M-CRIL Microfinance Analytics 2009

M-CRIL
Micro-Credit
Ratings International
Limited

M-CRIL Analytics 2009

A Celebration and a Lament

Contents

Introduction to M-CRIL

A pioneer and world leader in microfinance ratings

Micro-Credit Ratings International Limited is one of the pioneers of financial performance ratings and the worldwide pioneer of social rating for MFIs. It is the world's leading specialist microfinance rating agency. By September 2009, M-CRIL had undertaken nearly 650 financial performance and social ratings of over 350 microfinance institutions (MFIs) in 30 countries of Asia, Europe and Africa.

M-CRIL is based in Gurgaon – outside Delhi, capital of India. It has an excellent team of 14 specialist analysts with knowledge and experience of microfinance led by Dr Alok Misra, Director, Operations.

M-CRIL also provides sector-wide advisory services and undertakes research and policy studies compatible with its concern to avoid conflicts of interest. Its rating and advisory services have been provided in many countries of Asia including all countries of South Asia and in Cambodia, East Timor, Indonesia, Myanmar, Papua New Guinea and the Philippines as well as in Samoa. In the NIS countries of the former Soviet Union, M-CRIL has been active in Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Russia and Tajikistan. In Africa, M-CRIL has worked in Congo, Ethiopia, Kenya, Malawi, Morocco, Nigeria, Rwanda, South Africa, Tanzania, Uganda.

In keeping with its pioneering tradition,

M-CRIL is now introducing rating services

for

Affordable Private Schools

(for children of low income families)

and

Value Chain Initiatives

(to assess the impact on poverty and the efficiency and effectiveness of such programmes)

Sanjay Sinha
Managing Director

Review of Indian Microfinance

A celebration and a lament

India has the fastest growing microfinance sector in the world and is rapidly moving towards having the largest microfinance sector as well. This is a matter to be celebrated and lamented. The high growth rate even at levels above 10 million clients – now approaching 20 million – bears testimony to the professionalism and management capacity of some of the leading MFIs in the country. There has also been a rush to expand to hitherto under-served areas in the East and North of the country.

The concern is that some of this high growth may have been stimulated by the advent of investment in Indian microfinance by private equity groups keen to maximize numbers *under any conditions* in order to boost firm size and improve share valuations. This stimulus is apparently leading to the cutting of corners in matters of consumer protection – multiple lending, over-indebtedness and consequently coercive collection practices – that are likely to trigger interference by political, religious or other community groups in the practice of microfinance (and may already have done so). Such practices result partly from the geographical concentration and rapid consumer enrolment that has occurred due to high growth.

These matters are being researched currently but concern needs to be extended to a greater emphasis on the social performance of Indian MFIs. Social rating (offered by M-CRIL) is an important tool in assessing social performance and needs to be used to a far greater extent by Indian MFIs than it is at present.

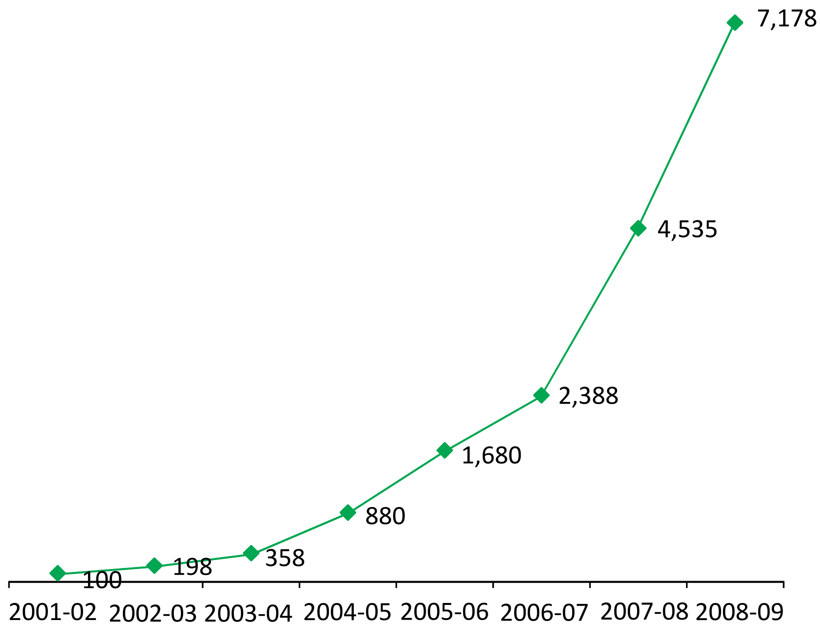
An even more serious concern is that India has around 500 million poor people caught in the web of poverty, malnutrition and lack of education. It is this large number of poor and low income families that create the potential for microfinance to grow. This is a dubious distinction.

This document reviews the growth, outreach and financial performance of Indian microfinance over the past few years until March 2009. It is essentially a summary version of the M-CRIL Microfinance Review 2009, to be released soon.

