

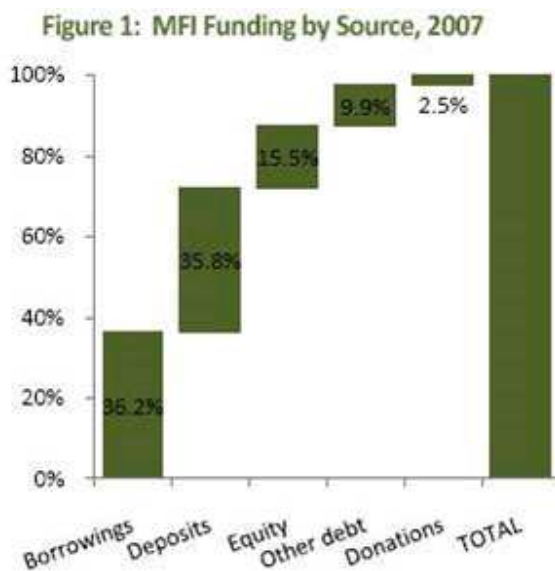
Emerging growth model for microfinance institutions – Banks or NBFC

By Souren Ghosal,

Microfinance Focus, April 20, 2010 : In recent years there is sudden spurt of growth could be observed in [microfinance institutions](#). These could be largely attributed to increasing stress given for inclusive growth and apparent success perceived in microfinance institutions to outreach poor on a sustainable business model. So much so the pioneer of MFI Prof. Yunus gave a call to youths to seize the opportunity to build a sustainable business model for poor by developing MFIs with the help of innovative technology to outreach them with least cost and maximum benefits.

Strategy Adopted

However at present these institutions are in a transition stage from self help group and donor driven to an increasingly looking for sourcing funds from banks and also from the capital markets through bonds and equities particularly through private equities and foreign institutional investors. An in-depth look would reveal that most of these institutions that have attained some success and matured enough to comprehend modalities of financial markets have taken recourse to diverse sources including securitization of loans.



Source: MIX 2006-07 MFI benchmark data
Note: Equity includes paid-in capital and retained earnings; Other debt includes concessionary loans and compulsory savings

Growing Interest of Outside Investors

In fact of late it could be observed that world over the investors have been evincing enhanced interest in these institutions as these are becoming highly rewarding and therefore such investors are increasingly participating and building their investment portfolio geared towards poverty alleviation programs of micro financial institutions particularly those who are growing and generating profit that could attract investors and help developing own resource to sustain their growth.

Impact of Recent Trend of Investors Interest

It has been rightly observed by VINOD KHOSLA – a venture capitalist- that such interest of investors in MFIs is ‘one of the most important economic phenomena since the advent of capitalism and ADAM SMITH. In fact to illustrate the impact of such interest could be gauged from the phenomenal growth of SHARE- an MFI in INDIA- which was just a NGO in 1992 could develop more than 10 million client base and have about 4 million rupee portfolio today.

Further it would be interesting to note that it is still growing. Similarly SKS MICROFINANCE one of the biggest micro finance company in India is one of the top attraction of foreign and Indian investors. Sequoias, a California based venture capital fund was one of the early investors in SKS as it started investing since March 2007. Some of the latest investors in SKS are CATARMAN MANAGEMENT SERVICES- a fund started by NARAYAN MURTHY of INFOSYS in India. In fact this is the first investment by the fund with a corpus of 600 crore. It has invested little over 28 crore. Further the company has recently taken a decision to raise 1150 crore through I.P.O. and for this necessary steps have already been initiated. To CRISIL the company which received NBFC license from RBI in 2006 have 5.3 million customer bases and at present it is India’s largest MFI on the basis of value of loans outstanding, number of branches and number of borrowers. It would be interesting to note that SKS was founded by VIKRAM AKULA of MCINSEY in 1997 as a NGO and converted it into NBFC in 2005. Further it needs to be highlighted that AKULA has already diluted his shareholding to 6% by selling his stake to private equity investors. It is true as has been observed by VINEET RAI of INTELLECTUAL CAPITAL ADVISORY SERVICES that ‘SKS public offer is the first such offer by an MFI but not the last, with a pipeline of such public offers.’

Similarly VIREN H MEHTA of ERNST & YOUNG has very aptly opined that ‘any entity which is first in its breed, industry or section, to go for an IPO (initial public offerings) gives signal of coming of age of that industry.’

In fact in fiscal year 2009-10 MFIs have added 8, 5 million customers and thus their customer base has reached the level of 22.6 million i.e. attaining a growth of 60%. Their growth of credit flow is still higher almost 97%—from 5,950 to 11.734 crore. Similarly with regard to the growth of customer base SPANDAN achieved the highest growth rate of 104% and the second and third best are BANDHAN AND SKS.—97% AND 87% respectively.

