Chapter - 3
Microfinance Institutions in India: An Overview

3.1. Introduction
Currently a range of institutions in both the public sector and private sector offer microfinance services in India. Such institutions are broadly classified into two categories, namely formal institutions and non-formal institutions. The formal category comprise of apex Development Financial Institutions, Commercial Banks, Regional Rural Banks and Co-operative Banks that provide microfinance services in addition to their general banking activities. The informal institutions that undertake microfinance activities are referred as Microfinance Institutions (MFIs) and are mainly found in private sector\(^1\). In this study, we have considered only the informal institutions i.e. MFIs for our discussion and analysis.

The Microfinance Institutions (MFIs) in India has grown rapidly since the last few years both in terms of client’s outreach and loan portfolio. At the same time, the MFIs have become an effective tool for poverty reduction, women empowerment and financial inclusion both in rural and urban India. But the sector encountered serious setbacks in their developments after the Andhra Pradesh Crisis (2010).\(^2\) The loan portfolio and the client outreach face negative growth for the first time in 2012 due to the crisis. However, the sector has shown the sign of recovery from the crisis in 2013.\(^3\)

The objective of this chapter is to draw an outline of the MFIs operating in India with reference to their growth and trend, delivery channels, products and services, risks involved in the sector etc. Section 3.2 is designed to analyse the trend and growth of Indian MFIs in terms of client outreach, loan portfolio outstanding and regional distribution of the sector. The delivery channels of the MFIs have been described in Section 3.3. Section 3.4 discusses the regulatory framework and legal forms of the MFIs. A detail study has been made in Section 3.5 to examine the features of products and services delivered by the MFIs in
India. Section 3.6 highlights on the sustainability issue of the MFIs. Risks involved with International and Indian MFIs have been depicted in Section 3.7. Finally, Section 3.8 summarised the chapter with concluding remarks.

3.2. Trend and Growth in Indian MFIs Sector

“Micro Finance Institution” means an entity (irrespective of its organisational form), which provides microfinance services in the form and manner as may be prescribed but does not include (i) a banking company; (ii) a co-operative society. “Micro-finance services” means one or more of the following financial services involving small amount to individuals or groups: (i) providing micro credit; (ii) collection of thrift; (iii) remittance of funds; (iv) providing pension or insurance services; (v) any other services as may be specified.4

Beginning with the first registered MFI, Self Employed Women’s Association (SEWA) at Ahmadabad in 1974, the numbers of MFIs operating in India have reached to near 1000 as estimated by M-CRIL.5 Not only the numbers of MFIs have changed but also the features and characteristics of the MFIs have changed significantly. In 1990’s, the MFIs were initially started as a mode of development work but now a day these are an alternative of viable business along with social development. Presently the MFIs do not only rely on the bank loan or donor fund, they are arranging fund through Securitization, Non-Convertible Debenture, Private Equity, Mutual Fund etc. The features of ‘First Generation MFIs’ and ‘New Generation MFIs’ have been summarized in the Table 3.1 below.

Table 3.1: Characteristics of First Generation and New Generation MFIs6

<table>
<thead>
<tr>
<th>Category</th>
<th>First Generation MFIs</th>
<th>‘New Generation’ MFIs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Promoter profile</td>
<td>Development workers</td>
<td>Management graduate, first-generation entrepreneurs</td>
</tr>
<tr>
<td>Objectives</td>
<td>Financial Inclusion with social intermediation</td>
<td>Aggressive expansion, social impact with growth</td>
</tr>
<tr>
<td>Legal forms</td>
<td>Not for profit structure</td>
<td>Start as NBFC</td>
</tr>
<tr>
<td>Capital structure</td>
<td>Look at debt as main instrument</td>
<td>Start with PE or Equity investors, securitization,</td>
</tr>
</tbody>
</table>
The following Exhibit-3.1 shows the demand for and supply of funds for the MFIs in India from 1990’s to late 2000’s. In 1990’s, the savings, grants and soft loans were the main sources of fund, whereas in late 2000’s commercial loans and equity are the main source of funding to the sector. The exhibit again depicts that the MFIs have been transformed from developmental tool to viable business and finally as an attractive asset class.

Exhibit-3.1: Demand and Supply of Funds for the MFIs

MFIs in India have made significant progress during the last two decades in terms of outreach and penetration in unbanked areas through several innovations in credit delivery and terms of lending, thereby emerging as a structural addition to the financial system. India’s microfinance sector was in a state of flux, presenting an abundance of opportunities for investors, policy makers and microfinance professionals alike. However, high growth of MFIs has encountered serious setbacks in their development due to adverse consequences of Andhra Pradesh crisis and its dark shadow over the entire sector across the country. The negative growth in terms of outreach and loan portfolio from the second half of the crisis year 2010-11 continued in 2011-12. Despite of the stagnating top line, the sector has been cautiously optimistic on account of strong regulatory initiatives, greater emphasis on client protection and improving governance with social focus.

A study conducted by ‘Economist Intelligence Unit’ on the global microfinance business environment reveals that the relative position of the Indian microfinance sector in the global context has made a significant downfall during the last three years. The overall MFI business environment of India which was in 4th position in 2009 and in 8th position in 2010 has come down to 27th position by the year 2011. At the same time, the relative position of ‘Regulatory Framework Practices’ and ‘Supporting Institutional Framework’ have also shown drastic downfall during the last few years. The Table 3.2 shows the global relative position of Indian microfinance sector.

**Table- 3.2.: Global Relative position of Indian Microfinance Sector**

<table>
<thead>
<tr>
<th>Particulars</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall MFI Business Environment</td>
<td>4</td>
<td>8</td>
<td>27</td>
<td>16</td>
</tr>
<tr>
<td>Regulatory Framework &amp; Practices</td>
<td>13</td>
<td>14</td>
<td>22</td>
<td>28</td>
</tr>
<tr>
<td>Supporting Institutional Framework</td>
<td>3</td>
<td>7</td>
<td>20</td>
<td>5</td>
</tr>
</tbody>
</table>

But the Indian microfinance sector has regained its lost reputation by developing its ‘Supporting Institutional Framework’ (Rank 5\textsuperscript{th}) and ‘Overall MFI Business Environment’ (Rank 16\textsuperscript{th}) from the year 2013.\textsuperscript{10}

3.2.1. Client Outreach and Loan Portfolio Outstanding of Indian MFIs

The numbers of clients outreach and the total loan portfolio of the Indian MFIs have made a sharp growth from the year 2001 to 2011. But for the first time, there was a negative growth in the year 2012 due to the microfinance crisis. The total client base of MFIs has come down to below 30 million marks due to the crisis. For the total of 184 MFIs that had reported to Sa-Dhan in 2012, the total clients outreach stands at 2,68,19,104 (26.8 million) and the total loan portfolio stands at Rs. 20,913 crore as on 31\textsuperscript{st} March 2012. Among these rural clients consist 52 percent of total client outreach.