Growth in 2008-09 continued to be strong

M-CRIL India Growth Index

M-Cril$_{15}$, March 2002=100



The M-CRIL India Growth Index: Composite index of growth of microfinance institutions in India – uses information on numbers of borrowers and size of loan portfolio of 15 leading MFIs

The Growth Index has reached

7,178

(March 2002=100)

…compared to **4,535**[1] when last released a year ago.

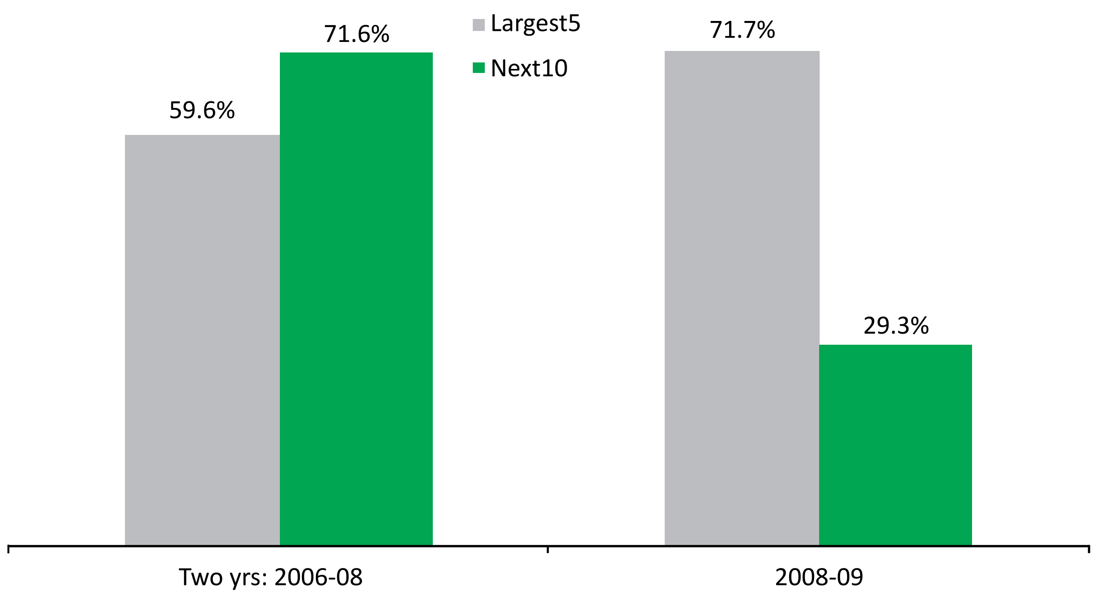
Growth in 2008-09 continued to be strong – 58.3%

only slightly reduced from the 64.3% average for the previous two years after adjusting for multiple lending.

[1]Actual level of index reported was 5,140. This has been adjusted for multiple lending and changes in data as more reliable information has become available.

…but while the Largest5 MFIs grew more strongly the Next10 slowed down significantly

Growth Rates of Indian MFIs



The Largest5 grew at 71.7% in 2008-09 (compared to 59.6% earlier), while the Next10 MFIs slowed down substantially (down from 71.6% per annum in 2006-08 to just 29.3% growth in 2008-09).

This has resulted from

- **competitive pressures and aggressive growth of the largest MFIs**

together with a

- **slowdown in the availability of funds from commercial banks**

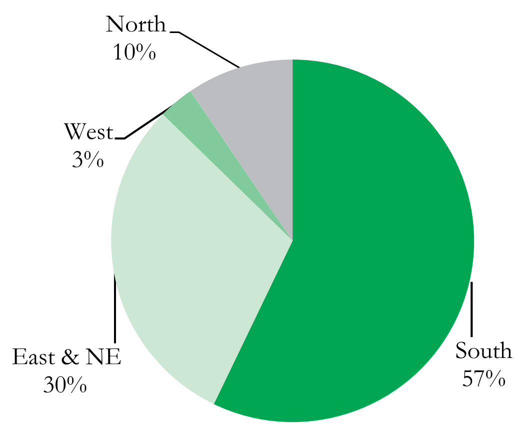
to all but the largest MFIs.

1 The M-CRIL Sample

Regional Distribution

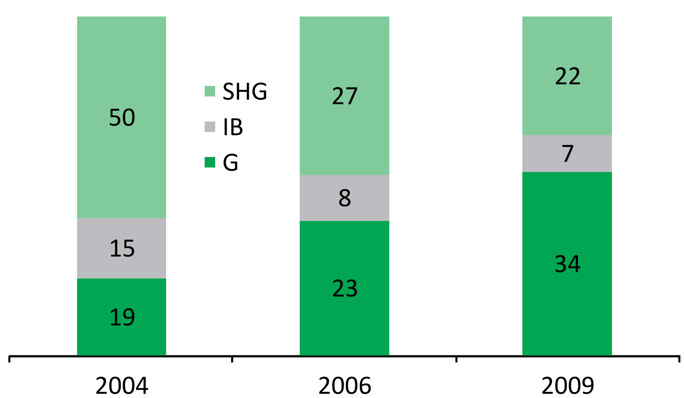
Still heavily concentrated in South India but the share of the East is growing.
MFIs in the North and the West have become less important
but, the larger institutions in the South and East have started to expand
North and West.

