M-CRIL Microfinance Review 2003

- revised Feb 2004

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Preface & Acknowledgements

The M-CRIL Microfinance Review, 2003 is a follow up to The M-CRIL Report, 2000. It is a part of the effort of Micro-Credit Ratings International Limited (M-CRIL) to stimulate professionalisation in the microfinance sector in Asia. Towards this end, M-CRIL undertakes the rating of microfinance institutions (MFIs) and micro- as well as macro-level studies of the microfinance sector.

M-CRIL's work is complemented by that of EDA Rural Systems Private Limited, its parent organisation. EDA undertakes impact studies and offers interactive, practice-oriented formal training programmes for MFI managers. These activities are usually undertaken in response to specific demand from client organisations. Sometimes it is also based on identification of the needs of microfinance in the region as perceived by the EDA team.

The Introduction to this report sets out M-CRIL's mission and provides a description of its rating methodology and its contribution to microfinance in Asia. The information and analysis contained in this, The M-CRIL Microfinance Review, 2003 is intended to improve knowledge and understanding of the microfinance sector in Asia. The objective is to facilitate the design of support activities for the sector by networking organisations, capacity builders and multilateral as well as bilateral donors. Most importantly, the aim is to enable MFIs to compare their performance with their peers and identify opportunities as well as weaknesses in their programmes. M-CRIL's mission will be well served if this leads to significantly improved access to financial services for the low-income families in the region.

As an analysis based on information obtained only from the MFIs rated by M-CRIL, the sample employed is not fully representative of Asia as a whole but covers most of the major MFIs in India and some of the key ones in Nepal, Bangladesh, Cambodia and the Philippines as well as some of the microfinance service providers in Indonesia. It therefore provides a substantive picture of microfinance practice in the region.

There are many institutions and persons who have contributed, both directly and indirectly, to the development of M-CRIL's methodology and who have supported its activities in various ways.

The two major institutions that M-CRIL has received support from are

- The Ford Foundation that put its faith in our abilities before anyone could possibly have predicted what would emerge from the proposal to develop an MFI rating methodology, and
- The SIDBI Foundation for Micro Credit (SFMC), which is M-CRIL's major client and has commissioned a large majority of the MFI credit ratings undertaken until now.

Other institutions that have supported M-CRIL's work are

- Swiss Agency for Development and Cooperation (SDC), Dhaka office, our first client that has also supported our efforts to engage the commercial banking sector in microfinance in Bangladesh
- UK Department for International Development (DFID), Dhaka office
- The Rating Fund of the Consultative Group to Assist the Poor (CGAP)
- Stichting HIVOS of the Netherlands
- SDC, Delhi office that supported the publication of *The M-CRIL Report, 2000*

Within M-CRIL and EDA, a number of people have contributed to this process. These include members of our Board of Directors -

- Prof Malcolm Harper, Emeritus Professor, Cranfield Institute of Technology, UK
- Ms Vijayalakshmi Das, Friends of Women's World Banking, India
- Dr Prabhu Ghate, Independent Consultant
- Prof MS Sriram, Associate Professor, Indian Institute of Management, Ahmedabad
- Prof R Srinivasan, Dean, Indian Institute of Management, Bangalore
- Ms Frances Sinha, Director, EDA Rural Systems Private Limited

Others who have graciously provided their time and expertise when requested to vet rating reports along with Board Members as part of M-CRIL's Rating Committee

- S Ramanathan, formerly of SDC, Delhi
- Sukhwinder S Arora DFID, Delhi (now London)
- David Wright, Independent Consultant (formerly of DFID)
- Damian von Stauffenberg, MicroRate, Washington DC

Most importantly, M-CRIL would like to thank the management, staff and members of the 125 MFIs rated by us until June 2003 (Appendix 1). The M-CRIL team would like to thank all of the above for their cooperation, suggestions and support. Special thanks are also due to Prof Sriram for graciously and promptly providing detailed comments on a draft of this report. The responsibility for any shortcomings in the report is entirely ours.

The M-CRIL team

Managing Director	Sanjay Sinha	
Team Leaders	Sanjay Gandhi	Shipra Goyal, Ms
Senior Executives	Ragini Chaudhary, Ms Pranav Sharma	Nilotpal Pathak
Executives	Deepak Alok Abanti Mitra, Ms	Jyoti Gidwani, Ms Nitin Agarwal

Others who were members of the team in the past and participated in the ratings included in this report are

Team Leaders	Niraj Verma	Tanmay Chetan
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15 January 2004

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Executive Summary

- performance is improving and the overall scenario is encouraging as there are enough good experiences to hold out hope that the sector can, in the future, become a dynamic and sustainable component of the poverty reduction effort in the region

Over the period from September 1998 to June 2003, Micro-Credit Ratings International Limited (M-CRIL) – a public company established to facilitate the flow of commercial funds to the microfinance sector – undertook 170 ratings of some 123 MFIs in South Asia. M-CRIL has compiled the information from its rating studies in a database and used it to analyse the performance of the microfinance sector in the region. This analysis of information, from the 110 MFIs rated until end-June 2003, constitutes The M-CRIL Microfinance Review, 2003.