The loan portfolio growth trajectory has changed direction a little and posted a decline in 2012, nearly by three percent, as compared that in 2011. Cautious bankers releasing lesser funds to the sector and the operational constraints faced by the Andhra Pradesh based MFIs would have contributed to the decline. However, the growth in states outside the Andhra Pradesh and southern states are normal. Table 3.3 summarised the year-wise clients’ outreach and loan portfolio outstanding by the Indian MFIs along with percentage increase and decrease.

<table>
<thead>
<tr>
<th>Year</th>
<th>Client Outreach (in lakhs)</th>
<th>Percentage increase/decrease over the previous year</th>
<th>Rs. (in crore)</th>
<th>Percentage increase/decrease over the previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>3</td>
<td>--</td>
<td>64.5</td>
<td>--</td>
</tr>
<tr>
<td>2002</td>
<td>3</td>
<td>--</td>
<td>183.5</td>
<td>184.50</td>
</tr>
<tr>
<td>2003</td>
<td>9</td>
<td>200.00</td>
<td>283.4</td>
<td>54.50</td>
</tr>
<tr>
<td>2004</td>
<td>33</td>
<td>266.66</td>
<td>433.9</td>
<td>53.10</td>
</tr>
<tr>
<td>2005</td>
<td>35</td>
<td>6.06</td>
<td>468</td>
<td>7.85</td>
</tr>
<tr>
<td>2006</td>
<td>40</td>
<td>14.28</td>
<td>2070</td>
<td>342.30</td>
</tr>
</tbody>
</table>
The above table shows that there is an increasing trend in client outreach over the years. The number of clients has increased by 200% & 266.66% in 2003 and 2004 over the previous year 2002 & 2003. Again there is a sharp increase by 150% in 2007 & 60.28% in 2009. But for the first time the client outreach has decreased by 15.72% in the year 2012 in terms of 2011. Regarding loan portfolio outstanding, there is a remarkable increase of 184.5% in 2002, 342.5% in 2006, 66.95% in 2007, 72.28% in 2008 and 97.07% in 2009 corresponding to the previous year. Exhibit-3.2 shows this scenario.

3.2.2. Client Outreach across Different Regions of India

The southern region continues to dominate in terms of client outreach. Nearly 50 percent of the clients belong to this region. The eastern region stands second and the rest of region have lower outreach. The skewed outreach pattern delineates the importance of MFIs to focus in northern and north eastern regions of the
country to bring about a balanced growth. The Exhibit-3.3 below is showing the region-wise distribution of client outreach in India for the year 2011 and 2012.

**Exhibit – 3.3: Client Outreach across Different Region of India**

![Client Outreach Across Regions](source)

(Source: Microfinance India – State of the Sector Report 2012)

3.2.3. Loan Portfolio Outstanding across MFIs Size and Legal Forms

In tune with the characteristics of the Indian microfinance, MFIs with larger portfolio and NBFC-MFIs possess the majority of the loan portfolio outstanding of the sector which was amounted to Rs. 20,913 crore in the year 2012. Considering the size of the MFIs, the MFIs with portfolio > Rs. 500 crore share 71% of the market, whereas MFIs with portfolio < Rs. 1 crore share only for 1% of the market. Again the NBFC-MFIs share 86% of the market in terms of loan portfolio whereas the Co-operatives share only 2% of the market. The following Exhibit-3.4 shows the percentage share as well as the amounts of loan portfolio outstanding across MFI size and legal form for the year 2012.

**Exhibit 3.4: Share and Amount of Loan Portfolio outstanding across MFIs Size and Legal Forms in 2012 (Rs. in Crore)**

![Loan Portfolio Outstanding by MFI Size and Legal Form](source)

(Source: Microfinance India – State of the Sector Report 2012)
3.2.4. Average Per Capita Loan Size

The average per capita loan size during 2012 was Rs. 7,803 which was about 15 percent higher than the previous year 2011. Exhibit – 3.5 depicts the per capita loan size from 2008 to 2012.

Exhibit-3.5: Per Capita Loan Size over the Years

<table>
<thead>
<tr>
<th>Year</th>
<th>Per Capita Loan Real Term (2004-05 Prices)</th>
<th>Per Capita Loan Nominal Terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>3521</td>
<td>4223</td>
</tr>
<tr>
<td>2009</td>
<td>4120</td>
<td>5192</td>
</tr>
<tr>
<td>2010</td>
<td>3521</td>
<td>4223</td>
</tr>
<tr>
<td>2011</td>
<td>4963</td>
<td>6870</td>
</tr>
<tr>
<td>2012</td>
<td>4984</td>
<td>7803</td>
</tr>
</tbody>
</table>

(Source: Microfinance India – State of the Sector Report 2012, p-50)

However, the loan size is still small compared to the demand for the livelihood development. While the loan size in nominal terms is increasing, in real terms after factoring the effect of inflation, the growth size is modest only.

3.3. Delivery Channels of the MFIs

India hosts the maximum number of microfinance models, both in indigenous practice as well as in modern microfinance. The models differs from ‘home spun’ varieties like the SHG and the co-operatives to the ‘adapted’ models like the Grameen methodology and for profit corporate model. In the dynamic filed of microfinance, there is clearly no one best way to deliver services to the poor. So, in India, multiple models exist and each has succeeded in its respective context. Various traditional as well as innovative approaches have been adopted by MFIs for increasing the credit flow to the unorganised sector. They can be divided into six broad categories:

- SHG model
- Federated SHG model
- Grameen Bank model
- Cooperative/Mutually-aided Cooperative model
3.3.1. Self-Help Group

A Self-Help Group (SHG) is a registered group of micro entrepreneurs having homogenous social and economic background voluntarily coming together to save small amount regularly, to mutually agree to contribute to a common fund and to meet their emergency needs on mutual help basis. The group members use collective wisdom and peer pressure to ensure proper use of credit and timely repayment thereof. In fact peer pressure has been recognised as an effective substitute for collaterals. SHG are mostly informal groups where members pool saving and re lend in the group on traditional basis. The group have a common perception of need and improve towards collective action. Based on the local requirement, SHG have evolved its own characteristics of functioning. Some of these characteristics are stated below:-

- The group members usually create common fund by contributing their small saving on a regular basis. Any requests for loan are considered by group in periodic meetings.
- Lending is done mainly on trust with a bare minimum documentation and without any security.
- The interest rate varies from group to group and the purpose for loans. It is generally more than that of bank but less than the local money lender.
- Generally 10-15 members are there in a SHG.

Exhibit- 3.6 shows the process of first loan to a group.

