of these satellite units and ensure the best quality through transfer of technology and knowledge. Thus NABARD facilitates the overall skill development, organization and supervision of the satellite units and also supports them by providing the contingent expenditure of satellite units.

**Community Service Center (CSC)**

NABARD has created several CSCs in different parts of the country with the help of NGOs and community. As domestic market has tremendous competition from the foreign players, NABARD acts as a catalyst by creating a platform for the community through providing all the basic products and services at one place. For e.g., all the raw material, spare parts, skill development etc., are arranged at one place thereby facilitating the community to avail these resources easily.

**Micro financial Sector (Development and Regulation) Bill, 2007**

Is there need for legislation to promote the microfinance sector in the country? As per the bill, the major goal is to ensure financial inclusion of poor who continue to face difficulties in accessing the forms banking
system. To bring about financial inclusion, the bill aims at developing the microfinance section which is faced with many constraints including absence of legal framework for its growth. The aim as stated in the bill is “to provide for promotion, development and orderly growth of the microfinance sector in rural and urban areas for providing an enabling environment for ensuring universal access to financial services, especially to women and certain disadvantaged sections of people, and thereby securing prosperity of microfinance organizations not being regulated by any law for the time being in force and for matters connected therewith or incidental there to.”

Financial inclusion of the poor continues to be a major challenge. The recent All India Debt and Investment Survey have revealed that only about 13.4 per cent of the rural households have access to institutional credit. For the households in the lower four asset holding classes the same proportion varied from 3.6 to 10.9 per cent indicating a very low outreach of the poor by the institutional agencies. Further, though institutional credit accounted for about 57 per cent of the debt incurred by all the households, for the households in the lower four asset holding classes, it is the non-institutional agencies which accounted for the major share. Similarly, the Rural Finance Access Survey (RFAS) conducted by NCAER had also revealed the acuteness of the financial exclusion of the poor. The RFAS has found that nearly 87 per cent of the poor households were without access to any formal credit and about 70.4 percent of the poor did not have any deposit account. Given the enormity of the problem of financial exclusion, any attempt to reserve the trend therefore assumes importance. It is from the above angle that the relevance of the bill may be seen. However, what is more important
to be assessed is in what way the bill tries to pursue its goal. For attaining the stated goal, the bill is focusing on regulating hitherto unregulated organization delivering microfinance. But there is no clear explanation in the bill as to how the absence of a legal framework is constraining the MFIs and in what way the provision of such framework would help attain the goal of financial inclusion.

As in many other countries, NGOs in India have played a crucial role in the spread of microfinance. Their success in delivering microfinance has made many of them explore the possibility of scaling up their operations further. The success is also attracting many newer NGOs to enter the field. It is estimated that in India as of 2006 there are about 800 NGOs involved in the delivery of microfinance with an outreach of about 7.3 million households [Ghate 2006]. However, these NGOs are mainly involved in providing credit by borrowing from outside. What is constraining them in scaling up their outreach is the inability to provide integrated services (credit plus savings). Enabling NGOs to provide integrated services is likely to contribute to financial inclusion in the following ways.

Like credit, the poor need savings services to meet various contingencies they face in their livelihood. However, the poor find it difficult to save with formal banks for many reasons. In the absence of formal savings mechanism, the bulk of the poor adopt various unsafe and inconvenient methods of savings. The bill hopes that this problem can be addressed by enabling NGOs to offer savings services to the poor and that the success achieved NGOs in delivering credit is replicated in the case of savings too.
For the NGOs, the inability to accept savings from their clients is considered to be a major hindrance in mobilizing cheaper funds needed for scaling up. This in turn is supposed to have contributed to the problem of high lending rates charged by the NGO-MFIs. Easing the restriction on savings mobilization by NGOs is likely to help address the problem of fund constraint along with helping them in providing affordable loan services to the poor. Moreover, with the repaid growth of their microfinance activity, NGO-MFIs are faced with the dilemma which emanate from the nature of their organizational form. Increased outreach and loan business has created skepticism about the not-for-profit nature of the NGOs. NGOs are increasingly finding that their present from is not conducive for up-scaling and attaining sustainability of microfinance operations. Microfinance being an activity required to be pursued on a cost recovery basis, the not-for-profit from is found to be operationally constraining and inherently contradictory by the NGOs. At the same time, the uncertainty over the tax statues of the surplus generated from microfinance operations has created serious concern among NGOs. Many of them are looking for a suitable form of organization which can help them take up microfinance in a full fledged way with low capital requirement and without any dilemma over profit. However, due to the restrictive nature of existing regulatory norms for commercial form of organization (like NBFCs), NGOs are finding it difficult to attain the required transformation. Though many of them have found a way out by promoting a not-to-profit company under Section 25 of the Companies Act of 1956, they are still constrained in providing integrated services to the
poor. It is here that the bill is expected to help the NGOs to overcome the above constraints and dilemmas.

The bill may thus be seen as an attempt to recognize the role of NGOs in financial intermediation and help them play a more effective role. However, since it is talking about the overall development of the microfinance sector it is essential for the bill to simultaneously emphasize the role of formal financial institutions in attaining financial inclusion. Also, while the argument about absence of a legal framework appears to hold good for NGOs, the same is not true for cooperatives. The bill wrongly assumes that cooperatives lack legal framework for providing integrated services. Hence the inclusion of cooperatives can only be construed as an intrusive step.

Scope of the Bill
The bill tries to cover broadly two categories of institutions, namely, NGOs and cooperatives. The institutions proposed to be regulated are called microfinance organizations (MFOs). The NGOs proposed to be regulated include both societies and trusts established under central and state enactment. Cooperatives include all thrift and credit cooperatives established under various cooperatives acts of both the state and central governments. If exclude from its purview other institutions like NBFCs, section 25 companies and scheduled banks including RRBs. The proposed regulations therefore are more institution-based than activity-based.

In fact, the constraints identified with regard to NGOs are true of even other institutions like NBFCs and section 25 companies. Therefore, the bill takes a
very narrow view. Unless it widens its scope to include other MFIs the broader objectives may not be realized. Leading MFIs in the country are in the form of either NBFC or section 25 companies and account for over 90 per cent of the total clients served by the MFIs in the country. By focusing only on NGOs and cooperative, the bill attempts to shift the burden of social banking away from commercial banks to civil society institutions. It is desirable to keep cooperatives out of the purview of the new regulation except for receiving any capacity building support.

All groups are kept outside the purview of regulation. These groups can continue working on the basis of their informality and autonomy. The groups linked to banks may not get affected by the bill as they would be able to continue functioning in the same way. In the case of groups coming under MFIs, there is a possibility of MFIs exercising control over their savings. Deposit mobilization by MFIs should be largely on a voluntary basis with groups free to choose between their MFI or any nearby bank. It is also desirable that the NGOs help and encourage member – based institutions like cooperatives or SHG members to retain ownership and control over the MFIs and their resources.

Eligible clients: In the bill only members of the groups formed for microfinance purpose can become eligible clients of the MFIs are therefore supposed to deal only or exclusively with their target group. To that extent the risk of any failure gets confined to a limited client base. However, MFIs working with the extreme poor or in poorer regions, may find it difficult to mobilize adequate savings from the eligible clients, the bill among other,
includes small farmers owning land up to two hectares and women in general. The bill seems to have given enough scope to MFIs to target mainly the economically better – off among the eligible groups and exclude the core poor. Outreach of core poor may suffer unless MFIs are made to proactively target such groups.

**Microfinance service:** The bill has made are attempt to define microfinance services. Even though the services covered by MFIs include loan, thrift insurance, pensions and any other services, the bill does not explicitly include savings/thrift under the definition or microfinance services. It is unclear as to why the term thrift has been used in the place of savings. The main reason seems to be to encourage the poor to generate thrift on a relatively long-term basis through economical ways. The bill envisages mobilization of only savings and term deposits by MFIs. In terms of loan purpose, the bill specifies both consumption and production loan (farm and non farm). Inclusion of grant and loan in kind under financial assistance to be provided by MFIs is confusing. An MFI can sanction loan in aggregate of ₹50,000 per individual for various production or consumption and ₹1.5 lakh for housing purpose. While the limit seems to be well within the loan being offered by MFIs there could be difficulties in the case deviations in genuine cases. The bill suggests even fixing limitation on the size of savings to be mobilized. The aim appears to be to reduce the risk of failure in absolute terms. Mature groups may find the savings limitation restrictive if they mobilize large savings from the members. At the same time, while members can borrow have individual savings account causing inconvenience to individual servers.
**Regulatory Norms**

The bill has proposed both prudential and non-prudential norms for regulating the MFIs. For core regulation purpose, the bill is considering only those MFIs which want to take up thrift services and exclude credit only MFIs. Exclusion of non-deposit talking MFIs may case the burden or supervision. However, if there is any self exclusion by MFIs from regulation, the poor served by those MFIs may not get access to savings service.

Deposit – talking need to obtain a certificate of registration subject to satisfying conditions like begins in existence for three years with a credible management term and with a minimum net owned fund of ₹ Five lakh. The existing MFIs offering thrift services too need to obtain the certificate within six months of the enactment of the bill. Among existing MFIs, mainly cooperatives may have to apply for this certificate which is an unnecessary requirement. How far will these provisions be effective in ensuring entry of only credible MFIs? While the requirement of three years of operation might become restrictive for newer MFIs, very small NGOs and cooperatives might find it difficult to mobilize the required entry capital. Many of them may remain unlicensed as is the case with many primary cooperatives banks. The entry capital not being very high, the chances of entry of unscrupulous elements cannot be ruled out. The real test would lie in ascertaining the credibility and character of the management. It is here that NABARD may have to exercise due diligence by relying on district development managers and local civil society associations.
The other major prudential norm prescribed is the creation of reserve fund by the creation of reserve fund by the MFIs out of their net profit or surplus. MFIs are required to keep aside 15 per cent of their net profit annually to create the reserve fund.