Effect of Sudden Growth

Such phenomenal growth no doubt is a commendable feature but equally its sudden spurt of growth would throw up many challenges and problems that need to be examined and resolved to avoid any future crisis or fall. In fact some of the obvious issues that have to be addressed could be summed up as follows:

1. there is growing dearth of efficient and well groomed managers to face the emerging challenges arising from the sudden spurt of growth due to sudden flow of fund in these institutions;
2. managers in MFIs need to comprehend management practices and strategies in a holistic manner with its socio economic dimension but that is not happening;
3. liquidity management is the key challenge for MFIs as their client groups both investors and borrowers belong to almost diametrically opposite category both economically and socially and therefore look for different types of rewards and returns and therefore it has become an altogether different type of challenge;
4. since financial sustainability is paramount for an organization to become an effective service provider it has to be manned by a management team with better sense of empathy and understanding of people and fund.
5. It has to raise money from the capital market to be in a position to reduce their lending rates. In fact it has started happening with increasing [investments](#) of outside venture funds. In one of their (investor company) it has been revealed that the lending rates of MFIs have come down to an average of 29% in 2010 from 2001.

Assessment of Present Position

It is revealing from a study made by ACCESS of some 230 MFIs that though the industry is growing fast but all MFIs are not running profitably. In fact one out of three MFIs in India made losses in the year 2009. Further it has brought out that larger number of small MFIs i.e. those having a loan portfolio of not more than 5 crore have suffered losses. It is true that report has also highlighted that in the year 2009 on an average most of them have been able to recover their loans up to 99%.

A Revealing Study of Financial Management Capability of Poor People

An interesting study has been made by D COLLINS, J MORDOUCH, S RUTHERFORD & O RUTHVEN on the Portfolios of the Poor. It is not only highly revealing but also provides a very educative and emulative insight on financial management by the poor. The authors of the book "Portfolios of the Poor" have collected [financial diaries of the poor](#) people of different countries and have come out with a startling revelation that poor does not live hand to mouth as is commonly believed.

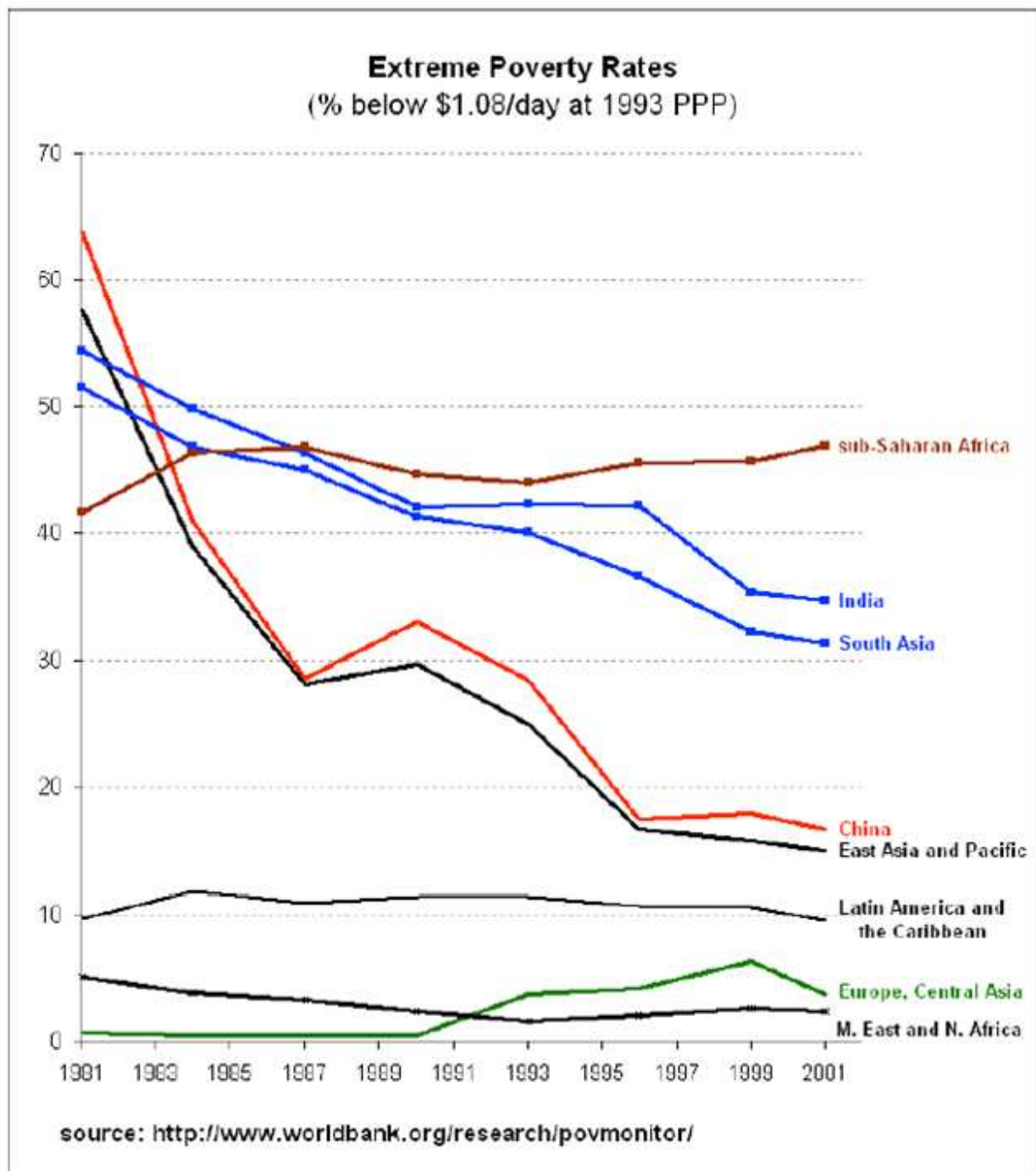
In fact poor people particularly woman member of the household generally are endowed with qualities like frugality almost inherently and therefore applies a complex combination of financial budgeting to keep the family afloat. It is obviously first of all hard labor and further the added quality of high level of sacrifice that enables them to keep the family afloat even with