**Exhibit-3.6: Process for First Loan to a Group**
3.3.2. Federated Self-Help Group

Federated SHGs were emerged with the unique features of SHG-based microfinance to improve the sustainability of the groups. This approach built the unique features of SHG-based microfinance and contributes to factors that improve the sustainability of SHGs. Federation increase the economic opportunity offered by the SHGs, expand empowerment through leadership building and address the component of security through insurance services. Federation usually come under the Societies Registration Act. PRADAN and MYRADA the two large NGOs were the earliest agencies to promote SHG federations. Table-3.4 summarises the structure of federations.

**Table-3.4: Three –tier Structure of Federations**

<table>
<thead>
<tr>
<th>The SHG basic unit</th>
<th>The cluster intermediate unit</th>
<th>An apex body</th>
</tr>
</thead>
<tbody>
<tr>
<td>They have between 1000 to 3000 members</td>
<td>i.) Each SHG participates directly in the representative body from each SHG attending the monthly cluster meeting. ii.) Information from the groups to the federations (apex body) and vice versa. iii.) A highly effective tier for group monitoring and strengthening.</td>
<td>The executive body at the apex level is the executive committee, which is typically made up of nine to fifteen members.</td>
</tr>
</tbody>
</table>

(Source: Sa-Dhan, 2004 - SHG Federations in India: Emerging Structures and Practices)

**Features of Federated SHG approach:**

- Enhance the empowerment of the poor by developing local human capital.
- Helps SHGs realise benefits of a larger organisation, without losing the advantages of a small organisation.
- Reduces transaction cost and collaborate directly with financial institutions, banks and insurance companies that have business with SHGs.
- Reduce the cost of promotion of new SHGs.
- Assist SHGs with loan recovery and in strengthening weak group.

3.3.3. The Grameen Bank Model

This methodology was evolved by Grameen Bank in Bangladesh. Many MFIs in India like SHARE Microfin Ltd., Activist for Social Alternative (ASA) and CASHPOR Financial and Technical Services Ltd. have adopted this methodology with small changes.

Salient features of Grameen Bank Model

- Homogeneous, affinity groups of five members are formed at local level. The field workers facilitate the process of group forming.
- All the group members undergo a seven day compulsory training of one-two hours each day. Some groups undergo the Group Recognition Test (GRT). Once the preliminary group passed the GRT, women became the member of Banks by paying one time membership fees.
- Savings are compulsory for the members. All the loans are repayable within a year equal instalment spread over 52 weeks.
- Collateral is replaced by peer pressure. There is a provision for checks on loan utilization. This is mainly carried out by the field worker with the help of group members.

3.3.4. The Cooperative Model

The Cooperative Development Forum (CDF), Hyderabad has been the most successful in using the cooperative form in rural microfinance in India. CDF has relied on a credit union model involving a ‘saving first’ strategy. It has been built up a network of financial cooperative based upon women’s and men’s thrift group. The main features of CDF system are as follows:
➢ The primary entities in CDF’s cooperative system are the women’s/men’s thrift cooperative which consist of 300 members, usually from the same village.

➢ The women’s thrift cooperatives are divided into smaller groups of 10-50 members to facilitate better monitoring of thrift and loan payments.

➢ Each group is headed by a leader who convenes the group meetings, collects savings, and monitors the repayment of loans.

### 3.3.5. Joint Liability Groups (JLG)

A Joint Liability Group (JLG) is an informal group comprising preferably of 4 to 10 individuals coming together for the purposes of availing bank loan either singly or through the group mechanism against mutual guarantee. The JLG members would offer a joint undertaking to the bank that enables them to avail loans. The JLG members are expected to engage in similar type of economic activities like crop production. The management of the JLG is to be kept simple with little or no financial administration within the group. JLGs can be formed primarily consisting of tenant farmers and small farmers cultivating land without possessing proper title of their land.

The success of JLG concept depends on several factors. However, following factors are critical;

- The concept depends heavily on mutual trust within the groups and on peer pressure for the repayment of loans.
- The quality of group leadership is critically important for the sustainability of the group.
- The JLG exists only for the single purpose of expediting certain categories of loans. Generally they are not multifunctional groups.

### 3.3.6. Individual Lending

Along with the group lending model, many MFIs are now following the individual lending process. Some significant issues in introducing individual lending are increased information asymmetry, absence of group-based guarantees, comparatively higher-value loans and the resulting higher credit risk.
Individual lending requires different processes and systems such as sophisticated and flexible Management Information System (MIS) to gather and analyse client information and highly skilled staff with ability to conduct detailed due-diligence (to assess the market, management, suppliers, customers of the business to be financed) and prepare realistic cash flow analyses and assess collateral. Individual based lending technology is one where the MFI has to be very careful in assessing the repayment capacity of the borrower. A major innovation in this area is required for the MFIs to train its loan officers to assess the repayment capacity of its potential borrowers. MFIs like SHARE Microfin Limited, SEWA, Aadarsha Welfare Society are following this lending model.

3.3.7. Innovative Models used by ICICI Bank

ICICI Bank views that MFIs may be the key partners in tapping the potential of the rural market. It aims to leverage their current infrastructure and relationship towards delivering microfinance. Through the wholesale linkage model, ICICI Bank provides credit directly to the MFIs for on-lending to the clients. The Bank has also a strategy that includes buying out MFIs loan portfolio, on-tap securitisation and the partnership model in which the MFI acts as a loan service agent. Through this linkage the Bank provides the MFI access to loan funds as well as mezzanine capital. Its strategy was multi-pronged:

- Enter into strategic partnership with NGOs/MFI that serves the rural poor.
- Build rural outreach through low-cost technology networks.
- Create a franchise for social entrepreneurs to start up MFIs.

3.4. Regulatory Framework of MFIs in India

Since microfinance was taken up mainly as a development initiative rather than as a commercial activity, the voluntary development agencies (or NGOs) who are involved in these activities, are registered either as societies, trusts or Section 25 companies etc. The desirability of undertaking microfinance activities on a for-profit basis are coming into focus as the scale of operations started growing. As a result, MFIs in India can now be found in the form of Non-Banking Finance Companies (NBFCs) as well. More recently, a trend to register MFIs as
companies has emerged. Some are registered as not-for-profit companies under Section 25 of the Companies Act, at least partially to take advantage of the Reserve Bank of India’s (RBI) exemption from registration for such companies providing microfinance services. Another form of registration that indicates a bolder, overtly commercial (and in the long term, institutionally more sustainable) approach to microfinance is the establishment of a for-profit company followed by registration with the RBI as an NBFC. A number of MFIs are considering this route and a few have either already transformed into NBFCs or are in the process of doing so. Legal forms of Indian MFIs along with their corresponding estimated numbers have been summarised in Table 3.5.