**Highlight of NABARD Activities**

- The growth in business was reflected in the bank's operating surplus, which is ₹1128 crore on a business volume of around ₹81,000 crore.
- The growth has also reflected in increase in per employee business, which now stands at ₹24.13 crore against ₹19.30 crore last year. Therefore, increase in productivity.
- This has been without breaching the 1% best practice of administrative cost as a percentage of working funds (.73%).
- Within investment credit refinance, 75% goes to farm sector supporting agriculture investments and 25% goes to non-farm sector. The 1/4th non-farm sector is important because 40% of rural households are non-cultivator households engaged in non-farm activities. This sector is unorganized, exclusion is high and our refinance, which has a credit plus orientation, is aimed at lessening the financial exclusion. In non-farm sector, the major activities are agro processing (55%), rural housing (17%) and artisans etc. the balance.
- In farm sector, the major components are farm mechanization (21%), micro finance (15%), minor irrigation (7.6%) and dairy development (5.7%).
• In the case of production credit refinance, the focus has been on realizing at ground level crop loans being extended to farmers at 7% as per GOI policy. With this end in view, NABARD has increased availability of refinance to 40% of ground level credit, facilitated more number of cooperative banks becoming eligible for refinance, provided refinance at concessional rate of 2.5% for cooperatives and 4.5% for RRBs and linked refinance to institutional reforms towards strengthening the cooperative banking system. This facilitated increase in production credit refinance to ₹14,758 crore during 2006-07 as against ₹9617 crore in 2005-06 (53% growth).

• So far focus made on the levels of business operations. However, business performance of NABARD should be judged by other standards as well, viz.
  - Promotional and development support extended by it
  - Institutional reforms
  - Building rural infrastructure
  - Banking supervision

• 40% of rural households are non-cultivator households, where financial exclusion is high and, therefore, our support to the non-farm sector by way of promotion and development initiatives are extremely critical.

• Within the non-farm sector, we have four major initiatives. District-wise Rural Industry Programmes (DRIP), development of activity clusters, training of rural youth for purposes of employment through entrepreneur development programme backing and rural marketing.

• DRIP programme now extends to 106 districts facilitating overall credit flow of ₹13,363 crore with refinance support at around ₹2,077 crore.
This has facilitated setting up of around 12 lakhs business units and providing employment to 26 lakh persons.

- NABARD have identified, promoted and developed as many as 42 clusters in 18 states during last year alone. These include handlooms, handicrafts, silk, horticulture, bamboo, leather goods, jute etc. We are grateful to our NGO partners for this support.

- In regard to training of rural youth, we conducted 663 entrepreneur development programmes last year with a cost of around ₹4.43 crore as grant funds. Cumulatively, 2.42 lakh youth have been so far been trained for self-employment.

- Promotional initiatives in the farm sector covered watershed development, tribal development programmes and micro finance related initiatives. NABARD does a Watershed Development Fund (WDF) of ₹200 crore and also gets support from kFW for the Indo-German Watershed Development Project. Our focus during 2006-07 has been on getting a cluster of watersheds of 15000 hectare each in the distressed 31 districts across 4 states. This programme will address the issue of soil and moisture conservation and help improve agronomic practices in distressed areas. Apart from this, the Indo-German Watershed Development Project has also been extended to Maharashtra to Andhra Pradesh and Gujarat covering the entire Maharashtra and 4 districts each in AP and Gujarat.

- NABARD has a Tribal Development Fund (TDF) of ₹50 crore which has been used for development of orchards in tribal settlements. NABARD has sanctioned an assistance of ₹21.16 crore for 11 projects in 9 states.
The micro finance movement in India has been designed and nurtured by NABARD for over a decade.

During 2006-07, against a target of 3.85 lakh SHGs to be credit linked, 3.12 lakh new SHGs and 2.41 lakh existing SHGs were facilitated credit linkage. Bank loan of ₹2922 crore was disbursed supported by NABARD refinance of ₹1161 crore. Cumulatively, the number of SHGs credit linked as on 31 March 2007 was 25.50 lakh groups with a bank loan of ₹14320 crore and NABARD refinance of ₹5320 crore. One redeeming feature is that the share of non-Southern states in SHG movement has increased from 29% in 2000-01 to 50% in 2006-07.

NABARD has been extending support for this programme by providing grant support to banks and NGOs for promoting and credit linkage of SHGs, training and capacity building of NGO personnel, bank/government officials and SHG members. In 9 states, NABARD has also initiated a pilot project for radiating matured SHGs into micro enterprise groups.

The focus has been mainly on building a vibrant and healthy cooperative banking structure. The revival package for the Short Term Cooperative Credit Structure (STCCS) is presently being implemented in 10 states. 7 more states have already agreed in principle to implement the reform package. Amendments to the Cooperative Societies Act giving effect to the reforms as envisaged in the package have already passed in Andhra Pradesh and a number of other states are in the process of amending their Cooperative Societies Act. Special audit of Societies have commenced training modules for Cooperative Societies and bank personnel have been designed, a Common Accounting and Management
Information System is being finalized and implementation of the package is monitored by a National Level Monitoring Committee. In the RRBs segment, merger of RRBs sponsor bank wise at state level is near completion.

• On the occasion of NABARD's Silver Jubilee year, we plan to launch an ambitious programme of Village Adoption and Total Development (VATD) scheme. This will be for integrated and holistic development. One village in each of the 400 districts where we have our DDMs, will be adopted.

• Bank of the respective district will also be requested to adopt 2/3 villages. Development plan will encompass preparation and implementation of social and economic infrastructure plans for achieving 100% financial inclusion. It will entail, among other things, debt counseling, financial education, centre for information on prices, seed replacement, testing and quality certification, extension practices, deepening of SHGs etc. I believe that financial education and counseling, credit counseling and debt counseling are extremely important for the villagers and will strive towards achieving this objective.

• Developing rural infrastructure has emerged as a major portfolio for NABARD in the last 12 years. With the Rural Infrastructure Development Fund (RIDF), running through XII tranche so far, the cumulative sanctions for infrastructure investments to various State Governments has crossed ₹60,000 crore. Nearly, 72% of sanctions as per phasing of projects has been disbursed so far. During 2006-07, under RIDF XII more than 42000 projects were sanctioned to various State
Governments for ₹10,571 crore. Rural connectivity (36%), irrigation (32%) and social sector projects (19%) were the major investment categories. Apart from this a separate window under RIDF to fund the Rural Roads Component of Bharat Nirman has also been opened in NABARD. This would help in providing all weather road connectivity to all villages with a population of above 1000 (500 in the case of hilly or tribal areas) by 2009. The corpus for RIDF (2007-08) has been raised to ₹12,000 crore and added to this will be ₹4,000 crore under Bharat Nirman.

Some of the milestones in NABARD's activities

- With its effective overseeing and monitoring of the implementation of the Government of India's programme to double the flow of credit to agriculture over a three-year period from 2004-2005, the total disbursement of credit reached Rs 1,25,309 during 2004-2005. Ground level credit flow to agriculture and allied activities reached Rs 1,57,480 crore in 2005-2006.

- Refinance disbursement to commercial banks, state cooperative banks, state cooperative agriculture and rural development banks, Regional Rural Banks and other eligible financial institutions aggregated Rs 8,622.37 crore.

- As on 31 January 2007 through the Rural Infrastructure Development Fund (RIDF), Rs,59,795.35 crore have been sanctioned for 2,31,702 projects covering irrigation, rural roads and bridges, health and education, soil conservation, drinking water schemes, etc. Developing among hosts of other infrastructures, RIDF will create 20971 schools,
6239 primary health centers and provide drinking water supply in 7267 villages

- Watershed Development Fund, with cumulative sanctions of ₹578.95 crore for 427 projects in 124 districts of 14 states, has created a People’s Movement in rural India.
- Farmers now enjoy financial access and security through 582.50 lakh Kisan Credit Cards that have been issued through a vast rural banking network.
- District Rural Industries Project (DRIP) has generated employment for 23.34 lakh persons with 10.95 lakh units in 105 districts.

**NABARD’s Function in Microfinance**

Forming and nurturing small, homogeneous and participatory self-help groups (SHGs) of the poor has today emerged as a potent tool for human development. This process enables the poor, especially the women from the poor households, to collectively identify and analyze the problems they face in the perspective of their social and economic environment. It helps them to pool their meager resources, human and financial, and priorities their use for solving their own problems.

The emphasis on regular thrift collection and its use to solve immediate problems of consumption and production not only helps to meet their most urgent needs, but also trains them to handle larger financial resources more skillfully, prudently and with a more lasting impact.
SHG-Bank Linkage Programme

Facilitating SHGs to access credit from formal banking channels. SHG-Bank Linkage Programme has proved to be the major supplementary credit delivery system with wide acceptance by banks, NGOs and various government departments.

Region-specific Initiatives

NABARD has intensified its efforts for roping in new partners for promotion and linkage of groups in regions where the growth of groups has not been commensurate with potential. Priority has been assigned to awareness-building and for identification of NGOs and other partners in 13 priority states, which account for 70% of rural poor in the country.

Capacity Building

NABARD sponsors capacity building Programmes for various partners in the field of microfinance to sensitize and equip them with concept & nuances of SHG bank linkage programme. NABARD provides training inputs on SHG financing to training establishments of participating banks, to help them to internalize the training requirements at their level. NABARD gives technical support to banks to evolve suitable intermediate structures like Farmers' Clubs to increase the outreach of their branches in promotion and linking SHGs. NABARD supports and helps banking institutions (especially RRBs & cooperative banks) to take on the role of Self Help Promoting Institutions (SHPIs).
Support to Governments

Necessary assistance is provided to the governments by NABARD for dovetailing mF practices with the poverty alleviation programmes. NABARD also encourages the association of Panchayati Raj Institutions (PRIs) in adopting group processes for maximization of empowerment. NABARD, in association with Lal Bahadur Shastri National Academy of Administration, Mussoorie conducts tailor made exposure programme on self help group and microfinance for senior and middle level officers of Indian Administrative Services (IAS) who are posted as district collectors/Chief Executive Offices of local administrative set ups (Zilla Parishad).

Support to NGO Partners

Several steps have been taken by NABARD for capacity building of NGOs which partner in promotion and nurturing of SHGs. The emphasis is on involving a large number of NGOs. Special focus is on those NGOs participating in watershed development, health, literacy and women development, to encourage them to take up promotion, nurturing and linkage of SHGs as an 'add-on' activity. NABARD has a scheme of part-financing the cost of promotion of groups by NGOs. NABARD has developed specialized programmes for use by CEOs of NGOs for appropriately envisioning this as an add-on concept. Separate programmes have also been designed for NGO field staff to appreciate the nuances of SHG functioning.