paltry income. Strangely enough these are psychological and social straight of character and not necessarily always economic.

The authors have provided evidence of maturity and comprehension with which poor people manage their finance despite apparent hardship and limited earnings. In fact authors have revealed how poor woman in most of the countries are joining and or forming saving clubs and or groups to create their own 'money guards'. It is interesting to find that diaries of the poor reveal that they are not worried if they do not have enough money but they are seriously feel aggrieved if they are unable to manage with that meager income. Over the years they have been developing ingenious ways to manage without perturbing family members as far as possible. It shows that they have inherent qualities of sound financial management. Their diaries do reveal that they earn more on some days and less on other days but still they are able to juggle out so much dexterity to maintain their families with so little money. Such startling revelation could provide a better base to formulate policies and institutions to combat poverty.

It may be highly probable that Mohd. Yunus also had the opportunity to observe this ingenious method of financial management of female members of households and that gave him the vision of GRAMEEN BANK. In fact broad economic surveys on which most of the strategies for poverty alleviations are formulated are not as much revealing and rewarding in building an effective strategy and or institution for amelioration of poverty as perhaps the book on PORTFOLIOS OF THE POOR. In fact the multilayered portfolios of equity and debt need to be designed to help poor to avail these and make their financial management more sophisticated particularly due to the rising trend of poor people in some countries and slow rate of deceleration in other countries as would be evident from the following diagram.

Figure II Poverty Growth



Lessons to Build a Healthy Model

In view of these it would be necessary to conceive a model of MFIs that would not only create a group of poor women in villages but also to develop a cluster for any such economic activities that could be pursued by the group formed for lending. This way these institutions would provide not only consumption loans but also trading, manufacturing and marketing loans. For this it would be imperative for MFIs to become a subsidiary of a rural bank or commercial bank with rural branches and rural portfolio. It is true today MFIs are in a transition stage from self help group driven and donor funded institution these are rapidly emerging as bank funded and private equity funded and soon outreach capital market by offering shares to the public. It is true that MFIs originated with an assumption that empowerment of women to manage family finance would help alleviation of poverty. But with the growth of MFIs and on acquiring intimate knowledge of financial health of rural poor it is increasingly felt that merely providing supplemental income and that too for a short period would not help poor family to come out from poverty trap and in fact such a strategy may ultimately lead them to debt trap. Any insider of MFIs if asked in confidence would admit the growing trend of multiple borrowings from competing MFIs and or financial institutions and money lenders.

Ultimately the age old adage that 'loan repays the loan' has become the order of the day with almost all MFIs some perhaps are aware of and some may not be aware of the same or may even pretend to have no knowledge of the same.

Suggested Model

It has therefore become imperative that MFIs need to be constituted to empower poor both by funding and training to become an entrepreneur to be in a position to run a sustainable business with confidence and competence. This would be feasible only when MFIs are strengthened both in management competence and fund adequacy by banks- particularly the public sector banks – by adopting them or making them as their subsidiary under public private partnership model. Such an institution could transform the village economy as vibrant as that of urban areas and also help government to implement their rural development schemes with greater degree of success and lesser degree of leakages. NREGA will no longer remain a scheme of digging and filling of mud or just sitting idle, as no job could be identified by the administrative wing of the program, but getting wage as per the provision of the scheme. In fact MFIs could conceive and plan projects both in farming, marketing and domestic industries like sewing clothes, making shoes and furniture etc. These could be not only funded but also supported by management inputs needed to fill up any inadequacy observed in these areas among villagers. It would also be helpful to develop entrepreneurs by providing village youth both men and women to help them to conceive and run their own enterprises.

MFIs – BANK or NBFC

It could be concluded that the future of MFIs depend on either becoming a bank on their own or become a subsidiary of a public sector bank and come out of the groove of providing only consumption loan to supplement income of a poor family but try to transform village economy through project financing on a cluster basis and become one of the stakeholders of business enterprise of village poor people for sometime till these people could run on their own like venture capitalist. Indeed one need not stress that for economic transformation economic institutions are more effective as compared to political institutions. However since private interest would be lukewarm or even exploitative it has been suggested that such institutions could be created on PPP model as that way government will have direct control and would get the benefit of private fund and private management expertise. It would also do away the proposed creation of a separate law and regulatory authority for MFIs. It is obvious therefore that NBFC format would not be able to undertake the revisited strategy as has been highlighted here.

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