Client outreach & financing: Of the 2.7 million members (clients) of M-CRIL's sample of rated MFIs in South Asia; around 1.2 million are borrowers with outstanding loans equivalent to US$91 million. Amongst these, the MFIs following the Grameen Bank solidarity group methodology are dominant in terms of size. The fact that the combined deposits of members of the rated MFIs are about 54% of the loans outstanding shows the value microfinance clients place on savings services. It also demonstrates the potential for raising lending resources from the clients of microfinance institutions. Overall, donor funds are still very important (31%) in the financing of MFIs in the region but the increasing commercial orientation of the activity is apparent since client savings make up 25% of the total, while institutional debt accounts for another 35%. Unfortunately, only 65% of the total $147 million available to rated MFIs has been deployed in loans to clients while as much as 11% is placed in short term investments. For many individual MFIs, the management of idle cash balances is also an issue. In this context, efficiency in the deployment of funds needs considerable improvement.

Financial performance: In terms of performance, operating expenses (20.5% of average outstanding portfolio) are relatively low on average and compare well with international best practice norms. However, the typical MFI has a far higher 36% operating expense ratio and much lower portfolio yield leaving a gap of 15% between operating expense and yield. Not surprisingly, the sample as a whole has a 0.2% negative return on assets compared to the 0.1% profit of the MicroBanking Bulletin (MBB) sample. The M-CRIL sample average also performs poorly on indicators like operational self-sufficiency (typical MFI, 79%) and financial self sufficiency (typical MFI, 69%) though the weighted averages are significantly higher due to the good performance of a few large MFIs. However, there are still enough MFIs in the M-CRIL sample with positive returns to indicate a significant trend to improved performance of the microfinance industry as a whole. The M-CRIL Top10 achieve an OSS of 109% (weighted) in comparison with the MBB sample's 115%.

Trends in Asian microfinance: The impression of a positive trend is reinforced by an examination of the performance of 35 MFIs with rating updates. Over an average 21 month period between the previous rating and the most recent update, these MFIs had registered a 34% p.a. growth both in number of borrowers and in the portfolio. Performance improved very significantly as OER declined from 49% to 35% for the typical MFI while portfolio yield

increased from 19% to 22%. This improved performance is indicated by significant increases in staff productivity and better portfolio quality resulting in a substantial improvement in the sustainability of the MFIs with rating updates.

Institutional issues: The relatively disappointing, if improving, performance of the sector as a whole is almost surprising in the context of the considerable management experience of the chief executive officers of MFIs in the region. However, it is an experience tempered by the NGO backgrounds of the individuals and is not always consistent with the need for MFIs to exercise financial discipline. The limitations of this experience are compounded by often mediocre staff quality and spatially over-extended operations of the sample MFIs. Management information systems in use are improving but still often inappropriate and the concept of portfolio quality is only now beginning to be understood. Accounting and other microfinance management issues also need attention.

Nevertheless, some of the more professionally run MFIs in the Asian region have started to integrate with formal commercial markets while others are moving in this direction. The conclusion of this report is that microfinance in Asia is growing and is progressing significantly towards professionalising operations to meet the financial needs of low income families…a few more years could see the emergence of a significant and substantial microfinance sector in most of the poorer countries of the region.

Introduction to M-CRIL

The mission of M-CRIL is to facilitate the delivery of microfinance services in developing Asia by **minimizing information asymmetry** and **mitigating the limitations caused by lack of exposure** between commercial investors and banks, on the one hand, and microfinance institutions (MFIs), on the other.

Towards this end, M-CRIL undertakes the rating of rural and cooperative banks, finance companies and not-for-profit institutions that provide financial services to low income clients. In addition, M-CRIL undertakes proprietary economic research, monitoring & evaluation, policy studies and market research designed to facilitate the provision of microfinance services.