Alternate MF practices

The NGOs and other local bodies at village block and district levels in the North Eastern States are encouraged to take up alternative micro-credit
delivery mechanisms through direct funding. Formation and operation of SHG Federations is supported and encouraged by NABARD. Similarly, networking of NGOs is also encouraged.

**Coordinating MF Efforts in India**

NABARD coordinates the MF activities in India at international/ national/ state / district levels. These include organizing international/national Workshops, Seminars, etc for experience sharing, Organizing National and State level Meets of Bankers and NGOs etc. Dissemination of best practices in SHG / microfinance.

**Monitoring and Review**

Block/district/state level review meetings are organised and/or organised by NABARD. The relative documentation and database is also carried out by NABARD. In addition, periodical Monitoring studies are conducted through NABARD/Bank Officers. Internal Impact Studies and are conducted by NABARD periodically.

**Microenterprise Development Programme (MEDP) for Matured SHGs**

The progression of SHG members to take up micro enterprise involves intensive training and hand holding on various aspects including understanding market, potential mapping and ultimately fine tuning skills and entrepreneurship to manage the enterprise. Hence, a separate, specific and focused skill-building programme ‘Micro Enterprise Development Programme (MEDP)’ has been formulated. This involves organizing short duration, location specific programmes on skill up gradation / development
for setting up sustainable micro-enterprises by matured SHG members. The duration of training programme can vary between 3 to 13 days, depending upon the objective and nature of training. The training may be conducted by agencies that have background and professional competency in the field of microenterprise Development with an expertise in skill development.

**Distance education programme in collaboration with IGNOU New Delhi**

Indira Gandhi National Open University (IGNOU), New Delhi is conducting a six-month certificate course on “Empowering Women’s Self Help Groups” as a distance education programme. NABARD reimburses the course fee of Rs 1000/- to candidates who successfully complete the course in the first attempt. This approach was expected to facilitate spread of the SHG concept by developing a cadre of competent resource persons in the subject area.

**Scheme for financial assistance to banks for rating of Micro Finance Institutions (MFIs)**

In order to identify MFIs, classify and rate such institutions and empower them to intermediate between the lending banks and the clients, NABARD has decided to extend financial assistance to Commercial Banks and Regional Rural Banks by way of grant. The banks can avail the services of credit rating agencies, M-CRIL, ICRA, CARE and Planet Finance in addition to CRISIL for rating of MFIs. The financial assistance by way of grant for meeting the cost of rating of MFIs would be met by NABARD to the extent of 80% of the total professional fees subject to a maximum of ₹80,000/-. The remaining cost would be borne by the concerned MFI. In addition to 20% of the professional fee, the cost of local hospitality
(including boarding and lodging) towards field visit of the team from the
credit rating Agency, as a part of the rating exercise, would also be borne by
the MFI. Those MFIs which have a minimum loan outstanding of more than
₹ 50.00 lakh (Rupees fifty lakh only) would be considered for rating and
support under the scheme. Financial assistance by way of grant would be
available only for the first rating of the MFI.

**Refinance support to banks for financing MFIs**

The scheme is to provide 100% refinance to banks for financing MFIs. Interest rate on refinance to Commercial Banks and Regional Rural Banks
on their loans to MFIs for on lending to poor clients will be at interest on
refinance applicable to lowest slab irrespective of size of bank loan to MFIs,
with the stipulation that banks will charge not more than 9% per annum rate
of interest to the MFIs. As the banks are free to determine the rate of interest
on their loans, the rate of interest on NABARD refinance will be 3% less
than that charged by the banks on their loans to MFIs. However, the
minimum rate of interest on the refinance to banks for their loans to MFIs
will be at interest rate on refinance applicable to the lowest slab stipulated by
NABARD from time to time.

**Scheme for financing matured SHGs for Farm Production and
Investment activities**

The objective of the scheme is to facilitate the members of matured SHGs to
meet their credit requirement for farm production and investment activities
and to enable them to diversify their income generating activities. Term
Loan and Cash Credit limit given by the banks for a period of five years to
SHGs exclusively for farm production and investment activities covering agriculture sector and allied activities. Banks can also sanction composite loans by combining consumption credit to the extent of 30% of the total limit. Matured SHGs which have successfully utilised bank loans and whose members have moved from consumption requirements to production requirements, may be considered for financing for farm production and investment activities. Due freedom may be given to SHGs to monitor and ensure end-use of credit as is usually practiced by banks under SHG Bank Linkage Programme. Refinance - 100% of the bank loan under Automatic Refinance facility (ARF). The refinance provided to the banks under the scheme will be payable in 5 years at half yearly intervals.

**Scheme for Capital/ Equity Support to Micro-Finance Institutions (MFIs) from MFDEF**

The scheme attempts to provide capital/equity support to Micro Finance Institutions (MFIs) so as to enable them to leverage capital/equity for accessing commercial and other funds from banks, for providing financial services at an affordable cost to the poor, and to enable MFIs to achieve sustainability in their credit operations over a period of 3-5 years.
Table: 6.1 Overall Progress under Micro-finance during the last Five years (₹ in Crores)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No. of SHGs</td>
<td>Amount</td>
<td>No. of SHGs</td>
<td>Amount</td>
<td>No. of SHGs</td>
</tr>
<tr>
<td>SHG Groups</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Loan Disbursed</td>
<td>1105749</td>
<td>6570.39</td>
<td>1227770</td>
<td>8849.26</td>
<td>12253.51</td>
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<tr>
<td>Bank Loan outstanding</td>
<td>2894505</td>
<td>12366.49</td>
<td>3625941</td>
<td>16999.91</td>
<td>22679.84</td>
</tr>
<tr>
<td>SHG Saving with Banks</td>
<td>4160584</td>
<td>3512.71</td>
<td>5009794</td>
<td>3785.39</td>
<td>6121147</td>
</tr>
<tr>
<td>Growth (%)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>11.0</td>
<td>34.7</td>
<td>31.1</td>
<td>38.5</td>
<td>-1.4</td>
</tr>
<tr>
<td></td>
<td>(30.5)</td>
<td>(31.7)</td>
<td>(7.3)</td>
<td>(8.5)</td>
<td>(1.0)</td>
</tr>
<tr>
<td>Microfinance Institutions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank Loan Disbursed</td>
<td>334</td>
<td>1151.56</td>
<td>518</td>
<td>1970</td>
<td>581</td>
</tr>
<tr>
<td>Bank Loan outstanding</td>
<td>550</td>
<td>1584.48</td>
<td>1109</td>
<td>2748.94</td>
<td>1915</td>
</tr>
</tbody>
</table>
Summary

While the programme started with the objective of sustainably expanding the outreach of the formal banking system to the unreached rural poor, in the process it has created a doorstep microfinance system for the poor. These people’s platforms have opened up opportunities for convergence of other social sector intervention and have set in a strong empowerment process leading to creation of a demand driven system. Further, the linkage banking enables the poor to handle larger micro enterprise investment thereby preparing them as clients for larger enterprises. Another unique feature of the NABARD microfinance programme is its marketing strategy. The programme is positioned as a tool for depending the impact of the social sector interventions of the NGOs and delivery of services by government agencies. Thus, a great deal of synergy of objectives and actions is built among a wide range of social sector agencies and banks. In other words, instead of using the credit plus approach, we use the plus microfinance approach! This explains the extremely low ‘expandable resource’ required. The programme has therefore enabled the poor to access financial services from the banks at the lowest transaction costs anywhere in the world at less than almost one Dollar per poor person.
6.2. SWAYAM KRISHI SANGAM (SKS):

Development of Organization

Swayam Krishi Sangam (SKS) employs the Grameen bank lending methodology like SHARE, but its operational approach is unique and provides a contrast to both SHARE and BASIX in terms of the successful drivers of micro credit delivery. SKS is a young MFI, which recently transformed into an NBFC and was established as an NGO in 1997 by Vikram Akula, a social entrepreneur and graduate of both Yale & Tufts Universities. The mission of SKS is, “To empower the poorest of the poor to become economically self-reliant by providing financial services to poor women, through groups at the village level, in a self sufficient manner.” SKS is most notable for developing the first MIS system among Indian MFIs for which it won awards. Its goal going forward is to raise money in order to scale up and reach 100,000 customers by 2007. Since its founding, SKS has delivered US$40 million in micro credit to over 150,000 women in Southern India through 45 branches and 500 employees. SKS provides a useful addition to the case studies of SHARE and BASIX because it has only recently transformed into a NBFC and therefore its financials will reflect more of an NGO. Thus, we are interested in how it has fared as an NGO and what has driven it to transform. It then completes the picture of the various approaches to becoming an NBFC that an MFI can take and therefore, allows us to see a wider and richer array of benefits and costs. We can already begin to see that there is an even larger menu of options and paths an
MFI can take and that the question might not even necessarily be NGO or NBFC.

Chart 6.2 THREE C TO SCALING MF... AND THE SKS SOLUTION

<table>
<thead>
<tr>
<th>Capital</th>
<th>Capacity</th>
<th>Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>A profit-oriented model to access commercial capital</td>
<td>Scalable processes from the business world</td>
<td>Deploying technology to automate and lower transaction costs</td>
</tr>
</tbody>
</table>

(Sources: www.sks.com)

**Sources of Capital**

SKS transformed from and NGO into an NBFC in January 2005 order to improve financial sustainability and access commercial funds in order to scale up outreach to 1,000,000 clients by 2010. SKS cited the benefits that it now enjoys as an NBFC as:

1. Greater access to funds as commercial lenders have greater comfort lending to a regulated company with transparent ownership.
2. A diverse funding source because as an NBFC, SKS can raise equity and offer financial returns, enabling it to access commercial investors and international capital markets.