**Table-3.5: Legal forms of MFIs in India**

<table>
<thead>
<tr>
<th>Types of MFIs</th>
<th>Estimated Number</th>
<th>Legal Acts under which Registered</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Not for profits MFIs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NGOs – MFIs</td>
<td>400-500</td>
<td>Societies Registration Act 1860 or Indian Trust Act 1882</td>
</tr>
<tr>
<td>Non profit Companies</td>
<td>30</td>
<td>Section 25 of Indian Companies Act 1956</td>
</tr>
<tr>
<td><strong>B. Mutual Benefit MFIs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mutually Aided Co-operative Societies (MACS)</td>
<td>200-250</td>
<td>Mutually Aided Co-operative Societies Act enacted by State Governments.</td>
</tr>
<tr>
<td>and similarly set up institutions</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>C. For profit MFIs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non Banking Financial Companies (NBFCs)</td>
<td>40</td>
<td>Indian Companies Act, 1956, Reserve Bank of India Act, 1934</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>700-800</strong></td>
<td></td>
</tr>
</tbody>
</table>

(Source: NABARD –Report 2009)

The following section discusses the legislation and the present regulatory framework and prudential norms that must be adhered to by MFIs operating in India.

**3.4.1. Societies Registration Act, 1860**

NGOs are mostly registered under the Societies Registration Act, 1860. Since these entities were established as voluntary, not-for-profit development organisations, their microfinance activities were also established under the same
legal umbrella. A wide range of development activities, some key institutions in the country today were established specifically for microfinance but registered as societies for lack of an appropriate alternative. Examples of these are Swayam Krishi Sangam (SKS), based at Hyderabad and operating in the Telangana region of Andhra Pradesh, and Grameen Koota based in Bangalore and operating in the rural areas near the city.

The relative advantages of the MFIs registered as Societies are: simple process of registration; simple record keeping and even simpler regulations; low possibility of interference by the regulator; (largely) exemption from tax due to the overtly charitable nature of operations; and appropriate for taking up micro-insurance (as an agency) on behalf of insurance companies.

The relative disadvantages are as it is the charitable institutional form so are inappropriate to the for-profit, financially sustainable strategic goal of microfinance operations. Commercial investors generally regard the investments in such entities risky primarily on account of their lack of professionalism and managerial practices and are, therefore, reluctant to commit large volumes of funds to such MFIs. After the issue of ‘usurious interest prevention acts’ of various state governments acts, the status of microfinance has become debatable as a charitable activity.

3.4.2. Indian Trusts Act, 1882

Some MFIs are registered under the Indian Trust Act, 1882 either as public charitable trusts or as private, determinable trusts with specified beneficiaries/members. Institutions like ASA Trust, Tamil Nadu and Nav Bharat Jagriti Kendra, Jharkhand were established initially as a trust under the Indian Trust Act.

The advantages and disadvantages related to MFIs registered under the Societies Act are equally applicable to trusts. However, while Insurance Regulatory and Development Authority (IRDA) recognises NGOs registered as societies as a distribution channel for the micro-insurance, there is no such clarity with regard to trusts. Apart from this, private trusts may be even more unsuitable as the tax
exemption extended to societies may apply to such trusts only to the extent the Income Tax department accepts their activities as being charitable.

3.4.3. Co-operative Banking Model

Under the Banking Regulation Act only the State Cooperative Banks, District Central Cooperative Banks and Primary Cooperative Banks (Urban Cooperative Banks — UCBs) are recognised as cooperative banks. The relevant category of cooperative banks suitable for MFIs is Primary Cooperative Banks (Urban Cooperative Banks — UCBs). Urban Cooperative Banks are registered under the Cooperative Societies Act of the respective governments. UCBs having a multi-state presence are registered under the Multi-State Cooperative Societies Act (MSCA) 2002. The RBI is the regulatory and supervisory authority of UCBs for their banking operations, while their managerial and administrative aspects remain under the respective state governments (for banks registered under the State Cooperative Societies Act), or the central government (for the banks registered under the MSCA 2002). Bagnan Mahila Bikash Cooperative Credit Society Ltd. (BMBC) based on Bagnan, West Bengal and Shri Mahila Sahakari Bank Ltd. popularly known as SEWA Bank based on Ahmadabad, Gujarat is registered under this model.

The relative advantages of Cooperative MFIs are: ability to accept demand and time deposits; low-capital requirement; and access to clearing-house functions. The relative disadvantages are duality of control, problems are greater in case the relevant state does not have a Mutually Aided Co-operative Societies (MACS) Act; poor public image of cooperative banks following recent governance and management problems resulting in the failure of a number of such banks. On account of these failures it is now also extremely difficult to obtain new licenses from the RBI.

3.4.4. Andhra Pradesh Mutually Aided Cooperative Societies’ Act (APMACS Act) 1995

AP MACS Act of 1995 has emerged as the popular choice for an organisational form for many MFIs in Andhra Pradesh. This law has also worked as a model
act for many other states that have either amended or changed their cooperative societies’ laws. The acts of other states have more or less similar provisions as the APMACS Act. There are now many significant Mutually Aided Cooperative Thrift Societies (MACTS) in Andhra Pradesh. Some better performing examples of such MACTS are the ACTS Mahila MACTS based in Chittoor, the PWMACTS in Vishakhapatnam and the Indur MACTS Federation in Nizamabad.

The relative advantages of the MFIs are: ease of formation and management; ability to accept deposits; minimal interference from regulators – unlike cooperative societies formed under the traditional cooperative laws; and client centric and therefore mobilise equity also from the clients.

3.4.5. State Acts on Mutually Aided Cooperative Societies

Many states have brought amendments in their cooperative societies acts thereby making the functioning of cooperatives more autonomous and free from government interference. This act was first passed in the Andhra Pradesh and has functioned as a model for many states which have brought fresh legislations to effect changes in their state cooperative society acts. Some of the states have gone a step further and brought in reforms that have far reaching implications for the functioning of MFIs. Noted among these states are Orissa, Bihar, Madhya Pradesh and Karnataka. The Orissa act allows the SHGs to become members of cooperative societies while the other state acts do not have this provision.

Notable examples of cooperatives operating under the conventional acts are the Annapurna Mahila Cooperative Credit Society in Mumbai, the Indian Cooperative Network for Women (of the Working Women’s Forum) in Chennai, Ankuram Sangamam Poram in Hyderabad and Pushtikar Laghu Vyaparik Pratishthan in Jodhpur. Some of the district cooperative banks – such as DCCB Bidar (in northern Karnataka) – have also started to take a significant interest in microfinance. Of the state-level MACS Acts there has been a significant impact so far only in Andhra Pradesh – which pioneered this regulatory form.
3.4.6. Not-For-Profit Companies under Section 25 of Companies Act, 1956

An organisation given a license under Section 25 of the Companies Act 1956, is allowed to be registered as a company with limited liability without the addition of the words ‘Limited’ or ‘Private Limited’ to its name. MFIs that are registered as Section 25 companies enjoy certain advantages. These are related to exemption from Income Tax, leveraging capacity, easier processes and low regulator interference. The relative disadvantages are regarding to deposit mobilisation, not an attractive option for equity mobilisation and lack of clarity on ceiling.