1 The Genesis of M-CRIL

The sustainability issue has become particularly important in microfinance in recent years. This has happened as microfinance portfolios have started to shift from being almost exclusively donor-funded to significantly debt-financed. Loan funds are sourced increasingly from apex-level NGOs, development banks and even, increasingly, from commercial banks. Prominent amongst the institutions lending to MFIs in South Asia are the Palli Karma Sahayak Foundation (PKSF) and Sonali Bank in Bangladesh, the Rural Microfinance Development Centre in Nepal, Friends of Women's World Banking, India (FWWB) and the Small Industries Development Bank of India (SIDBI). The encouraging experience of these institutions in revolving wholesale funds for microfinance has led to growing interest in this activity and more apex institutions (as wholesale lenders) and commercial banks are starting to become involved.

Since lending activity inevitably generates concerns about the borrower's cash flows, viability and sustainability, the availability of skills for MFI appraisal and risk analysis has, increasingly, become an issue. The response of the apex NGOs wholesaling development funds in microfinance has been to attempt to develop the skills internally. Banks with large portfolios but relatively miniscule outstandings to the microfinance sector have been more reluctant to undertake appraisals as purely internal exercises.

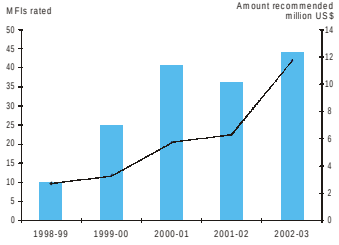
There are two reasons for this. Firstly, as custodians of commercial rather than development funds they need a quality of risk analysis that is more sophisticated than is customary in the development sector. Secondly, it is difficult for a bank with a loan portfolio worth a billion dollars or more, invested in a diverse range of industrial and agricultural activities to persuade many of its staff to specialize in MFI appraisals when the microfinance portfolio is likely to be no larger than $10-20 million in the immediate future. Yet, the potential for microfinance lending in India alone is estimated to be in the range of $6-8 billion if only the substantial (and liquid) resources of the banking system could be channeled in its direction.

Thus, the microfinance funding situation in the region can be characterized as one of information asymmetry between banks that have funds but not the skills and experience to understand microfinance operations, on the one hand, and MFIs that have a high demand for funds but many of which have doubtful records on issues like sustainability and viability. It is in this context that EDA Rural Systems Private Limited (EDA) – an organization with the reputation of a highly professional and competent provider of technical services to the development sector in South Asia – decided to develop a service for the rating of MFIs.

After around 18 months of research and field-testing, a credit rating service for MFIs was introduced in South Asia – virtually for the first time globally – by Micro-Credit Ratings & Guarantees India Limited (M-CRIL, later renamed Micro-Credit Ratings International Limited in line with its international workflow and evolving profile), a subsidiary company established by EDA specifically for this purpose.

In the five years since the launch of its rating service in late 1998, M-CRIL has built up a rating team consisting of 10 professionals. It has an active Board of Directors made up of professionals and academics with an intimate knowledge and experience of Asian microfinance and also uses the services of professionals as part of its Rating Committee to provide independent oversight of the ratings undertaken by the organization. This vetting mechanism has served to ensure that no issues of prejudice, conflicts of interest or sins of omission arise to cloud the judgements made by M-CRIL's rating analysts. As a result, M-CRIL's MFI rating service has come to be accepted in Asia as a highly reliable assessment of the creditworthiness of institutions engaged substantially in providing financial services to low income clients.

MFI ratings undertaken by M-CRIL & lending recommendations



Ratings – based on intensive visits by a team of two analysts to MFI head offices, branches and clients in the field – have provided the detailed, independently verified information on MFI operations that financial institutions need in order to make lending/investing decisions and judgements of creditworthiness. Until end-March 2003, M-CRIL had undertaken 156 MFI ratings in Asia resulting in a cumulative lending recommendation of around US$30 million.

The progress of M-CRIL's rating service – on an annual basis – over the past five years is depicted in Figure.

The opinions of M-CRIL as a professional institution engaged in the capacity assessment of MFIs have served as a key factor in enabling the lending decisions of wholesale lenders to them. In doing so, M-CRIL's innovative service has greatly accelerated the rate at which lending has emerged as a means of funding MFIs – particularly in India.

2 Criteria used for the assessment of MFIs

The M-CRIL rating evaluates the strengths and weaknesses of the operations of the financial service provider to low-income clients – bank or MFI – as well as its creditworthiness. It assesses the risks associated with lending to the organization and assigns a grade based on the extent of risk. Some categories of risk that form the basis of the assessment are external risk, credit risk, market risk and the risk of fraud. With reference to these, the critical aspects covered are – the quality of governance, the depth and efficacy of management systems and the financial health of the institution.