Regions	**2004**		**2009**	
	MFIs	**%**	**MFIs**	**%**
South	50	60	34	57
East & NE	18	21	18	30
West	10	12	2	3
North	6	7	6	10
India	**84**	**100**	**60**	**100**



Microfinance model

MFIs have increasingly shifted towards Grameen-type programmes (G) at the expense of SHG-based programmes (SHG). IB = Individual banking (mainly cooperatives).



2. Outreach

The sample – effectively the 60 leading microfinance institutions in India – covered over 15 million clients (members of MFIs) and 14.6 million borrowers by the end of March 2009.

This compares with about 20 million MFI clients served by the leading MFIs in Bangladesh, the only other country in the world with a comparable number of microfinance clients. India's SHG-bank linkage programme has about 2.5 million groups or 35 million clients but is subject to substantial double counting. Emerging issues of multiple lending in Indian microfinance mean that the MFI client numbers are subject to double counting to the extent of around 10%.

Outreach to borrowers by microfinance methodology

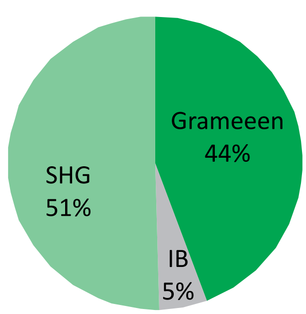
MFIs using the Grameen model reach ever larger proportions of borrowers, increasing from 44% in 2002 to 88% by March 2009 – figure below.

Since 9 of the Top10 organisations follow the Grameen model, their share in total outreach has expanded from 40% in 2002 to 88% in 2009.
Nearly 13 million borrowers are now served by Grameen-type programmes.

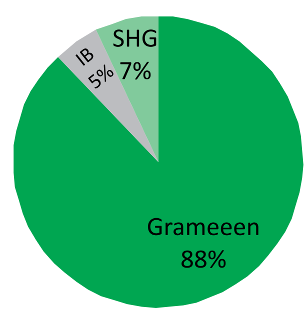
MFIs are increasingly converting to the Grameen methodology which enables faster growth than SHG programmes that entail substantial initial effort at group formation.

borrowers, in millions

	2002	2004	2006	2009
No. of MFIs	90	84	58	60
Grameen	0.51	1.09	3.00	12.80
Individual Banking	0.06	0.17	0.77	0.76
SHG	0.58	0.50	1.82	1.02
Total	1.15	1.76	5.59	14.59
Top10	0.52	1.17	3.31	11.54
proportion of total	40%	66%	59%	79%



2002



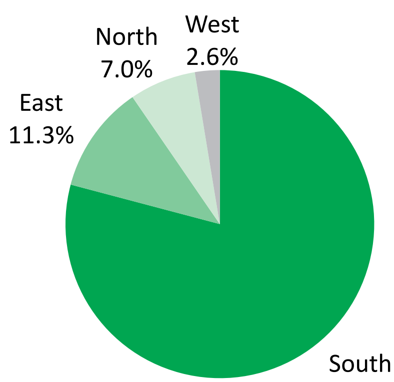
2009

Outreach by region

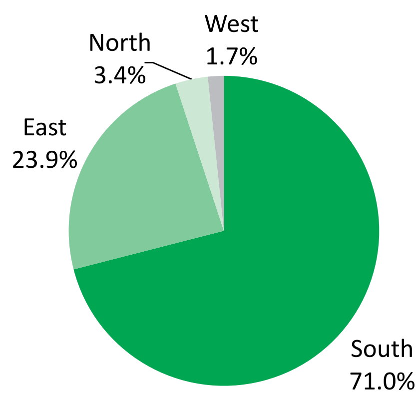
There has been a significant relative shift in regional concentration of MFI clients from the South and North to the East. The Eastern region's share has increased to 24% from 11% in 2002 and the South's share has fallen from 79% to 71%; the North's share has declined from 7% to 3.4%. Absolute numbers of MFI clients have increased substantially everywhere.

borrowers, in millions

	2002	2004	2006	2009
No. of MFIs	90	84	58	60
South	0.91	1.41	4.06	11.70
East	0.13	0.24	1.30	2.69
North	0.08	0.06	0.21	0.28
West	0.03	0.04	0.02	0.02
Total	1.15	1.76	5.59	14.69