More recently, a trend to register MFIs as companies has emerged. Some are registered as not-for-profit companies under Section 25 of the Companies Act, at least partially to take advantage of the Reserve Bank of India’s (RBI) exemption from registration for such companies providing microfinance services. Notable examples of these include the Cashpor Microcredit Company Ltd (CMC), based at Varanasi and operating in the eastern part of Uttar Pradesh and western Bihar, and Sanghamithra Rural Financial Services Limited (SRFS) based at Bangalore, operating in Karnataka.

3.4.7. Non-Banking Financial Companies (NBFC)

NBFCs are the only type of MFI falling clearly under the purview of the Reserve Bank of India (RBI) and subject to prudential regulations. As for-profit companies, they need to pay income tax on their lending operations. Registration with RBI as an NBFC offers advantages also. Some of these advantages are: investor confidence: limited regulation, attractive option for social investors: up-scaling of operations.

Some of the largest MFIs in the country now operate as for-profit NBFCs. Key MFIs that have already converted their MFI form into for profit NBFCs (or started as such) are Bhartiya Samruddhi Finance (of BASIX), Hyderabad (operating in the states of Andhra Pradesh, Karnataka, Orissa and Maharashtra), Bandhan Financial Services Pvt. Ltd., based on Kolkata and operating in 18
states of India, SHARE Microfin, based at Hyderabad and operating in the states of Andhra Pradesh, Orissa and Chattisgarh, Spandana, based at Guntur and operating largely in the urban areas of coastal Andhra Pradesh and Sarvodaya Nano Finance (of ASSEFA), based at Chennai and operating in much of Tamil Nadu.20

3.4.8. NBFC-MFI

RBI has been decided to create a separate category of NBFCs viz; Non-Banking Financial Company-Micro Finance Institution (NBFC-MFI) vide its Circular on dated July 1, 2013. An NBFC-MFI is defined by RBI as a non-deposit taking NBFC (other than a company licensed under Section 25 of the Indian Companies Act, 1956) that fulfils the following conditions:

i. Minimum Net Owned Funds (NOF) of Rs. 5 crore. (For NBFC-MFIs registered in the North Eastern Region of the country, the minimum NOF requirement shall stand at Rs. 2 crore).

ii. Not less than 85% of its net assets are in the nature of “qualifying assets.”

In this definition, “Net assets” are defined as total assets other than cash and bank balances and money market instruments. “Qualifying asset” shall mean a loan which satisfies the following criteria:

a) loan disbursed by an NBFC-MFI to a borrower with a rural household annual income not exceeding Rs. 60,000 or urban and semi-urban household income not exceeding Rs. 1,20,000;

b) loan amount does not exceed Rs. 35,000 in the first cycle and Rs. 50,000 in subsequent cycles;

c) total indebtedness of the borrower does not exceed Rs. 50,000;

d) tenure of the loan not to be less than 24 months for loan amount in excess of Rs. 15,000 with prepayment without penalty;

e) loan to be extended without collateral;

MFIs like Bandhan Financial Services Pvt. Ltd., SKS Microfinance Pvt. Ltd., Share Microfin Ltd. have already got the NBFC-MFI license from RBI and and
many other MFIs have already applied to the RBI for availing the NBFC-MFI license. Table 3.6 have summarised the features of each types of MFIs.

Table-3.6: Types of MFIs in India

<table>
<thead>
<tr>
<th>Types of MFIs</th>
<th>Regulation</th>
<th>Example</th>
<th>Start up Capital</th>
<th>Provision of Micro insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Societies</td>
<td>Societies Registration Act, 1860</td>
<td>SKS, Grameen Koota</td>
<td>No minimum requirement</td>
<td>Societies are allowed to function as an agency for an insurance company registered with IRDA.</td>
</tr>
<tr>
<td>Trusts</td>
<td>Indian Trusts Act, 1882</td>
<td>ASA Trust, Tamil Nadu</td>
<td>No minimum requirement</td>
<td>Trusts are not allowed to insurance business.</td>
</tr>
<tr>
<td>Section 25 Companies</td>
<td>Section 25 of the Companies Act 1956</td>
<td>Cashpor Microcredit Company Ltd.</td>
<td>None required</td>
<td>IRDA allows the Section 25 Companies to act as an corporate agent of the insurance company registered with IRDA.</td>
</tr>
<tr>
<td>Non-Banking Finance Companies</td>
<td>Reserve Bank of India</td>
<td>Arohan Financial Services Pvt. Ltd.</td>
<td>Rs. 2 crore</td>
<td>NBFC are allowed to participate in the insurance business either by setting up their own business or as agents of insurance.</td>
</tr>
<tr>
<td>Mutually Aided Co-operative Societies (MACS)</td>
<td>AP Mutually Aided Cooperative Societies Act (APMACS Act) 1995</td>
<td>Annapurna Mahila Cooperative Credit Society</td>
<td>Nominal</td>
<td>MACS can provide insurance coverage to their clients by covering all their clients They cannot obtain corporate agency of life or non-life insurance company.</td>
</tr>
<tr>
<td>Co-operative Banks</td>
<td>RBI</td>
<td>Shri Mahila Sahakari Bank Ltd. (SEWA Bank)</td>
<td>Moderate Rs. 1 lakh</td>
<td>RBI allows the scheduled and licensed cooperative bank enter into insurance business but without any risk participation.</td>
</tr>
<tr>
<td>NBFC-MFI</td>
<td>RBI</td>
<td>Bandhan Financial Services Pvt. Ltd.</td>
<td>Minimum Net Owned Funds of Rs. 5 crore</td>
<td>As applicable for NBFC.</td>
</tr>
</tbody>
</table>

(Sources: Compiled by Researcher)
3.5. Products and Services Delivered by MFIs in India

The Indian MFIs that began the journey as a single credit product programme have now moved into a different realm with MFIs trying to understand their client’s financial needs in a more meaningful way and designing products to suit these needs with the scope of regulatory restrictions. The period 2005-10 witnessed an intense growth at the cost of innovation as it was easier to increase outreach with a standard product. Further, the regulatory framework did not permit broadening the range to savings and other services like remittances. The MFIs are now providing credit plus services i.e. they are providing microinsurance, health services, money remittance services, training and capacity building services etc. along with formal credit products. Main features of some of these products and services are described below:

3.5.1. Credit Services

The concept of MFIs was basically based on credit or loan services for the poor people. Different MFIs have classified their loan products in different categories according to the requirements and capacities of the borrowers. Generally the MFIs commenced their loan disbursement with minimal amount and gradually on the basis of good repayment of the borrowers the amount are increased in subsequent loans. The features of credit or loan services of the MFIs are as follows:

- The loans are generally collateral free.
- Disbursement of loan and collection of instalment amount are made at doorstep of the clients.
- The interest rate of loan ranges from 22-26%.
- The borrowers are mainly women.
- Normally the loan repayments are more than 95%.