M-CRIL's methodology utilizes the extensive experience of its parent company, EDA, in the monitoring and evaluation of programmes to promote the livelihoods of low-income families. It combines this experience with the results of research to identify determinants of credit-worthiness – based on a rating literature review, discussions with rating experts, bankers, academics and MFI leaders. M-CRIL indicators are categorized into three broad areas of Governance, Management Systems and Financial Strength

1 ***Governance*** that assesses the quality and appropriateness of the composition of the MFI's board, its role, experience with microfinance, the MFI's outreach and its overall strategy for fulfilling its mission and goals. The major indicators used include

- **Role of the Board**: relevant experience and technical knowledge of board members, interest and extent of involvement of board members in governance
- **Strategy**: appropriateness of operational strategy in the context of the operating environment, focus / specialisation in financial services, suitability of loan products, presence / concentration in the operational area.

2 ***Management systems***: the quality of human resources, their productivity, the strength of critical systems like accounting, management information and management planning as well as internal control and policy compliance are assessed.

- **Human resources**: adequacy and qualifications of staff, their understanding of crucial microfinance issues, staff productivity, incentive systems and management stability
- **Systems:** appropriateness and efficacy of systems for managing portfolio information, accounts and internal audit through various indicators like rigour, accuracy and timeliness
- **Strength of clients**: Most MFI clients in Asia are illiterate and poor with little or no access to financial services. In this context, M-CRIL feels that it is important for an MFI to have an informed, disciplined and engaged client base with some sense of loyalty to the institution. This is assessed as part of the rating.

3 ***Financial strength*** is evaluated on the basis of information from financial statements specially prepared (or re-drafted, if necessary) using internationally accepted accounting practices and prudential norms to present a fair picture of the MFI's operations. In case the institution is engaged in more than one activity, the costs of the financial operation are carefully separated, the allocations being based on a field assessment of resource utilization – human and material. The segregated and reformatted financial statements are used to assess the MFI's financial strength based on indicators like portfolio quality, liquidity, asset-liability management (ALM) and profitability. Indicators used include

- **Portfolio quality**: The quality of an MFI's loan assets based on an age statement of overdues, portfolio at risk (more than 60 days) and portfolio diversification over a range of activities.
- **Credit discipline** of both the MFI clients as well as the MFI itself in relation to its lenders by analyzing their repayment history
- **Repayment ability**: For a lender it is very important to get an objective sense of a borrower's repayment ability; M-CRIL assesses this by examining the rated MFI's liquidity, capital

adequacy and ability to service debt from operations

- **Profitability and sustainability**: The microfinance sector is fast moving away from a donor-driven charity oriented paradigm to a sustainability oriented commercial one and the focus of M-CRIL's initiative has been on facilitating this process. An MFI's profitability is assessed through ratios like Return on Assets (ROA), Operational Self Sufficiency and Financial Self Sufficiency. This profitability / sustainability analysis forms an important part of M-CRIL's risk assessment.
- **External risks affecting operations**: Every organization is exposed to risks arising out of its environment and no risk assessment would be complete without this. M-CRIL assesses external risk on parameters related to the macro-economic strength of the MFI's operational area and other factors like economic infrastructure, institutional development of the region and political stability.

Appendix 2 contains a note on M-CRIL's credit rating service with details of the rating process and methodology.

3 M-CRIL's methodology versus that of formal sector ratings

M-CRIL's ratings differ from formal sector ratings in their institution-wide focus and enabling intent. Formal sector ratings tend to be solely focused on assessing the risk associated with a particular credit product of an organization based on its present situation, systems and industry outlook and using pre-specified indicators bearing proven historical correlation to credit risk emerging from experience.

However much the utility of these methodologies, M-CRIL believes that taking such an approach would be a disservice to the microfinance industry. Firstly, most MFIs do not make market offerings so there is virtually no scope for an offering-specific approach. Secondly, given the still relatively early stage of debt-finance based microfinance, the correlation between indicators and performance is still being tested. Thirdly, the systems employed by most MFIs are relatively unsophisticated and, not only is the availability of data inadequate, its reliability is often also open to question. In the context of a nascent activity, the typical commercial rating could be somewhat regressive, condemning the lack of performance and poor systems of the rated institution without providing any systematic feedback for improvement. M-CRIL's approach to rating MFIs, by contrast, incorporates the following features

- Data collection and authentication as a key element of the rating exercise to ensure the use of authentic and reliable data for the assessment. This means that the authenticity of an MFI's reporting system is first determined by a snap system audit and, if its reliability is found to be unsatisfactory, data is physically reconciled from base level records. In an average, small-medium Asian MFI with 3-4,000 loan accounts, this could entail examining all the loan ledgers to get accurate portfolio information.