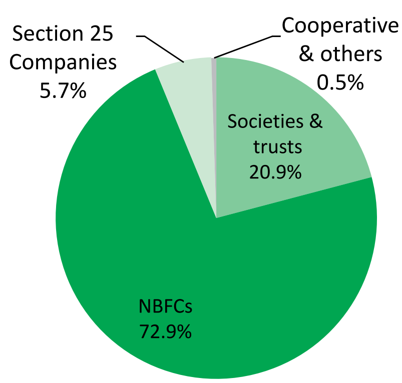
2002



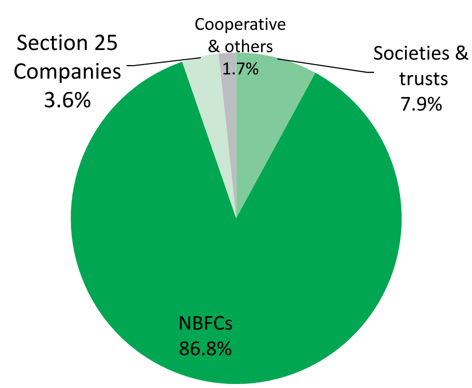
2009

Outreach by form of registration of MFI

The search for legitimacy and the umbrella of central bank regulation has led increasing numbers of MFIs to convert to non-bank finance companies (NBFCs). Within the past three years NBFCs have increased their share of the total number of MFI clients from 73% to 87%. This increase is as much due to the conversion of MFIs from Societies/Trusts to NBFCs as on account of the faster growth of NBFCs (which largely follow the Grameen methodology).



2006



2009

3 Portfolio growth and loan size

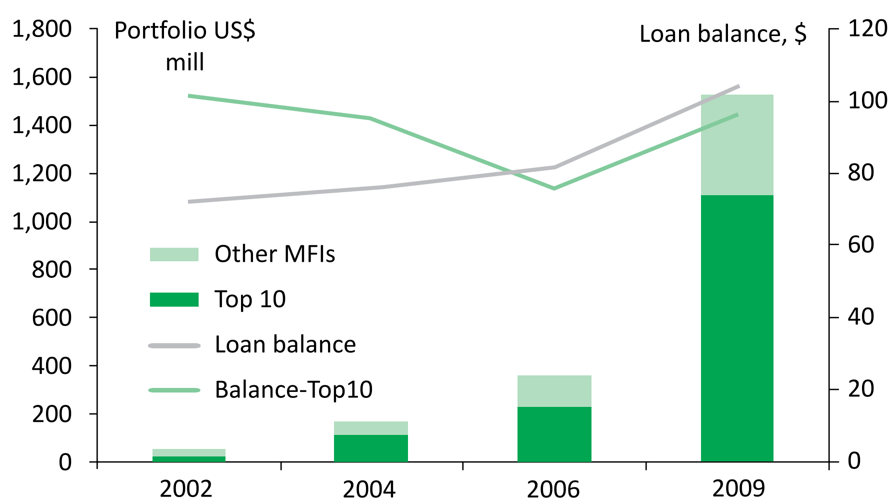
Private equity/MIV investment has fuelled dramatic portfolio growth

MFI loan portfolios grew by a factor of nearly 35 between 2002 and March 2009 reaching a figure of around Rs8,000 crore or over $1.5 billion. The share of the Top10 MFIs increased from 43% in 2002 to over 72% in 2009. Equity investments by private equity funds at high valuations and by microfinance investment funds (MIVs) coupled with liberal lending by commercial banks and SIDBI have made this dramatic growth possible.

Average outstanding loan balances have increased from Rs3,300 ($72) in 2002 to Rs5,300 ($104) with average disbursements of Rs8,500 ($173) in 2009. Due to the increase in GNI per capita from $650 to $950 during this period, loan balance as a proportion of GNI has remained very low at around 11% (disbursements, 18%).

	2002	2004	2006	2009
No. of MFIs	90	84	58	60
Loan portfolio, Rs crore	229.0	747.7	1,452.9	7,788.4
All MFIs US$ million	50.8	167.3	354.4	1,531.3
Top10, US$ million	21.8	112.0	224.3	1,110.0
proportion of total	43.0%	66.9%	63.3%	72.5%
Loan balance, $	72	76	82	104
Top10, $	101	95	76	96
Loan disbursed, all MFIs	115	167	163	173*

* Estimated at 60% of disbursement



4 Operating Efficiency & Staff Productivity

Indian microfinance continues to be the most efficient in the world

The operating efficiency of Indian MFIs measured by the average operating expense ratio declined further, from 15-16% in the mid-2000s to 11.5% in 2008-09. This compares with a median OER of 15.0% for Asia and 18.1% globally.