3.5.2. Micro Insurance

Microinsurance, commonly called as insurance for the poor is referred as the provision of insurance services to low-income households, which serves as an important tool to reduce risks for the vulnerable population. Microinsurance in
India has broadly developed as a sub sector of the insurance industry. India is among the few countries to draft and implement specific microinsurance regulations. The Rural and Social Sector Obligation (2002) and the Microinsurance Regulation (2005) have helped the growth of regulated microinsurance in India. According to the IRDA, Annual Report 2010-11, about 3.65 million microinsurance policies were sold in India in the year 2010-11 covering life of 18.9 million people. However, these data constitute only the policies sold by the insurance companies.

The MFIs used to sell the microinsurance products after collaborating with the insurance companies. The MFIs in India provides microinsurance like life insurance, credit life insurance, cattle insurance, rainfall insurance etc. Maximum of the MFIs provide credit life insurance which is again compulsory insurance for the borrowers. The MFIs like Arohan, Ujjivan, Swayam Krishi Sangam (SKS), Vivekananda Sevakendra –O- Sishu Uddayan (VSSU) provides other microinsurance products namely life insurance, health insurance etc.

3.5.3. Micro Pension

Apart from compulsory pension schemes of employers, few voluntary pension schemes have popular support. Among the microfinance clients, the need for pensions is clearly felt and expressed. India Invest Micro Pension Services (IIMPS) has partnered with Nyaya Bhoomi for providing micro-pension to 85,000 rickshaw workers in Delhi. IIMPS has also partnered with BASIX and SEWA Bank for covering 7,00,000 working poor in 15 states of India. Sheperd India and Dhan Foundation are also implementing pension solutions for their customers.

The large footprint pension schemes are UTI Micropension scheme with over 1.25 lakh subscribers, promoted through BASIX, SHGs and other community based groups and the Society for Elimination of Rural Poverty (SERP) –Life Insurance Corporation partnered micro-pension scheme in which over 3.7 lakh women members of SHGs had subscribed as of April 2010. In West Bengal, Bandhan have started pension services through the New Pension Scheme (NPS).
of Government of India. Arohan’s micro-pension schemes are managed by UTI Retirement Benefit Pension Fund (RBTF) and Life Insurance Corporation of India (LICI) for investment sizes as small as Rs. 100 per month.

3.5.4. Savings
The service in savings is fundamental to sustainable economic development. Access to savings and deposits enables households to smoothen the consumption of uneven income flows, accumulate assets for the future, invest in improved human capital and be better prepared for unexpected emergencies. Indian MFIs which are registered as Society, Trust, Section 25 Companies & NBFC are not eligible to collect deposit or savings from their client as per the current regulation. Only the MFIs registered as Co-operative are permitted to do the same. In West Bengal, Bagnan Mahila Bikash Cooperative Credit Society Ltd. (BMBC) & VSSU are collecting savings from their clients or members. MFIs such as SEWA Bank, which promotes savings groups, provide the poor a safe place to save. The members of these groups do not take time off from their work to save with SEWA, rather they deposit money with the village leader, who either gives it to SEWA organizers or drops it at the nearest district office.

3.5.5. Money Remittance
Inland money transfer in India is dominated by the public post system through money order services. The postal system enjoys widespread credibility, and the service is not very expensive. However, the time taken for transfers using money orders is long. The poor migrate in order to supplement their household income. So, they require quick and responsive money transfer services in order to send money to their families.

Many of the larger MFIs are now establishing multi-state operations. There is substantial migration within states, and large state-wide MFIs might become interested in providing a remittance service to borrowers in different locations. Adhikar based on Bhubaneswar, Orissa has the potential advantage that it offers loans to members, both in Gujarat and in Orissa, as well as insurance. Thus it
enjoys the advantage of economies of scope over informal competitors. MFIs like Bandhan have started this service in West Bengal in collaboration with the Western Union Money Transfer. In Assam, Rashtriya Gramin Vikas Nidhi (RGVN) based on Guwahati is planning to introduce remittances as a service to its approximately 35,000 Credit and Savings Programme members spread over 10 districts of the state.  

**3.5.6. Sanitation Loan by MFIs**

Globally, lack of access to hygienic sanitation facilities causes 2.7 million deaths annually, and 0.8 million children die of diarrheal disease every year. Over 1 billion people (15% of total population) still defecating in the open. The issue is more acute in developing countries such as India. Of all people in the world defecate in the open, a majority i.e. 600 million live in India which is more than 50% of the country’s population. According to the Census of India (2011), 67% of rural household (and 53% of all Indian households) still do not have access to proper sanitation facilities.  

In India, very few MFIs are providing this service. Gurdian, a water and sanitation-focused MFI set up in 2007 in Tamil Nadu is one of them. It provides loans via Joint Liability Group for installing new household water connection or toilet. Since 2007, Gurdian has expanded from 1 to 4 districts in Tamil Nadu and has given out 25,000 loans for toilets ranges from Rs. 5,000 for renovating and Rs. 10,000 for constructing new toilet. Hand in Hand, an NGO headquartered in Tamil Nadu has an MFI arm through which it has been lending for sanitation since 2005, with sanitation loan accounting for 6-7% of its loan portfolio. It has provided loans for 8,000 toilets so far, including 3,000 in rural areas and 500 in urban areas. Sanghamithra Rural Financial Services started sanitation financing in rural Ooty in 2010. It has financed 1,700 toilets up to September, 2013 across several districts of Karnataka, providing loans of Rs. 10,000-15,000 at 18% interest. Bandhan Financial Services Pvt. Ltd is also providing sanitation loan up to Rs. 10,000 in West Bengal since 2012.
3.5.7. Housing Microfinance

Housing microfinance consists mainly of loans to low-income people for renovation or expansion of an existing home, construction of a new home, land acquisition, and basic infrastructure (e.g., hooking up to city sewage lines). In India, National Hosing Bank (NHB) has recognized the penetration of Housing MFIs as delivery mechanism for channelizing the housing finance to the unserved section of the society. Cumulatively, till June 30, 2013, the Bank has sanctioned loan amount to Rs. 101.68 crore to 32 MFIs for financing 40,210 urban and rural housing unit.30

Sanghamithra Rural Fianacial Services (SRFS) a MFI promoted by MYRADA and operates in three states Karnataka, Tamilnadu and Andhra Pradesh has ventured into housing microfinance in 2004. In its housing microfinance programme, any SHG group comprise 15-20 women, if qualifies, will receive Rs. 30,000 to 50,000 per member for three years loan repayment terms. Gujarat Mahila Housing SEWA Trust provides housing credit to their clients - poor women working in the informal sector like head loaders, rag pickers, vegetable vendors etc. for repairing, extension/upgradation and addition of services like water, drainage and electricity facilities. Gujarat Mahila Housing SEWA Trust had also recently started a housing mortgage loan where loans were extended to members for a period ranging from 5-15 years and the amount ranged upto a maximum of Rs. 5 lakh.