3. Greater Outreach Potential due to increased access to funds.

   SKS has historically sourced most of its capital from donors and loans. This isn’t surprising considering that it is a younger MFI than SHARE or BASIX and this transformed into an NBFC very recently. This is evidenced by a debt to equity ratio in 2004 of 11.988% which seems high compared to its 2.4% level in 1999. This indicates that its primary growth vehicle has been debt. In 2001, SKS indicated that 40% of the company is owned by its clients with 15% of it owned by employees and the rest by a group of institutional and individual investors. We would expect to see that SKS’s founding base will diversify and increase with its transformation to an NBFC as is the case with BASIX. However, we will be especially interested in whether this transformation will result in sustained profitability and social impact.

Analysis of benefits & costs of Transformation

(1) Financial Analysis

Continuing in line with our analysis of SHARE and BASIX, the financial analysis of SKS is drawn from SKS’s profile on the MixMarket using the selected ratios and time period to allow for better comparison. The only ratios calculated from audited financial statements are Net Interest Margin and Capital Formation Rate.
SKS’s financials raise a number of red flags. However, we might keep in mind that it is a small company with only four years of operations and may overcome these with time. It has grown fast with a loan portfolio of $2,702,826 in 2003, and increase of 17,158% from its 1999 level of $15,135. Its loan portfolio in 2004 was $7,604,876, just below the benchmark of $9,844,044. This rapid growth has reasonably impacted portfolio at risk which accordingly rose from 0% in 1999 to 5.18% in 2004 far above the benchmark of 1.30%. This shows that SKS’s rapid growth is resulting in a decline in the quality of its loans and it might want to manage and reduce its PAR in order to have more managed growth. SKS seems to have relatively poor productive use of assets and impact on shareholder value, something that is mitigated by the fact that it is a very young company. SKS’s return on equity during the period in which it transformed from 2004 to 2005 was -6.50%, which is substantially lower than its ROE of -59.44% in 1999. This is a positive trend but shows that as an NBFC SKS is actually reducing shareholder value and we would hope to see improve in the next several years. Another positive trend is that SKS’s return on assets was substantially improved from -55.85% in 1999 to -0.06% in 2004. In line with this, SKS’s operating self sufficiency was 99.79% in 2004 up from 12.89% in 1999 and 7.67% in 1998 but is still low compared with the benchmark of 153%. SKS’s Net Profit Margin increased from -675% in 1999 to -0.21% in 2004 which is a very positive sign but again is far below its peer average of 23.50%. Overall, SKS could show a lot of promise if it is able to manage its growth properly and improve some of its financials. This will mean that its next several years will be critical in its ability to develop proper systems and improve its ratios. In its 2001 annual report, SKS states that it charges
interest on its loans so as to cover its costs in order to avoid donor dependency. The specific interest rate it charged was not readily available. However, SKS seems extremely close to becoming profitable. If the trend in its financials continues it should become profitable in the next year and could have the potential for very positive and substantial growth. SKS’s negative financials are not surprising for several reasons, first because it has been an NGO almost entirely during the period in which these ratios have been calculated and therefore was not driven by the profit motive, secondly because it is a very young organization and therefore naturally would take at least several years to start generating returns due to the capital investment needed to start operations.

(1) Social Impact Analysis
For SKS, like SHARE, it is integral to its strategy and mission to target poor clients and women. The words, “To empower the poorest of the poor” in its mission are a strong statement that SKS endeavors to empower the very poor and not simply provide them with relief. SKS operates with the dual goal of generating financial returns for sustainability and empowering the poorest of the poor in India. Accordingly, as shown above, SKS geographically targets poor populations and claims 100% of its clients served are considered poor as well as being women. As with SHARE, SKS states that its reasons for targeting women are that they are the most marginalized and tend to use resources more productively than men. The question as to whether SKS can really reach the “poorest of the poor” remains unanswered as of yet due to the lack of meaningful measurements of that impact. Again, we are left wanting of information on what kind of poor SKS targets and whether it is
having any sustained impact on the income and living standards of its clients. As mentioned, in India the ‘poorest of the poor’ are often landless migrant laborers who travel to work for half the year, making it extremely difficult to bring them into the groups that Grameen style lending requires. This may prove especially difficult as SKS endeavors to achieve financial sustainability and access commercial funds. Experience shows that sometimes reaching the poorest of the poor is a challenge even for NGOs let alone MFIs who are sometimes challenged by financial sustainability. It seems safe to say that SKS has made a sufficient effort to target the poor, but whether it has reached the poorest of the poor and had any impact on their poverty status is yet unclear.

(3) Organization & Management Analysis

Strategic Vision
The strategy of SKS to achieve its mission is to help poor people access small, low interest loans during times of crisis, so that they can avoid falling into debt traps. SKS endeavors to offer the poor alternatives from Banks that require collateral and bureaucratic procedures as well as moneylenders that charge exorbitant interest rates. The company does so by delivering collateral-free microfinance in the form of small loans and savings facilities to the doorstep of the poor. SKS seems to have a strong strategic mission but there is some uncertainty about its ability to balance that mission while attempting to transform into a more financially sustainable and commercially oriented institution. The rapid growth of the organization shows its commitment to outreach and scale in the service of the mandate of microfinance. Our main concern surrounds its ability to balance its
ambitious mission to serve the “poorest of the poor” in a financially viable manner.

Management & Governance
SKS has a board of directors composed of seven members about which not much was said in the 2001 annual report. Thus, the diversity and strength of SKS’s board is somewhat unclear. However, the members of SKS’s Foundation, its fundraising arm, are a diverse group of professionals and academics from India and the U.S. SKS’s management also appears to be quite strong based simply upon ranges of experience in business and development and education.

Transparency
The transparency of SKS seems rather good in that its financial statements are readily available and up to date, however not all information was outlined as clearly as that of BASIX or in some instances SHARE. Information detailing governance, human resource management, and poverty impact analysis as well as poverty outreach strategy was hard to extract and not readily available. Again, this may simply be a factor of the size of the company and its length of time in operation.

Information Technology System
SKS has won numerous awards for its innovation in technology for microfinance and particularly its management information system, which it pioneered in India. SKS’s MIS system is the cornerstone of the organization’s technology platform in that it enables the company to manage
small transactions efficiently, to increase staff productivity, reduce operational costs, etc. It is designed for simple use, scale, and integrates all the accounts of the organization. SKS created a technology management team which has developed software applications to manage client’s portfolios and accounts. In addition, SKS developed a Smart Card program that enables technology to replace the manual passbooks and collection sheets with Palm Pilots and smart cards that serve as “electronic passbooks.” While the effect of such technologies is not yet clear, the endeavor to employ technology to improve the impact and efficiency of the organization is a positive sign.

**Loan Methodology**

Like SHARE, SKS’s loan methodology is to offer solidarity loans to groups of women and require some small mandatory savings and use peer pressure to ensure repayment. The main three loan products it offers are income generating loans, group fund loans, and emergency loans. However, SKS has adapted the Grameen methodology by integrating some industry practices and some of its own innovations, such as technology development. Currently, SKS seems to offer little in terms of additional products. This loan methodology in comparison to BASIX is much simpler. We would be most interested in the comparison of poverty impact and profitability of the various loan methodologies of SHARE, BASIX, and SKS in order to make some sort of meaningful statement about what kind of loan methodologies are most effective. We would then need to decide what tradeoffs of profitability and poverty impact are acceptable. This provides compelling reasons for the need to develop better measurements of these impacts in
order to create a matrix of trade-offs and MFI may face when developing its loan methodology and organizational structure.

**Summary**

The picture we have of SKS is of a very young NGO in India that has only very recently transformed to an NBFC, mainly for the reason of accessing larger and more diverse funding in order to have greater outreach. As a young NGO, SKS’s financials show that it is not yet profitable but we might expect it to be in the next year or so. We might note than that its rapid growth has occurred as an NGO, which is evidence that with a good donor base an NGO-MFI can indeed have large outreach but that there may be some level of ‘ceiling’ on that outreach at which point, as with SKS, an NGO-MFI might feel compelled to transform into an NBFC in order to continue to grow. However, we are again left with an incomplete picture of the quality of SKS’s growth in terms of poverty impact because we are unable to find any meaningful measurements of SKS’s impact on clients or even what categories of poverty its clients it falls into.
6.3 SOCIETY FOR HELPING, AWAKENING RURAL POOR THROUGH EDUCATION (SHARE):

Background
SHARE is India’s largest MFI in terms of outreach or number of loans given. Thus, any comprehensive study of MFIs in India will have to consider SHARE. SHARE provides a contrast to BASIX in both lending methodology and organizational style. SHARE (Society for Helping, Awakening Rural poor through Education) was originally registered under the Societies Act as a service organization in the year 1989 by Mr. M. Udaja Kumar, Founder and Chairman. It then transformed into ‘SHARE Microfin Ltd,’ a regulated Non-banking Financial Institution (NBFC) under the companies act in the year 2000. SHARE operates mostly in the rural areas of the states of Andhra Pradesh and Karnataka. Its mission is “the reduction of poverty by providing financial & support services to the poor, particularly women, for viable productive income generation enterprises enabling them to use their skills and reduce their poverty.”SHARE is one of the few Grameen Bank replicators in India, meaning that it uses the Grameen methodology in its operations by focusing on loaning to groups of women. The focus on women is to ensure that the benefits of increased income accrue to the general welfare of the family, particularly children.

During the years 1991-1994 SHARE had started its microcredit operations as a two year action research project with a US$25,000 recoverable grant
from the Asia Pacific Development center and a soft loan of US$35,788 from the Grameen Trust in Bangladesh. SHARE’s major expansion however, began in 1997 with the opening of six new branches to a total of ten branches with one branch achieving self sufficiency. With this, SHARE felt it had a viable model that could be replicated all over India. Up until this point, SHARE had been a non-profit organization registered as a charitable society. SHARE decided to transform for several reasons, one of which was the legal constraints it faced as an NGO. However, it also felt that transformation would allow it to attain financial self-sufficiency which its NGO legal status did not permit. SHARE saw the profit motive as against the principles of charity. We might expect then, to see an improvement in the financial sustainability of SHARE after transformation. On the other hand, we might also expect to see a change in the social impact of SHARE if the profit motive results in lending to clients that are more profitable, and thus, likely less poor. Of course, this might not happen if SHARE is able to cross-subsidize its poorer clients with the larger returns it earns from lending to better off clients. Also, we might see a loss of innovation and flexibility in product development as an NBFC due to the requirements and restrictions placed on regulated organizations.