The Top10 MFIs, however, have not improved their efficiency over the past few years. The increase in OER for the Top10 MFIs from 10.8% in 2004 to 12-13% in recent years is a result of the fast growth of these organizations. The

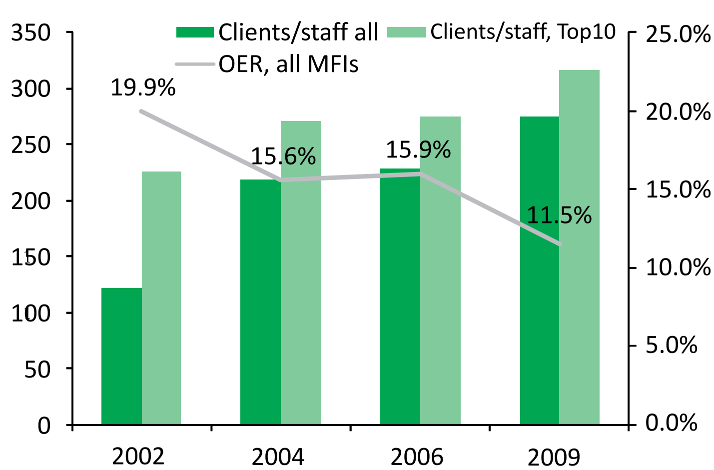
- cost of opening new branches in geographically diverse areas,
- training new staff, and
- enrolling new clients

is inevitably higher than that of maintaining steady operations, affecting OER.

Staff productivity is a major determinant of the OER and has improved steadily from 122 in 2002 and around 220 in the mid-2000s to 274 in 2008-09. While the staff productivity of the Top10 organisations has improved by 15% in recent years the OER has still declined on account of the factors listed above.

	2001-02	**2003-04**	**2005-06**	**2008-09**
Operating Expense Ratio, OER	19.9%	15.6%	15.9%	11.5%
Top10	22.4%	10.8%	13.1%	12.3%
MIX, South Asia (median)			14.3%	
Asia			17.2%	15.0%*
Global			20.6%	18.1%*
Staff productivity, clients/staff	122	219	228	274
Top10	225	270	275	315
MIX, South Asia (median)				
Asia			142	141
Global			120	120

* Calendar year, 2007



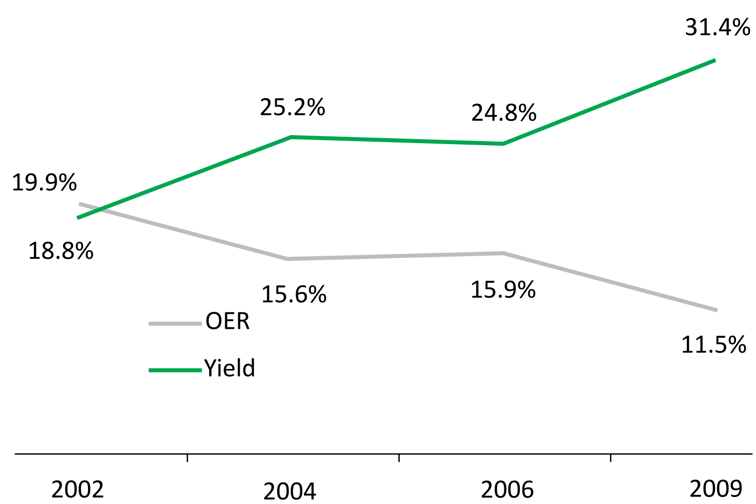
5 Yield versus Operating Efficiency

…but the yield has increased significantly, widening the margin

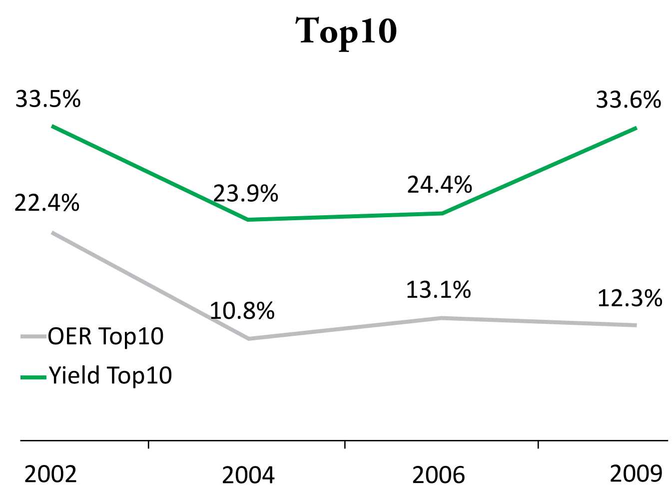
High efficiency should lead to the ability to charge relatively low rates of interest and, thus, a lower yield. Yet, despite the improvement in OER over the past few years, the yield on portfolio of Indian MFIs has risen significantly. This means that Indian microfinance borrowers are now paying a relatively high cost for their microfinance loans, higher than the global median – a reversal of the earlier situation when Indian MFI clients paid the lowest cost in the world – just 25% in 2006. This is caused mainly by the increase in yields of the largest MFIs; the Top10 average yield has risen to 33.6% by March 2009 - the extent of the widening margin is apparent from the figures below.