3.5.8. Training and Capacity Building

To provide the MFIs service more effectively and efficiently both of the clients/members and the staff of the MFIs required training and capacity building programme. So, many MFIs use to provide training for developing the skill of the clients so that the client can do their entrepreneur activities smoothly. MFIs like Village Financial Service Pvt. Ltd. (VFSP) provide training on zari works. Along with these many MFIs provide financial literacy camps for enriching the poor clients about the financial transactions and financial decisions.
Training for field staff in the MFI model is undertaken almost entirely by the MFIs themselves, mostly through on job training under the supervision of field staff. In addition, MFIs using the Grameen model have the additional training task of training borrowers, administering the Group Recognition Test (GRT), and so on. Some MFIs such as SKS are hiring fresh recruits also for the branch manager level for their "horizontal" expansion plans to new states, and training them in the same manner, rather than through the usual, much slower, promotion process.

### 3.5.9. Financial Literacy and Financial Inclusion

Financial inclusion is both a cause and consequence of economic growth. Financial inclusion has become a buzzword in development policy and has come to be regarded as an important and inevitable milestone in achieving inclusive growth. Financial literacy is the knowledge at varying degree about the financial terms and concepts and the ability to translate the knowledge skilfully into behaviour. Basic financial literacy is inevitable to ensure economical access to credits and its effective utilisation. A positive relationship is there between financial literacy and poverty alleviation. Financial literacy can break the cycle of poverty while the people associated with below poverty line (BPL) have been supplied with microcredit to support their lives. The common notion that higher the financial literacy, higher the knowledge to manage the microcredit fund effectively.

MFIs play a significant role in facilitating inclusion, as they are uniquely positioned in reaching out to the rural poor. Many of them operate in a limited geographical area, have a greater understanding of the issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in operations providing a level of comfort to their clients. MFIs used to provide financial literacy training to the clients through their loan officer in the weekly collection meeting or by organizing special camps. Table-3.7 provides a snapshot of the developmental activities taken by different types of MFIs in India.
<table>
<thead>
<tr>
<th>MFIs</th>
<th>Livelihood</th>
<th>Housing</th>
<th>Health</th>
<th>Education</th>
<th>Capacity Building</th>
</tr>
</thead>
<tbody>
<tr>
<td>Society and Trust</td>
<td>Small trading, Petty business, Small Enterprise, Client Awareness Training</td>
<td>Solar energy, Housing, Repair</td>
<td>AIDS &amp; Sanitation, Health Camps, Eye camps, Urban Health centre</td>
<td>Creche, Distribution of books &amp; stationary, Primary school, Financial literacy</td>
<td>Training, Entrepreneurship development, Financial literacy, HR Training</td>
</tr>
<tr>
<td>Section 25 Compani</td>
<td>Agriculture &amp; Dairy, Marketing, Training</td>
<td>Affordable housing, Water &amp; Sanitation</td>
<td>Community health care camps &amp; Sanitation</td>
<td>Education programme, Stationary</td>
<td>Leadership &amp; Training, SHG Liinkage, Dry Flower Cluster</td>
</tr>
<tr>
<td>Co-operatives</td>
<td>Agriculture &amp; Animal husbandry, Awareness &amp; Training</td>
<td>Micro housing</td>
<td>Awareness</td>
<td>Annapurna Mahila Mondal, Awareness and Camps</td>
<td>Training, Cattle Health Camps</td>
</tr>
</tbody>
</table>

(Source: The Bharat Microfinance Quick Report, 2012)
3.6. Sustainability of MFIs

MFIs concentrate exclusively on microfinance activities and try to adopt products, procedures and policies that enable them to provide these services in a profitable and sustainable manner. Initially microfinance operations depend on grant and subsidies and gradually as the experience shows these operations have the capacity to meet operational cost and loan losses when the volume of business increases significantly.

Sustainable microfinance is about providing financial services profitably to a section of society that is currently not adequately serviced. Sustainability is not just about financial, it should be looked from the view point of i) demand and supply characteristics ii) sustainability of the mission of MFIs iii) organizational sustainability iv) availability of startup equity for MFIs would help in building up a sustainable microfinance sector. Measures such as rating of MFIs, full cost pricing, services to weaker section, availability of startup equity for MFIs would help in building up a sustainable microfinance sector.

The concept of the "critical triangle of microfinance" is the need for any MFI to manage simultaneously the problems of outreach (reaching the poor both in terms of numbers and depth of poverty), financial sustainability (meeting operating and financial costs over the long term), and impact (having discernible effect upon clients’ quality of life). The most successful MFIs expand all sides of that triangle and tradeoffs are sometimes inevitable.

Few of the parameters that are considered important for sustainability of the MFIs are:

- A good Management Information System (MIS)
- Sustainability of Mission
- Financial Sustainability
- Organisational Sustainability
3.7. Risks involved with MFIs

In the wake of recent tragedies, MFIs around the world have had to cope with an array of financial, political, and weather-related crises, and MFI managers have learned the importance of risk management. For example, hurricanes in Nicaragua, floods in Poland, and currency crises in the Russian Federation and Indonesia have had devastating effects on the microfinance industries in those countries. In India, the low income also faces various types of risk like Tsunami, Aila, Flood, spoilage of grain due to heavy rain or no rain, draught etc. Whatever the emergency or the country, the effects are the same: higher costs, liquidity problems, and loss of assets. Microfinance is very much associated with risk so ultimately MFIs are always associated with various risk factors. There are four major risk categories associated with MFIs. The categories of risk are institutional risk, operational risk, financial management risk and external risk. The Table-3.8 summarized the major risks in microfinance sector globally along with their corresponding rank in 2012 & 2011.