There was a recognition that the activities of SHARE needed to be transformed in order to achieve financial sustainability. The legal status of SHARE at that time did not permit it due to a conflict of interest between the profit motive and the notion of a charity embedded in the legal identity of NGOs. According to SHARE, the two major limitations of being registered as a society where that the income tax law in India does not recognize
charitable institutions carrying on microfinance activity and thus, the MFI loses its tax exemption. Secondly, raising funds becomes a difficult task when financial leverages cannot be optimized because the net worth and equity of the MFI do not work for profit. Recognizing these constraints, SHARE transformed to a community owned and managed for-profit regulated financial institution registered under the companies act in the year 2000. SHARE’s target clients are women whose per capita income is less than ₹ 250 per month (Approx. US$5.80) and their asset holding is less than ₹ 20,000 (Approx. US$465).

Sources of Capital
SHARE’s sources of capital, both historically and going forward, are critical to its viability as an MFI and its ability to grow and reach more clients. Since MFIs are in the business of lending, a steady and growing stream of capital is central to its business. SHARE’s 2001 annual report states that 99% of the equity in SHARE has been contributed by its clients with the remaining 1% from unspecified individuals. In the 2004 audited financial statements, share capital was listed at ₹ 122,761,700 or approximately US$2,900,000. However, the debt equity ratio of SHARE for 2004 was 552% indicating that the organization is highly leveraged with share capital not constituting a significant source of funding for the MFI. Data from the Mix market, a microfinance rating agency operated by the Consultative Agency for the Advancement of the Poor (CGAP) at the World Bank, shows that SHARE’s debt to equity ratio was 57% in 1998 when it was an NGO and has risen significantly over the years, showing that SHARE has accessed capital for growth mainly from debt. This is not necessarily unusual of a
bank. However, more caution is needed in microfinance when leveraging assets than compared to traditional banking due to the lack of empirical data on performance of microfinance banks. Therefore, the same assumptions cannot be made about the ‘appropriate’ level of leverage for an MFI in the same way that is done in commercial banking by using years of empirical data on defaults risk in order to assess the safe level of leverage for the bank. Therefore, while becoming an NBFC might increase an MFI's access to commercial capital, if this capital is mainly in the form of debt it could increase the risk of the organization if it becomes too highly leveraged.

Analysis of costs & benefits of credit delivery model using metrics developed

(1) Financial Analysis

The data used in compiling the financial analysis for SHARE was mostly obtained using ratios provided by The Mix Market (CGAP) profile for SHARE. Some attempts were made to calculate ratios from financial statements, however many of these ratios for MFIs require adjustments in order to make them comparable among MFIs. According to Micro tool, a framework for reporting analysis of MFIs that was commissioned by USAID, adjustments are usually made for two purposes: to reflect true performance of MFIs and allow for benchmarking across a wide range of institutions. True performance reflects the desire for a way to assess an MFI’s ability to maintain the level of income of their operations over the long run. These adjustments stem from the fact that many MFIs operate in different jurisdictions with different accounting requirements and that traditional accounting data do not always take into account the risks that
MFIs face. The three major adjustments made that are traditionally applied to MFIs for ratio analyses are adjustments for subsidies, inflation, and Portfolio at Risk (PAR). For example, the adjustment on PAR is to reduce the size of PAR and the Gross Loan Portfolio by writing off PAR > 180 days. This limits the analysis to a part of the loan portfolio that might still reasonably be repaid and managers can focus their efforts on addressing delinquency that could be recovered early. Adjustment for subsidies that MFIs receive is important because planning for a future without subsidies, becoming an NBFC, requires looking at what an MFI’s performance would look like without them. It also allows for more meaningful a comparison of performance indicators with other MFIs. Two adjustments are used to offset the effect of subsidies: a subsidized cost of funds adjustment and an in-kind subsidy adjustment. The subsidized cost of funds adjustment is an adjustment that was designed to put a market value on any subsidized borrowing an MFI has to determining the likely cost of borrowing if an MFI had to pay a market rate for them. This allows for a financial analysis that better reflects what cost structure an NGO MFI will face once it becomes a financial company. The in-kind subsidy adjustment puts a cost on in kind subsidies that an MFI may receive, such as donated vehicles or free computers, in order to identify the true cost of operations of a MFI. It is valuable for management to know how dependent they are on such subsidies to continue operations. The only extra indicators that were calculated and not borrowed from the Mix Market profile were the number of shareholders and the capital formation rate. The financial data is taken from the two years before SHARE transformed, 1998 to 1999, and the most recent two year
period from 2003 to 2004 in order to give a picture of the MFI both before and after the transformation.

The Financial Indicators of SHARE show a brief picture of the company and how it is doing compared to a benchmark average of 49 MFIs serving the same target market. The benchmark used is in the Micro Banking Bulletin published by CGAP. One of the positive indicators which is notable is SHARE’s loan portfolio, which is four times the benchmark portfolio. This abnormally large size portfolio indicates the positive outreach of SHARE. It is interesting to note that between 1999 and 2003, since SHARE’s transformation to an NBFC, SHARE’s loan portfolio grew by 687%. Of course, this should be taken in light of the quality of these loans by looking at SHARE’s portfolio at risk which is surprisingly low in 2004 at 0.19% indicating that the quality of SHARE’s portfolio seems to have not diminished with its rapid growth. Also, SHARE shows a return on equity of 21.8% in 2004 up from -1.10% in 1999 before transformation. Its ROE is now above the benchmark adjusted return on equity of 16.6%. Overall, the trends seem quite positive regarding the financial impact of transformation. SHARE’s operating expense ratio decreased from 17.37% before transformation to 14% in 2004 after transformation and its cost per borrower went down over the same period from $19.50 to $17.10. Also, SHARE’s ROA and ROE have gone from negative before transformation to positive after transformation and its operating self sufficiency has increased from 97.52% before transformation to 120.03% after transformation. Lastly, SHARE’s borrowers per staff increased from 112 in 1999 to 184 in 2004 after transformation, showing higher level of productivity per staff member.
The indicators that raised some red flags were the debt to equity ratio, return on assets, and net income margin. SHARE’s financial leverage is significantly larger than the benchmark, showing that SHARE is highly leveraged, which could potentially pose risks to its shareholders and its clients. In 2004, SHARE had a debt to equity ratio of 740% up from 134% in 1999 before transformation, which is quite high compared to other MFI's of the same asset size and age who have an average ROE of 190%. There has been concern about microfinance banks taking on such high leverage in comparison to the commercial banking sector. Commercial banks are able to be highly leveraged because of the years of empirical data on the risk of commercial banking as a business, data which is not available for microfinance banking. Thus, the risk to shareholders is higher absent of guarantees, especially when shareholders are poor clients. SHARE’s return on assets is also 3.15% in 2004 up from -0.15% compared to the benchmark ratio of 7.70%, which shows that SHARE lags its peers on productive use of assets even though it has gone from a negative ROA to a positive one after transformation. Lastly, SHARE’s Net Profit Margin was 17% in 2004 up from -2.55% in 2003 which is a significant improvement although it is still below its peers with a Profit margin of 23.5%. This new profit margin makes SHARE more attractive to commercial investors because SHARE is now covering its costs with revenues sufficiently to generating income. Also, the higher the profit margin the more funds SHARE has to reinvest and loan, as well as dividends to pay to its shareholders, who also happen to include its clients.
(2) Social Indicators

As previously mentioned, compiling social indicators that could be used to compare across MFIs was found to be quite difficult because of a lack of standard for measuring social impact in microfinance. Even the most basic measure of clients crossing the poverty line is not always used in measuring impact. Therefore the social indicators found below, not only do not give us as accurate a view of social impact as we would like, they allow for limited comparison of that impact before and after transformation. This is because SHARE’s only assessment of poverty alleviation is in its 2001 annual report. Thus, SHARE’s impact assessment mainly focuses on its impact as an NGO and not as an NBFC, leaving little available comparison.

Overall, SHARE appears to rank well on social impact, although it is difficult to extract a change in this impact from transformation to an NBFC. In line with its mission to reduce poverty by providing financial services to the poor, particularly women, SHARE claims 100% of its clients are considered poor by Indian Standards, which has not changed post transformation. Of its poor clients, SHARE also claimed in 2001 just after transformation that by its poverty index, 64% of its total clients are considered ‘very poor.’ The very little we have in comparison of before and after transformation are outreach in terms of the size of SHARE’s loan portfolio which increased from 2,401,976 in 1999 to $40,218,274 in 2004, a 1574% increase. This is a substantial increase in loans disbursed to SHARE’s clients, however it does not tells us whether those loans contributed to a sustained change in household income or living standards, which we would like to see in order to say that SHARE has contributed to
poverty alleviation after transformation. We can look at SHARE’s impact assessment in 2001 which endeavors to do this, however ideally we would like to see an impact assessment that stretches to 2004 to see whether this positive impact is sustained.