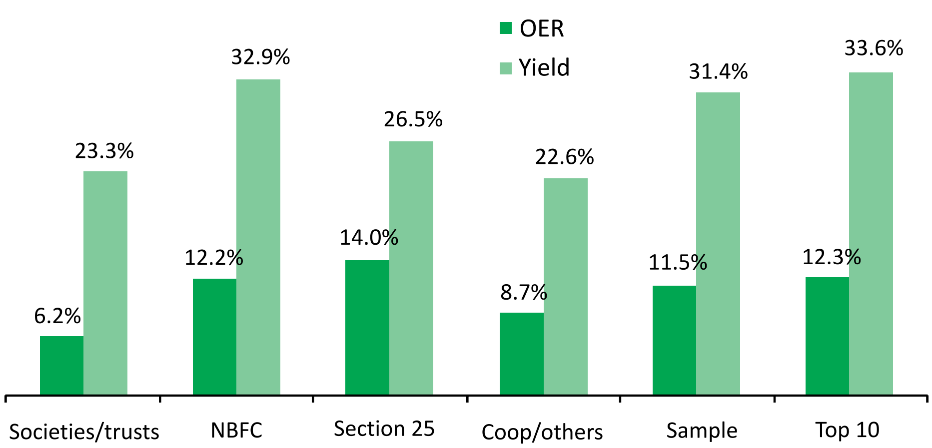
	2002	2004	2006	2009
Operating Expense Ratio, OER	19.9%	15.6%	15.9%	11.5%
Top10	22.4%	10.8%	13.1%	12.3%
Yield	18.8%	25.2%	24.8%	31.4%
Top10	33.5%	23.9%	24.4%	33.6%
MIX, South Asia (median)				
Asia			26.6%	27.0%
Africa			35.0%	30.2%
Global			30.6%	29.6%
Global, large			26.8%	27.0%

All MFIs

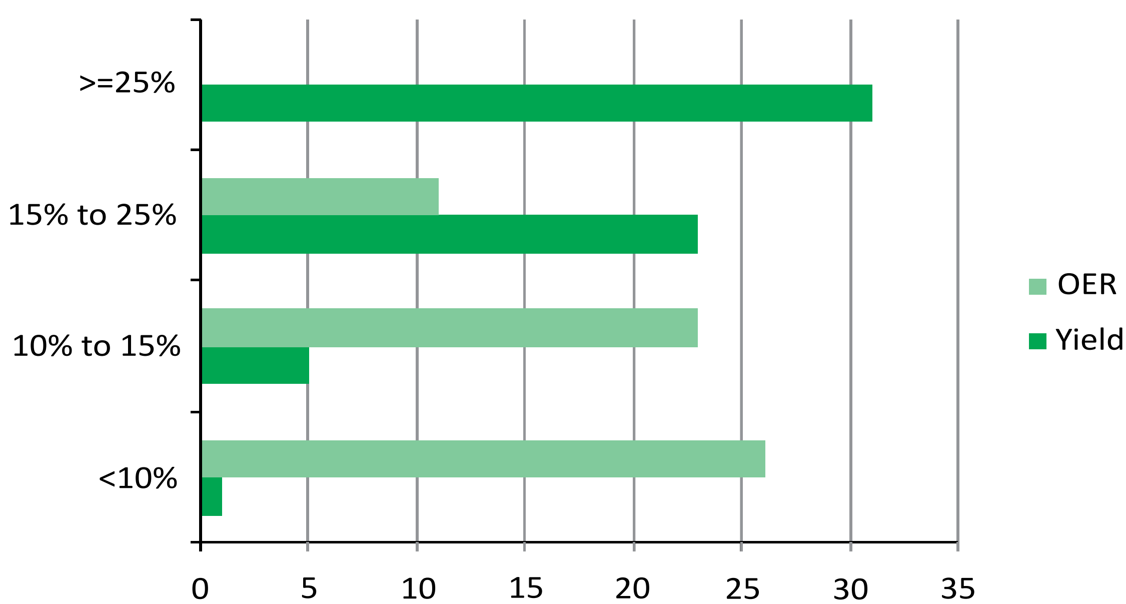


Analysing this issue by MFI organizational form shows that it is the NBFCs, as a group, that are charging the highest rates. Given the dominance of the Top10 in the Indian microfinance sector, and since all of these are NBFCs, this is no surprise. The margin between NBFC yield and OER is of the order of 20%.





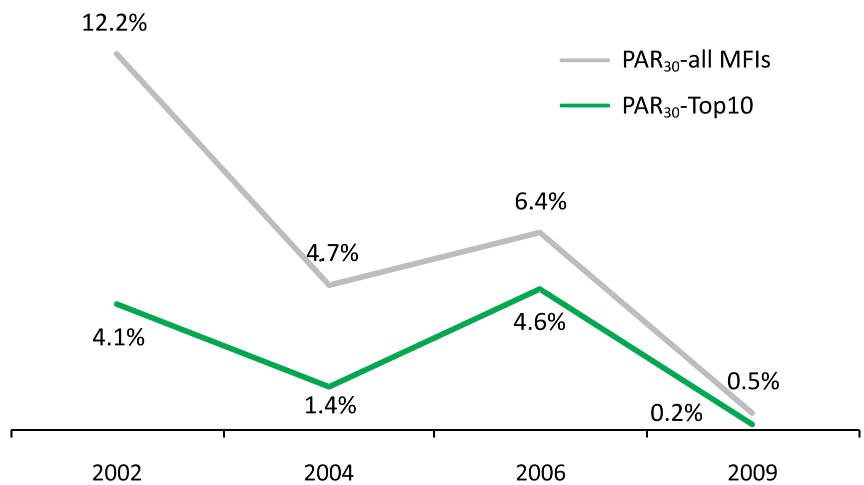
Nevertheless, as the frequency table below shows, it is not just the NBFCs; more than 50% of the largest 60 MFIs now have yields in excess of 25% while over 80% have OERs less than 15%. The implications of this for return on assets (RoA) are apparent in the discussion that follows.