<table>
<thead>
<tr>
<th>Rank in 2012</th>
<th>Name of the Risk</th>
<th>Position in 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Over-indebtedness</td>
<td>---</td>
</tr>
<tr>
<td>2</td>
<td>Corporate Governance</td>
<td>4</td>
</tr>
<tr>
<td>3</td>
<td>Management Quality</td>
<td>7</td>
</tr>
<tr>
<td>4</td>
<td>Credit Risk</td>
<td>1</td>
</tr>
<tr>
<td>5</td>
<td>Political Interference</td>
<td>5</td>
</tr>
<tr>
<td>6</td>
<td>Quality of Risk Management</td>
<td>---</td>
</tr>
<tr>
<td>7</td>
<td>Client Management</td>
<td>---</td>
</tr>
<tr>
<td>8</td>
<td>Competition</td>
<td>3</td>
</tr>
<tr>
<td>9</td>
<td>Regulation</td>
<td>6</td>
</tr>
<tr>
<td>10</td>
<td>Liquidity</td>
<td>16</td>
</tr>
<tr>
<td>11</td>
<td>Mission Drift</td>
<td>9</td>
</tr>
<tr>
<td>12</td>
<td>Back Office</td>
<td>13</td>
</tr>
<tr>
<td>13</td>
<td>Macro Economic Risk</td>
<td>17</td>
</tr>
<tr>
<td>14</td>
<td>Staffing</td>
<td>8</td>
</tr>
<tr>
<td>15</td>
<td>External Risk</td>
<td>---</td>
</tr>
<tr>
<td>16</td>
<td>Technological Management</td>
<td>11</td>
</tr>
<tr>
<td>17</td>
<td>Too little Funding</td>
<td>23</td>
</tr>
</tbody>
</table>

Table – 3.8: Risks involved in Microfinance Sector
It is found that *over-indebtedness* among microfinance borrowers is now seen to be the most pressing risk facing the industry. The other important risks are Corporate Governance, Management Quality, Political Interference, Regulation, Liquidity etc. In the Indian scenario, the major risks involved in MFIs are functional risks, financial risks and external risks. The different types of risks involved with Indian MFIs are summed up in this section.

- **Over-indebtedness**
  Sometime clients take 4-5 loans from different MFIs by going beyond their capacities and earning. Many MFIs also sanctioned loan without appraising the capacities of the client. Both this situation led to the over-indebtedness of the client. Results of the over-indebtedness are non-repayment of loan instalment, coercive method of collection and even suicide by the clients. This was the main reason behind the AP crisis, after which the Indian MFIs have faced the biggest challenge in their normal operations and in their long term sustainability.

- **Political Risk**
  Since the Indian political system is quite decentralized, the laws and governments of the different states can greatly affect the climate for microfinance. Some state policies have been extremely supportive of microfinance, while others, primarily due to populist political pressures, have undermined the sector at times. In addition, states that maintain only a weak rule of law (Uttar Pradesh, Bihar, and Orissa have been mentioned in this category) may present a riskier operating environment for both MFIs and micro-enterprises.

- **Regulatory Risk**
  Regulatory risk is a risk that varies greatly from one country to the next. The areas of greatest concern are countries like India where the fall-out from the
Andhra Pradesh crisis has brought severe regulatory restrictions on the operations of MFIs: caps on margins and interest rates, as well as higher capital and other operating requirements. After the strict ordinance the situation became so odd that only players with critical levels of capital and customer base can survive in the regulated markets, because the margins are capped.

- **Functional Risk**

Functional risk include mission drift, staff fraud, inefficient staff performance, inefficient tracking system of credits or loan outstanding, over-dependent upon donors and staff dropouts.

- **Mission drift**

Mission drift means the divergence of an organization’s activity and outcomes from its mission. Mission is the core purpose of an organization that defines why it exists and what it does for whom. Normally the MFIs have dual mission i.e. social mission and financial mission. There are chances that the social mission overlapping on financial mission vice versa. So, the MFI must monitor the social mission and financial mission and that the two missions are not overlapping. If the social mission is overlapping the financial mission, the MFI incurs loss in its income-expenditure statement. If the financial mission is overlapping the social mission the MFI reflects poor social performance.

- **Staff fraud**

Sometimes loan officers demand bribes for sanctioning loan, cashiers and loan officers sanction loan to “ghost” clients etc. In few cases the MFI agents collect loan repayment but do not deposit it with MFI. Due to these facts, the MFIs incur substantial loss. The fraud made by the staff not only negatively impacted on the MFIs but also creates negative impression in the market and among clients.

- **Staff dropouts**

Maximum of the operational area of the MFIs are located in the remotest area which lack infrastructural facilities and basic amenities. The MFIs staffs undergo hardship in working such area. So many MFIs suffered from very less staff retention.
Financial Risks
The MFI suffers from two types of financial risk i.e. interest rate risk and foreign exchange risk. MFIs receive loan funds from foreign donors or banks and repay the loan in foreign currency whereas earn the revenue in local currency. As always there are risks associated with foreign exchange, so the MFIs also face high risk. The three major risks which are related with the MFIs are devaluation risk, convertibility risk and transfer risk.

Calamities:
During and after calamities and disasters the clients may lose the loan repayment capacities. So the MFIs suffer from loan loss, default and client’s loss etc. The major hurdle MFIs face during and after natural disasters is the access to adequate liquidity.

Government policies:
Recently one of the most critical risk associated with the MFIs are changes in the Government policies regarding the MFIs operations, financial products and interest rates etc.

3.8. Summary and Conclusion
The last decade witnessed an outstanding growth for the MFIs sector in India. The sector has been changed from its traditional donor based concept to commercial loan and equity based sustainable MFIs. Now a day these are an alternative or proposition of viable business along with social development. At the same time the sector faces huge criticism and challenges from every stakeholders after the Andhra Pradesh crisis in 2010. The client outreach and loan portfolio has declined for the first time in the last decade in 2012. In terms of regional distribution of client outreach, the northern and eastern region is far behind from the southern region. India has innovated various numbers of successful models for delivering the MFIs services. These are home-spun Self Help Group to Grameen methodology, joint liability groups, co-operative models etc. There are varieties in legal forms of Indian MFIs. They are...
registered as traditional Societies and Trust as well as newly regulated NBFC-MFI, Section 25 Companies etc.

A number of product and services are delivered by the Indian MFIs. These are credit, savings, micro-insurance, micro-pension, remittances, housing loan, sanitation loan, training & capacity building programme, financial literacy services etc. The sustainability of the Indian MFIs depend on four issues i.e. management information system, sustainability of mission, financial sustainability and organisational sustainability. Over-indebtedness has been proven to be most important risk for the sector. The other important risks are political interference, regulatory risk, liquidity risk, functional risk etc.

Notes & References


4 Micro Finance Institutions (Development and Regulation) Bill, 2011

5 Micro Credit Rating International Limited (M-CRIL)’s estimate, based on the experience through research in the field of rural finance and ratings of microfinance institutions in different parts of India.


7 ibid, p-55


15 Sa Dhan Microfinance Resource Centre (2003), “An Introduction to Microfinance Delivery Models in India”, p2-6

16 ibid, p-8

17 ibid, p-10

18 Investment with characteristics of debt and equity financing.

19 NABARD (2009), “Status of Microfinance in India”, New Delhi, p-55


21 RBI Cirulau No. RBI/2013-14/49 DNBS.(PD)CC.No. 347 /03.10.38/2013-14 dated July1, 2013

22 Sa-Dhan Microfinance Research Centre, op. Cit, pp15-18


28 ibid, p-5


36 Social Performance Working Group