SHARE’s approach to track poverty is that of composing indexes or scales of poverty based on important indicators, and to plot the positions of households on a composite index of poverty at different points of time. SHARE indicated that four indicators are given equal weight in its poverty index: sources of household income, dependency burden on that income, productive assets, and housing quality. If the category or position of a household has not changed the household is said not to have experienced a significant change in its poverty status. If the household has moved from one category to another over time, it is said to have experienced poverty movement either up or down the scale. SHARE does not include conventional indicators of poverty such as household income and food calories consumed for practical reasons. It found this process to be time consuming and costly to complete. SHARE also did not feel qualified to do the surveys required. The MFI completed a study of three of its branches in 2001 which indicated movement between its own categories of poverty. The table below shows the percentage changes between those categories of poverty. The largest movement is 38.4% of mature clients moving from the category of very poor to moderately poor. These measurements by SHARE show a positive impact on poverty alleviation. However, they were measured one year after transformation which is not a long enough time period to tell whether SHARE’s impact on the poor has been affected by
transformation. Also, while these measurements of poverty impact are closest to the basic platform we would like to see, they are not standardized within the field and therefore they are less meaningful for comparison. We might also be concerned about trends in the financial analysis of SHARE which could indicate a tendency to move away for poorer clients, such as the increase in SHARE’s profit margin after transformation as well as the increase in the number of clients per staff member. There are two main reasons we might attribute SHARE’s increased Profit margin, higher interest rates and reduced costs. SHARE does in fact show a decrease in its operating margin of approximately 3.5% over the period of transformation, but this does not exactly offset the roughly 17% increase in SHARE’s profit margin over this period. While SHARE’s interest rate SHARE charged before transformation or after is not readily available, we can still estimate a likely increase in the interest rate charged from the financial analysis. To sure, however, we would want more information on the interest rates SHARE has charged. Also, we might consider the possibility that charging higher interest rates might not necessarily result in a loss of targeting the poor if SHARE is able to cross-subsidize the cost of reaching poorer clients with the higher returns it might make on lending to less poor clients. Therefore, SHARE’s evolving loan methodology as an NBFC will be a key part of its targeting of poor clients. Also, SHARE’s increase in borrower per staff member post transformation might lead to the concern that less staff effort is being put into finding poorer clients. For this, we would need to see how SHARE’s field agents might have changed in their loan practices post transformation, information that is hard to glean from published information on SHARE. We would be most interested in finding out whether these
improvements in efficiency per staff member have contributed to lower levels of poorer clients targeted or whether they truly are a result of greater incentives and training for staff to reach more of the same poor clients they are currently reaching.

(3) Organization & Management Analysis

Strategic Vision
SHARE’s stated mission is the reduction of poverty by providing financial & support services to the poor, particularly women. Since SHARE has converted from a society under the Societies Act in India to an NBFC under the Companies Act it has become a regulated entity. We might be concerned about the impact on SHARE’s mission of transforming to an NBFC, in that it might become overly concerned with financial sustainability and outreach at the cost of its social mission. This does not seem to be the evidence with SHARE thus far, in fact, part of their reasoning for the transformation is that it is in the interest of reaching more of their target client base, the poor. Therefore, the organization’s commitment to its social mission does not seem to have waned with transformation. Overall, SHARE’s operations still seem to support its mission thus far with its continued focus as an organization to reduce poverty. Also, now that SHARE has made the transition to an NBFC, should it consider raising equity for growth in the future, it will have to find a way to balance its heavily socially motivated mission with the imperative to improve shareholder value. This will partly depend on the type of shareholders it might attract and whether they are motivated by social as well as financial gains. Currently, 99% of its shareholders are its clients so this is not as much a concern. However, the
balancing of social and financial goals is one of the challenges of becoming an NBFC. An MFI will have to work that much harder to maintain the same focus on social impact that it had as an NGO while also dealing with the regulatory constraints and financial pressures that come with being a regulated financial entity. This makes the clarity and strength of an MFI’s mission very important as well as staff having a good understanding of that mission in their work.

Management & Governance
The shareholders of SHARE are mainly its clients with the exception of a few individuals with experience in microfinance who have contributed to the equity of SHARE and have taken up positions in the Board of Directors. As of SHARE’s latest annual report in 2001, the total number of shareholders was 26,000 which is a direct result of SHARE’s transformation to an NBFC. SHARE’s board of directors is elected yearly, once from amongst the shareholders of the company and two women clients of SHARE also serve on the Board of Directors. Roughly a total of eight members constitute the Board of SHARE. The board members “render continuous support to the institution through their valuable suggestions and active participation in policy decision making and operations of the institution.” SHARE’s board is the final policy maker in guiding the institution.

Transparency
SHARE has regular publication of audited financial statements as of 2002 that are in line with its counterparts and are clear and easy to interpret. Its latest annual report was published in 2001. This is a direct result of
transformation to an NBFC as annual reports are now legally required of the organization, and SHARE did not publish such reports prior to transformation. Very little incentive exists for an NGO to publish audited financial statements because of the time consuming process and cost of putting together these reports on an annual basis. However, on the social impact side, there is greater incentive for an NGO than an NBFC to do a careful impact assessment of poverty alleviation because donors might often require it. Therefore, it remains to be seen whether SHARE will continue to conduct such careful poverty alleviation impact assessments now that greater pressure is placed upon it to report on its financials annually.

**Human Resources**

In the practice of its Human Resource Management policy SHARE endeavors to instill a rigid discipline throughout the organization when it comes to loan disbursement and staff ethics. A paper presented by the founder and chairman, Mr. Udaia Kumar stated, “The dedication and integrity of every staff member is maintained in a unique way. He takes a pledge in front of the borrowers at their weekly meetings that he will dedicate himself, to their welfare, and will not be corrupted by taking even a glass of water.” Mr. Kumar attributes some of SHARE’s success to the close monitoring and supervision of all activities of SHARE and its borrowers in the village. Training programs and workshops are also mentioned as contributors to the success of SHARE. There does not seem to be a formal performance evaluation system for staff aside from routine evaluations from managers, which is assumed standard practice. SHARE had an issue initially with staff dropout during its first two years of operation due to the laborious
and rural nature of the work. It was also mentioned that the staff did not see as much career opportunity with SHARE. This problem has lessened with the expansion of the program. As of 1998, the staff dropout rate was 2%. SHARE feels that experience is a liability in hiring managers and senior managers for microfinance programs due to the high salary costs. Now SHARE recruits graduates, undergraduates, and fresh candidates with no experience for the post of project assistants and later promotes them for senior positions.

**Information Technology System**
SHARE also computerized every branch before transformation to an NBFC which it uses to monitor individual sources and uses of funds. It also claims an effective MIS system; however we are unclear about the quality of that system. In SHARE’s 2001 annual report it also announced the launching of a Smart Card which allows it to automate data capturing and transactions processing to increase efficiency and coverage.

**Loan Methodology**
As mentioned, SHARE employs the Grameen loan methodology. This involves providing small loans to groups of women along with some training, consulting, and business development services. The Grameen model is a widespread “model” of microfinance that focuses mainly on credit with some basic training. SHARE’s products are all loans, with some housing and sanitary loans and six different types of loans in total. The longest term loans are housing loans which have duration of 4 years. This loan methodology has not changed with transformation.
1.4 Summary

As of 2001, just after transformation, SHARE reported a loan repayment rate of 100%. Although MFIs in India do not seem to readily report the interest rate they charge, our financial analysis of net interest margin shows that SHARE was earning a 60% margin on its cost of lending in 2004. This indicates that the interest rate SHARE charge is sufficiently above its cost of lending, and therefore SHARE is not engaged in subsidized lending. Along these lines, SHARE’s profit margin has gone from -2.55% in 1999 before transformation to 17% in 2004. This indicates that SHARE has become more financially sustainable during the time period after transformation to an NBFC. Our analysis of SHARE shows that the financial impacts of transformation for SHARE appear positive overall, both in profitability as well as outreach. However, we still find a relatively incomplete picture of the impact of transformation on SHARE’s poverty alleviation. While SHARE’s 2001 Annual Report, just after transformation, reports relatively good impact on poverty alleviation, it remains to be seen whether this will be sustained, especially with incentives re-aligned to place greater emphasis on financial independence.
6.4 BHARTIYA SAMRUDDHI FINANCE LIMITED
(BASIX):

Background
Bhartiya Samruddhi Finance Limited (BASIX) is one of the largest MFIs in India when it comes to total loan portfolio, although its outreach in terms of number of loans is smaller than that of SHARE. BASIX is unique from both SHARE and SKS in that it began as an NBFC, but evolved into a holding company in which an NBFC, Local Area Bank (LAB), and NGO are held. The NBFC portion of the BASIX group, which will be the focus of the financial and social impact analysis of this case study, is Bhartiya Samruddhi Finance Limited (BFSL). The founder of the BASIX companies, Vijay Mahajan, had also founded an NGO, PRADAN and after conducting research decided to open a development finance company. Bhartiya Samruddhi Finance Limited (BSFL) provides an interesting comparison to SHARE. BSFL’s experience is the experience of an MFI from start to beginning as an NBFC. Thus, the question we are answering in this case will be slightly different. We are interested in the costs and benefits of having started an NBFC rather than an NGO, and the comparison to both SKS and SHARE who started as NGOs. This comparison in some ways provides a richer picture of the costs and benefits to NGOs of transforming to an NBFC by comparing the changes in indicators over time of an MFI that started as an NBFC but evolved to include both an NBFC and an NGO.

Bhartiya Samruddhi Finance Limited (BSFL) is an NBFC registered under the Indian companies act and regulated by the Reserve Bank of India (RBI).
‘Bhartiya’ means ‘Indian’ and ‘Samruddhi’ means ‘prosperity.’ The name was chosen in order to emphasize prosperity rather than poverty. The BASIX companies have a unique organizational structure and are very innovative in their loan methodology. BSFL uses its own hybrid method of both individual lending and Grameen-like group lending. The BASIX group together provides approximately 90,000 clients in nine states with credit, insurance, agricultural business development services and capacity building. Samruddhi (BSFL) is the financial arm of BASIX which provides financial services, predominantly microcredit, insurance, and technical assistance to the rural poor. The business is characterized by intense field presence due to unit offices located in the field and loans originated at the customer’s home or workplace through customer service agents (CSAs). Samruddhi, as of 2002, works in 3,300 villages spread over 18 districts in the states of Andhra Pradesh, Karnataka, Maharashtra, Orissa and Jharkhand. The company has cumulatively disbursed ₹ 1135 million or approx US$264,000,000 (Exchange Rate of 43 Rs/$) through 165 customer service agents (CSAs). Krishna Bhima Samruddhi (KBS Lab) is BASIX’s local area bank (LAB) and is therefore a regulated bank that can mobilize deposits in its local district in Andhra Pradesh. KBS Lab is BASIX’s newest company and India’s first micro-finance bank started in 2001 in efforts to offer clients savings services. The challenge for KBS lab so far has been the geographical restriction in offering savings to BASIX clients. However, KBS lab is young and pending its success, BASIX may be able to scale up operations. The last company, Indian Grameen Services (ISI), at BASIX is a non-profit registered “section 25” company that conducts livelihood research and development of potential products and services for the BASIX Group. A
map of BASIX’s corporate structure and funding is shown in the table below. This map shows the unique complexity of the MFI which provides a contrast to the evolution and organization structure of both SHARE and SKS.