6 Portfolio quality

…and portfolio quality has improved

The substantial improvement in portfolio quality since the Andhra delinquency crisis of 2006 is apparent from the figure below. By March 2009 portfolio at risk 30 days after the due date (PAR_{30}) was down to around 0.5% for the sample and much less for the Top10. At what cost this highly improved portfolio quality was achieved is yet to be established; it could be a contributory factor in the higher OER recorded by the Top10 over the past few years and it may have been achieved through measures for staff (incentives) and clients (collection practices) – that could generate a backlash for MFIs. The current delinquency crisis in southern Karnataka bears investigation from this perspective.

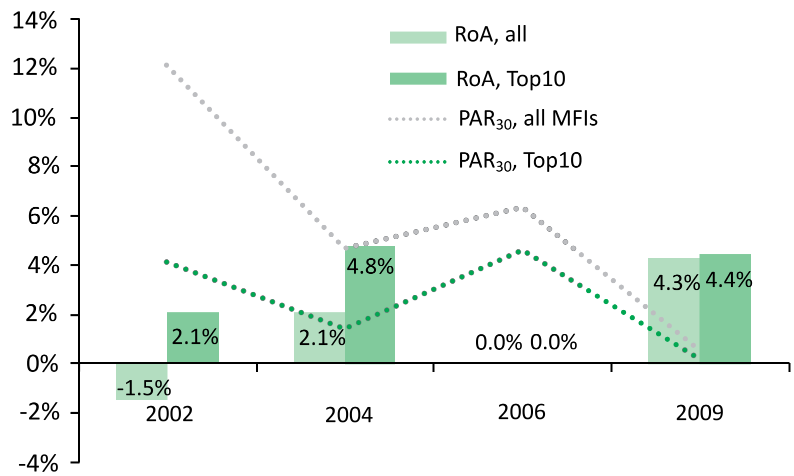


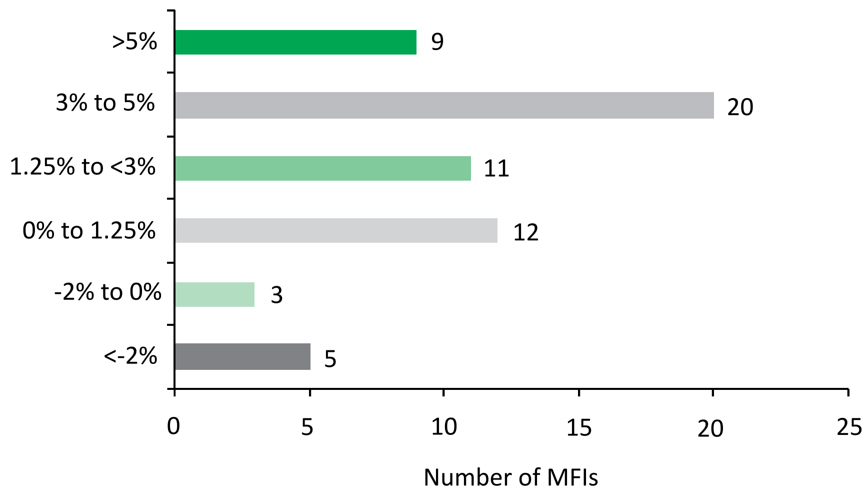
7 Return on assets

…boosting the return on assets

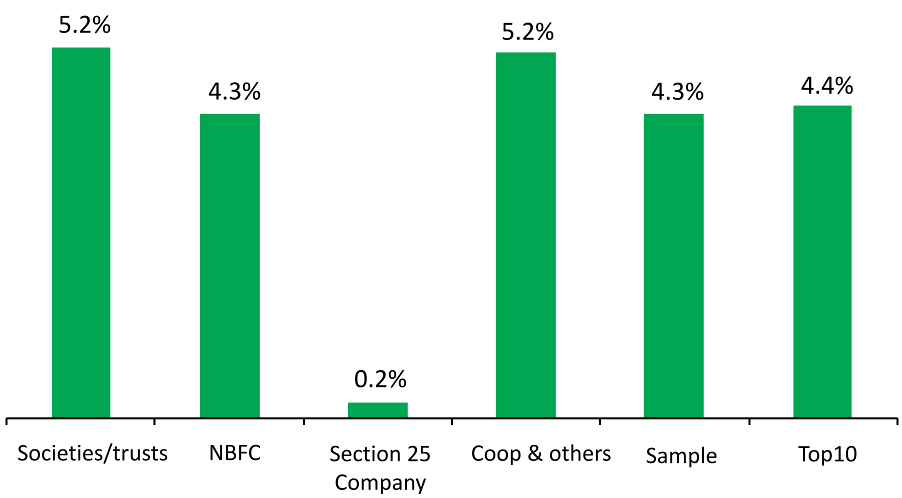
Return on assets (RoA) has improved significantly across the sector from an average of (-1.5%) in 2001-02 to 4.3% in 2008-09. This has clearly been helped both by the substantially increased portfolio yield and the dramatic decline in PAR since 2006.

The two figures below show that the improved RoA is not just a matter of a few MFIs but is broadly spread across the sector with as many as 29 MFIs earning more than a 3% (9 of these earning more than 5%) return on assets in 2008-09. This compares with 1.5% median returns for MFIs globally in 2007 and 1.8% for large MFIs.





The even spread of this high RoA is emphasized by the following figure which shows that all types of MFIs (other than not-for-profit Section 25 companies) have earned high returns on assets over the past year.



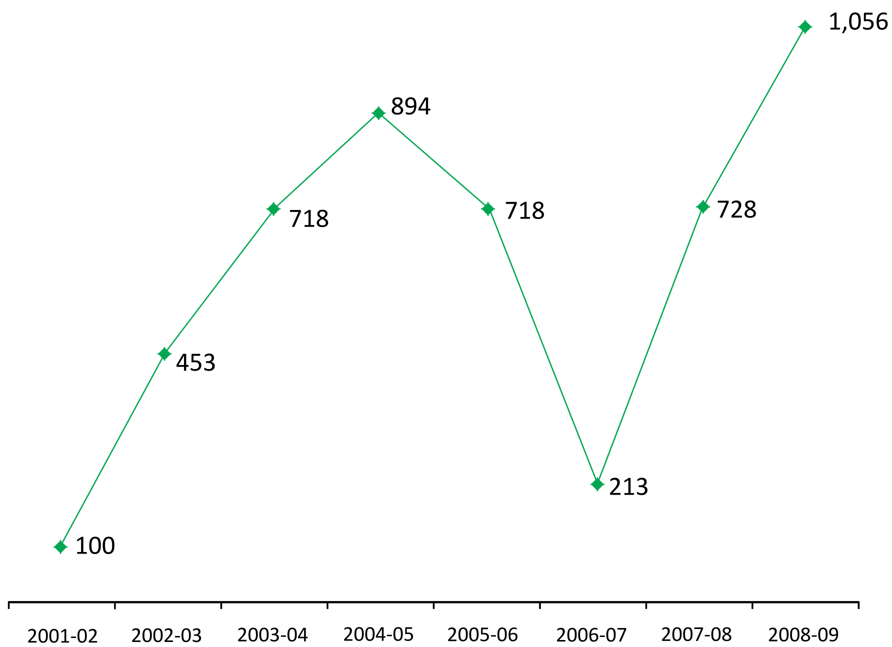
Concluding Remarks

…and performance has continued to improve from the lows of 2006-07

Given the increased yield, low operating expense ratio and low PAR, the high return on assets recorded by the Indian microfinance sector in 2008-09 is not surprising. As a result the M-CRIL India Performance Index for March 2009 has increased considerably.