The CEO and founder of BASIX, Vijay Mahajan, founded BASIX as an NBFC in 1996 along with Bharti Gupta Ramola and Deep Joshi. Mahajan is a graduate of the Indian Institute of Technology (IIT) in Delhi and the Indian Institute of Management (IIM) in Ahmedabad. BASIX was started with approximately US$25,500 (43 Rs/$) contributed by its founders who intended to leverage this equity with developmental loans. The founders of BASIX believed in promoting sustainable livelihood for the poor through social entrepreneurship which they defined as, “Business for a Social Purpose.” Thus, BASIX was founded upon the idea of an institution that would focus on reducing poverty through increased livelihood opportunities for the poor. The founders of BASIX believed in an institution in which there was a zone of overlap between business and a social mission, and a deep engagement in the social part. Originally, Mr. Mahajan’s concept paper for BASIX envisioned a commercial bank, however he was not able to raise the requisite equity of USD 30 million in those days and instead, along with two other promoters, he created BASIX as an NBFC.

Mr. Mahajan originally created BASIX as an NBFC because he felt that this was the best way to deal with the paradox he saw India in which there was neither widespread access to financial services nor sustainability of their delivery. Such an opinion was formed during a study Mahajan completed for
the World Bank along with Bharti Ramola on the demand for and supply of financial services for the rural poor and women in India. Their conclusions indicated that existing institutions in the formal sector were neither reaching the poor effectively nor doing it in a financially sustainable manner. The slogan for BASIX is “equity for equity” and its stated mission is, “To promote a large number of sustainable livelihoods, including for the rural poor and women, through the provision of financial services and technical assistance in an integrated manner.” BASIX’s mission also states, “BASIX will strive to yield a competitive rate of return to its investors as to be able to access mainstream capital markets and human resources on a continuous basis.” We note that this mission statement is much more commercially oriented in nature than that of SHARE, which likely stems from the fact that from inception, BASIX has had the dual goal of social impact and financial return. The one benefit BASIX has had is a continuity and clarity of mission because it has not had to undergo a major transformation that would re-align its mission statement. Mr. Mahajan has stated that the main goal of BASIX is to promote livelihoods for poor people, mostly rural as stated in the mission. BASIX endeavors to do this by providing credit, technical assistance, and support services such as market linkages and input support.

Sources of Capital
BASIX started in 1996 with equity from its founders which was followed by concessional loans from Indian and foreign donors such as the Ford Foundation and the Swiss Development Corporation (SDC). By 2002, BASIX had over fifteen different funders providing seven different forms of financing from convertible loans to deposits from the public and had
achieved its goal of a diversified and reliable funding base. This positions BASIX to provide a wide range of financial services to its clients over time. The flexibility of initial bilateral donors allowed BASIX to use subsidized funds for startup operations while equity from quasi-commercial and fully commercial sources has provided a base for leverage and scale. Commercial borrowings have enabled BASIX to manage liquidity and public deposits which have provided stable, community based funding. BASIX’s shareholders as of 2004 are BASIX itself, The International Finance Corporation (IFC), Triodes Funds of the Netherlands, Shore bank Corporation, ICICI Bank, HDFC (Housing Development Finance Corporation) of India, and other individuals not specified. The total Share Capital of BASIX is approximately US $4,860,500.63 BASIX’s funding evolution shows that it has tried to diversify its funding base in order to manage risk and ensure sustainability. How an organization sources funds in microfinance can say a lot about its impact potential. Whether funds are from public, private, or quasi-public sources, the more diverse the source of funding generally means the lower the risk of the MFI. It is interesting to note that BASIX’s funding is quite diverse both in source and type of funding. This might stem from the fact that BASIX started as an NBFC and therefore has had a longer history of reporting requirements, making it more likely to access both commercial and public sources of funds.

**Analysis of costs & benefits of Transformation**

(2) **Financial Analysis**

The process of gathering the financial data and ratios for BSFL, BASIX’s NBFC arm, is the same as for SHARE. Most ratios were taken from BSFL’s
profile on CGAP’s Mix Market. The only ratios calculated from audited financial statements were Net Interest Margin and the Capital Formation Rate. The financial analysis is done only on the NBFC arm of the BASIX companies to provide a better comparison with SHARE and SKS.

Most of the financial Analysis for BASIX seems to show a positive picture in terms of the health of the organization within the time period covered. The benchmark used to compare BASIX was the same one used for SHARE in the Micro Banking Bulletin. The peer group for BASIX is different than that of SHARE in that it is not low income but a broad target market. The ratios for this target market are slightly different. Overall, BASIX fares as well or better than the benchmark ratios except for in a few key areas: Portfolio at Risk (PAR), Operating Self-Sufficiency, ROE, and ROA. BASIX had a PAR of 4.80% in 2004 down from 13.64% in 1998 while the average for its peer group is 3%. The downward trend in PAR is a good sign but will need to be sustained to indicate quality growth in lending and outreach. In addition, BASIX’s operating sufficiency has actually decreased moderately from 110% in 1998 to 103.15% in 2004 and is still below the benchmark of 134% which indicates that BASIX isn’t doing quite as well as its peers in covering expenses with revenues. However, this may not yet be of concern unless it begins declining. BASIX’s (ROE) and (ROA) are also somewhat below its peers. Its ROE was 0.10% in 2004 up from -5.54% in 1999 but still far below the benchmark of 14% and its ROA was 0.04% in 2004 up from -2.28% in 1999 compared to the benchmark of 4.20%. There might be greater concern about BASIX’s return on equity than its return on assets which stems from the fact that BASIX’s leverage was 147% in 2004.
up from 78% in 1998, much lower than the industry average of 240%. Therefore, BASIX has much more equity to spread its gains in lending over which lowers return. BASIX’s low leverage might be considered a positive aspect in terms of safety and risk mitigation but might be considered a negative aspect in terms of profits. There is not enough of a body of knowledge yet about appropriate leverage ratios in the analysis of MFIs to make any conclusions yet as to the right level of leverage in MFIs.

(2) Social Impact Analysis

Trying to measure social impact with BASIX was even more difficult than with SHARE, which probably stems from the fact that BASIX started as an NBFC and so might have had less incentive to publish poverty alleviation impact analysis along with its annual reports and audited financial statements. The information we have on BSFL’s poverty impact is far from ideal, resulting in an impact analysis that is skewed towards the financial analysis.

BASIX takes a somewhat different approach than SHARE in its assessment of poverty alleviation and social impact. While it states its mission is “to promote a large number of sustainable livelihoods” it also states, “BASIX will strive to yield a competitive rate of return to its investors.” This statement differs from SHARE in that it balances both shareholder value and social impact. Even the wording of “promoting sustainable livelihoods” is different than that of SHARE which states directly that its focus is “the reduction of poverty.” This indicates that BASIX sees itself as a commercial entity that grows through access to mainstream capital. However, it has
chosen as its business to target a low-income market where it can improve the opportunities and income earning potential of its clients, and thereby create social value. This does not indicate that poverty alleviation is any less important to BASIX, but that it sees its role as an enabler rather than providing relief. BASIX measures its poverty impact in two main ways: geographical operations and average loan size. BASIX has assessed that 71% of its loans fall below approximately US$230 which it feels is a good indicator that roughly 71% of its customers are poor. However, focusing on loan size might not be a good estimation of social impact for the reason that increasing loan sizes might actually be a positive indicator if it meant that the clients of the MFI are growing with the MFI and taking out larger loans. Depending on the MFI, growing loan sizes might be a natural result of the success of the MFI in growing with and retaining clients while also attracting new ones. If this is indeed happening, the loan size will most likely be growing, because a repeat loan of US$800 for example, might be four times as large as a new loan of around $200. Since we don’t have information about the number of loans per year that are repeat loans at BASIX, we are unclear as to whether this is the reason BASIX has a higher loan size or whether it has more to do with its efforts to loan to small and medium enterprises that employ the poor and/or is simply because BASIX is reaching less poor clients than SHARE. We are therefore interested in understanding more than just the average loan size of an MFI, but what is driving that loan size. This requires MFIs to provide detailed information on what the sizes of their repeat and new loans are, and what percentage each of these represent of their overall portfolio.
In the delivery of its livelihood financial services, BASIX works on the premise that not all of the poor desire to be entrepreneurs. It feels that many of the poor actually prefer secure wage employment. Thus, the founding strategy for livelihood creation at BASIX was generating a combination of wage and self-employment. BASIX then targets both the rural poor, particularly the landless and women, to promote self employment as well as rural commercial farmers and non-farm enterprises that generate what the MFI considers as much needed employment for the rural poor. Such sustainable wage employment is located in commercial farms and in non-farm enterprises, often not owned by the poor. In considering this premise, we are then even more interested in BASIX’s impact on its clients but also the indirect impact it might have on improving livelihood opportunities through job creation. We would be most interested in how many jobs have been created by the growth in commercial farm and non-farm enterprises that BASIX lends to and whether these jobs have improved the livelihood opportunities and the living standards of the poor they employ. We would also want to know what category of poverty the employees of these enterprises fall into. Are they the moderately poor? This question makes us more interested in devising a way to measure categories of poverty to see whether an organization such as BASIX is effectively having an impact on a wider range of poverty as we might suspect from its unique strategy. The concept of combined direct and indirect poverty alleviation is quite compelling, which adds to frustration that there is not yet a sufficiently developed means of measuring its impact nor the data gathered to do so.
Unlike SHARE however, BASIX’s 2001 annual report does not include an up to date poverty impact analysis so it is much more difficult to assess poverty alleviation in any meaningful way, let alone even by such basic measures as clients crossing the poverty line. The only basic measures we have to estimate social impact are growth in BASIX’s loan portfolio and borrowers per staff member as measures of greater outreach. BASIX’s loan portfolio increased from $2,554,533 in 1999 to $13,009,883 in 2004 by 841% while its borrowers per staff member actually decreased from 160 in 1999 to 145 in 2004. As with SHARE, while growth in BASIX’s loan portfolio indicates a growth in outreach it does not provide any meaningful analysis of whether or not BASIX is actually improving the living standards of the clients it is reaching, nor does it provide analysis of just how poor its borrowers are. To make any real conclusions about BASIX’s poverty impact we would want to know whether or not BASIX is increasing the income and living standards of its clients and thereby helping them to move up and out of categories of poverty. This brings us back to the need for a basic platform across MFIs that measures poverty more precisely by dividing it into categories of poverty in order to better measure targeting and impact.

(3) Organization & Management Analysis
This section widens the picture to include all the BASIX companies as they all fall under the same management structure in order to give a more accurate picture of the organizational and management structure of BASIX.

Strategic Vision
BASIX has a strong strategic vision both in terms clarity of mission and operational support for that mission. BASIX is in the business of improving
livelihoods through the provision of financial services and support. Part of BASIX’s strong strategic inclination might be attributed to its visionary founder whose good education and development experience bring vision and wisdom to the company. What is important for the future is maintaining this strong vision without the founder, so that it will continue long beyond his tenure. This will involve grooming a strong second tier of management, something MFIs often forget or neglect to do.

Management & Governance
The board of directors of BASIX is comprised of individuals with a wide array of relevant experience from the fields of finance and rural development. Six key board members including the three founders hold office year round while during the year individuals from Shore bank Corporation in the U.S. and Hivos-Triodos Fonds in the Netherlands were inducted into the board. Both of these organizations are Shareholders of BASIX. These individuals have very relevant experience and are diverse both in nationality and field of practice. M-Cril, a microfinance rating agency, rated BASIX’s finance arm, Samruddhi an “alpha” indicating good systems and high safety. M-Crisil rating of BASIX gave high rating grades in the categories of governance aspects and managerial performance.

Transparency
In regards to transparency, BASIX ranks highly. It’s audited financial statements and annual reports are the most detailed and clear for the reader with an overall high quality. Transparency in microfinance might be measured best to ease of access to information and the clarity of its
presentation. The professional quality of BASIX’s financial statements is an indicator of the importance the organization places on sharing its information to investors and other interested parties. As previously mentioned, this might be attributable to the fact that BASIX was founded as an NBFC and therefore has had more extensive experience than SHARE and other NGOs in reporting financials. Generally, the greater the transparency, the more likely an organization is to access commercial funding. However, this is not to say that starting an organization as an NBFC has more advantages than starting as an NGO. It may simply mean that one of the benefits of doing so is that an MFI develops a fitness for good reporting and is therefore, more transparent. Transparency is so important in microfinance because it promotes greater efficiency. It is much harder to hide inefficiency and bad systems when an MFI must report its financials, management, and systems on an annual basis.

**Human Resources**

BASIX states that it believes that high quality human resources need to be deployed at the cutting edge to address the problem of promoting rural livelihoods in a creative manner. Therefore, the company selects people who combine practical skills and experience with analytical and conceptual abilities. BASIX then endeavors to employ staff that have management, technical, and commerce graduate experience and hires its field executives from reputable educational institutions and professional streams. This practice is a direct contrast to SHARE which sees such employees as a high cost to the organization. BASIX also employs a performance evaluation system called the Personal Learning Review (PLR) in which employees
participate in retreats every six months and to undergo a personal review with their superiors in order to develop areas of improvement and opportunities for learning. Utilizing a system of performance evaluation that is participatory and promotes learning by all staff might be considered an indicator of good Human Resource Management because it promotes learning by the staff and the organization. Another indication of this is training and induction. Along with Classroom training, BASIX puts its new recruits through a rigorous induction program that covers the overall concept of the company as well as operational issues through a six month induction phase before field executives are selected.

**Information Technology System**

BASIX has developed technology with a local software company in India particularly for microfinance, its FAMIS software, which is the backbone of its operating system. FAMIS provides online accounting and borrower information to the company and is updated regularly. BASIX management believes that a successful back office and MIS are critical to managing a retail portfolio such as that of BASIX. The company has also piloted a ‘Sudama Card,’ a computer with smart card reader and modem, in 2002 to integrate finance and technology in its rural lending. It is a point of transaction technology that allows customer service agents to capture financial transactions with accuracy and transfer it to Unit offices accurately and securely. This type of innovation in technology is becoming more and more important in microfinance as with any other industry because of the potential it has for the reduction of costs and improving efficiency.
Loan Methodology

BASIX’s loan methodology is somewhat of a hybrid in that it considers itself in the business of improving livelihoods, in which ‘livelihood financial services’ is one piece. It places equal emphasis on the provision of agricultural business development services and technical services in addition to the provision of financial services, which includes credit but is not limited to it. BASIX operates under the philosophy that credit is not sufficient alone to guarantee an improvement in the livelihoods of the rural poor. It believes that other financial and technical services are necessary and can be provided on a revenue model in order to be sustainable. Therefore, BASIX offers several types of group and individual insurance products as well as savings to its clients. This type of flexibility and innovation might be considered one of the key strengths of the company. BASIX has had to innovate constantly in the pursuit of its complex mission which emphasizes both social and financial return. The corporate structure of BASIX, as well as its loan methodology, reflects this complexity. BASIX’s research arm focuses its energy on identifying livelihood intervention opportunities for which its financial arm, Samruddhi, can implement through its “Livelihood Strategy,” comprised of the equal provision of three services: livelihood financial services, institutional development services (technical assistance, capacity building), and agricultural business development services.
A description of BASIX’s triad services are shown in the table.

Table 6.2 BASIX Livelihood Triad Services

<table>
<thead>
<tr>
<th>Livelihood Financial Services (LFS)</th>
<th>Agricultural/ Business Development Services (AGBDS)</th>
<th>Institutional Development Services (IDS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Savings</td>
<td>Identification of Livelihood Opportunities</td>
<td>Formation of Groups, federation, cooperatives, natural benefit association etc. of producers</td>
</tr>
<tr>
<td>Credit for consumption as well as productive needs</td>
<td>Productivity enhancement</td>
<td>Capacity building of the above</td>
</tr>
<tr>
<td>Insurance, for lives &amp; livelihood</td>
<td>Market Linkages-input supply, output sales</td>
<td>Accounting and management information systems</td>
</tr>
<tr>
<td>Commodity futures, to reduce price risk</td>
<td>Local Value addition</td>
<td>Performance management system</td>
</tr>
<tr>
<td>Financial orchestration (arranging funding from multiple sources for the same subsector)</td>
<td>Risk Mitigation (non-insurance)</td>
<td></td>
</tr>
</tbody>
</table>

(SOURCES: www.basix.com)
Once BASIX’s research and development arm, Indian Grameen Services (IGS), identifies a potential livelihood intervention, a combination of these services are identified in order to develop a strategy that combines the right mix of financial services, AGBDS, and Institutional development services to impact the livelihoods of their clients. In BASIX’s Livelihood Financial Services (LFS) approach, different channels are used to reach the needs of different segments of customers. These varied lending methods aim to reach the poor at reasonable transaction costs. Thus, two kinds of loans were developed:

1. Direct Loans extended to rural customers through a network of village based customer service agents (CSAs) and district Field Executives (FXs).

2. Indirect Loans given through intermediaries such as seed and fertilizer dealers. The figure below gives a view of BASIX’s products and the segments they are meant to target. BASIX targets small enterprises for employment creation through the provision of individual loans with collaterised security to the top of its customer pyramid, the non poor. It then targets the middle of the pyramid, micro-entrepreneurs and small farmers whom we might estimate are the marginally poor or vulnerable with individualized loans to join liability groups (Grameen Model). For the bottom of its pyramid, which we estimate are the “poorest of the poor,” BASIX offers loans to self-help-groups for on lending to members.

We might be especially interested in understanding whether or not BASIX is successful in targeting landless and women producers whom are supposedly the poorest individuals. There is reason to suspect that SHGs and NGOs are not even able to reach landless migrant laborers who form the “poorest of
the poor” in India due to their migratory lifestyle. We would then be most interested in finding out exactly who within this category BASIX is actually able help through its SHG lending before we are even able to ask whether it has been able to improve their livelihood opportunities. What is most interesting to note in BASIX’s lending methodology is that in providing this loans, BASIX established a framework for its services, its livelihood triad, which provides value-additions such as agricultural business development services that are not available in conventional frameworks of microfinance delivery, such as that followed by SHARE. The theory behind this approach is that BASIX will have a greater impact on a wider range of the poor. If this is true, there it will be an extremely compelling discovery in the field of microfinance as to how to make credit effective. Unfortunately, it is early and the methods and data for measuring this impact have not been developed or made readily available.

Summary
BASIX is a fascinating organization which brings together both organizational structures of an NBFC (Samruddhi) and an NGO (Indian Grameen Services (IGS)) under a holding company in order to give itself the benefit of both donor funds for research and development as well greater access to commercial sources of funding. The financial analysis of BASIX shows an organization that despite having been an NBFC from the start has not fared as well as SHARE in terms of financial return. BASIX’s profit margin in 2004 was 3%, its ROE of 0.10% and ROA 0.04% which are low compared to SHARE’s profit margin in 2004 of 17%, ROE of 24.63%, and ROA of 3.15%. While this still indicates that being an NBFC has
encouraged profitability at BASIX because of the fact that it is covering its cost of operations, it makes seems to indicate that the picture of financial strength of an NBFC can still vary widely. However, our small group of case studies shows an greater tendency towards profitability in NBFCs versus NGOs, which we might tend to expect because of the fact that it is acceptable to NGOs to run at a loss in the pursuit of social return. Despite its financial performance, BASIX’s loan methodology is extremely compelling in that it is driven by the theory that delivering financial services along with other interventions and services will produce a greater sustained positive impact on the lives of a wider range of poor in India. We would be much less concerned about the lower financial returns, in fact even impressed, if we were able substantiate this theory through meaningful measurements of BASIX’s impact on the various levels of poor both through direct and indirect methods of lending. If BASIX is indeed able to provide a much wider range of services to a wider range of poor individuals and have a sustained impact on a larger portion of the poor while still maintaining some level of profitability as a social enterprise, it would provide a compelling case for the wider replication of its livelihood triad strategy and organizational structure. It would also provide compelling reasons for considering the benefits of MFI s becoming NBFCs but also retaining a nonprofit arm for the purpose of preserving one of the largest benefits of an NGO-MFI, the ability to innovate through researching and testing products that could enhance the lives of the poor in India.