M-CRIL India Performance Index

M-Cril$_{15}$, March 2002=100



The Performance Index – a composite index of the performance of microfinance institutions – uses information on portfolio at risk and return on assets of 15 MFIs that account for nearly 90% of the overall portfolio of the 60 leading Indian MFIs in the sample used for this review. The change in the index numbers since September 2009 is due to a correction in the base year data as more information has become available. The shape of the graph has not changed.

The Performance Index this year has increased to

1,056

(March 2002=100)

…improvement in 2008-09 was 45%

compared to a negligible net improvement for the previous two years (including a huge decline in performance in 2006-07 on account of portfolio quality issues in parts of Andhra Pradesh and Karnataka).

…but this may not be a matter for celebration; MFIs need to re-focus on client interests and inclusion rather than purely on financial gain

While this improvement in the performance index is apparently a matter for celebration, it may regrettably result in lament. The concern is that the improvement has been achieved due to an emphasis on increasing yield and minimizing portfolio at risk in order to boost the equity valuations of MFIs. As such it may be a short term phenomenon achieved at the expense of relationships with clients and, as discussed above, likely to trigger political intervention with long term adverse consequences for the microfinance sector. An immediate re-focussing of MFI operations on the double bottom line balancing financial returns and social values – client protection and social mission – is essential to ensure the future of Indian microfinance as an instrument of financial and social inclusion and not as another means of exploiting the poor for financial gain.

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