- An analysis of strengths and weaknesses of the organization on key parameters is a critical part of M-CRIL's rating reports.

This includes detailed comments on
- appropriateness of strategy
- strength of accounting, management information and portfolio tracking systems
- credit performance and profitability.

M-CRIL also provides capacity building needs assessment reports based on specific requests. As an indication of M-CRIL's concern for this aspect of the rating exercise, the strength of systems is covered up-front rather than just specifying the risk grade. (Appendix 4)

- For the purpose of standardization and comparison across MFIs, presentation of adjusted financial statements and detailed explanations of the adjustments made in the construction of financial statements. For the financial statements, these adjustments range from the allocation of assets and staff time in a multi-service organization to determining adequate loan loss provisioning (and write off of defaults) for the institution based on portfolio ageing. Besides these, various other adjustments like subsidy calculations are done for specific indicators. This process serves as a guide to the MFI enabling it to improve its accounting practices at the same time as facilitating M-CRIL's analysis.

- An institutionalized process of ongoing instrument review within M-CRIL. M-CRIL reviews the instrument based on evolving experience and revises it periodically (roughly at two year intervals). This involves verifying the rating outlook with the actual credit performance. These revisions of methodology and instrument are based on advice from M-CRIL's board comprising technical experts in the field of microfinance. In the past, reviews have led to the strengthening of the minimum conditions for various rating grades, capital adequacy norms, redistribution of weights across indicators, and the relative weights between the governance, management and financial sections of the instrument.

- The regular sharing of information on good practice in microfinance as an "externality" resulting from M-CRIL's work. This has been done in two ways
  - By providing critical inputs to SA-DHAN, the premier association of Indian MFIs, particularly on standards. SA-DHAN regularly disseminates information through workshops, papers and technical documents.
  - Through its own publications and workshops. In 2002, M-CRIL conducted an all India study documenting the best practices followed by India's leading MFIs on critical functions like governance, strategy, products and delivery mechanisms, management information systems, accounting practices, financial management, internal audit and personnel issues. The findings were published in the form of a book and discussed and publicized at a national-level workshop including the leading stakeholders in microfinance.

This report incorporates an analysis of the performance of MFIs in the Asian region as seen through the ratings conducted by M-CRIL over nearly five years from September 1998 (the first rating) to June 2003. It begins by describing laying out the general characteristics of the MFIs covered by the analysis and then goes on to examine performance in terms of outreach, productivity, cost efficiency, portfolio quality, fund management and profitability. It concludes with a discussion of some institutional issues that M-CRIL believes are the key factors governing the performance of microfinance service delivery in the Asian region.

1 Microfinance in India & Asia

– as seen through M-CRIL's Database Sample of 123 institutions

From the commencement of operations in September 1998 until June 2003, M-CRIL had completed 170 MFI rating assignments (including updates) covering India, Nepal, Bangladesh, Cambodia, Indonesia, Kazakhstan, the Philippines, Sri Lanka and East Timor. Table 1.1 provides an overview of the M-CRIL database and the final set of MFIs rated by M-CRIL used for the analysis in the report.

Table 1.1 **Overview of the M-CRIL sample**

Sample details	Number
Ratings in the database	**170**
MFIs rated once	86
MFIs rated twice	28
MFIs rated thrice	8
MFIs rated four times	1
Total number of MFIs rated	**123**
The M-CRIL sample:	
MFIs rated once	75
MFIs with rating updates	35
Sample size for this report	**110**
Sample range for each analysis	87-110

Some organisations have been excluded from the analysis as the data available from them was (3 organisations) incomplete, others have been left out as they are apex organisations (on-lenders to MFIs- 2 organisations) whose inclusion would result in double counting. Other rated institutions excluded fromthe analysis are micro-enterprise promoting NGOs that were rated (7) and 2 large banks whose inclusion would unduly skew weighted averages. This leaves usable data from 110 MFIs – defined as organisations providing microfinance services to low income clients – in the sample. Within this sample, outliers (MFIs that substantially skew sample averages) have been removed resulting in a varying number (87-110) of data entries for each indicator.

Table 1.2 **Regional distribution of MFIs**

Country/ Region	Number of MFIs rated	Number of MFIs sample
India	**102**	**90**
South India	59	53
East India*	18	17
West India	18	15
North India	7	5
South Asia	**11**	**11**
Bangladesh	6	6
Nepal	4	4
Sri Lanka	1	1
South East Asia	**9**	**8**
Cambodia	2	2
East Timor	1	1
Indonesia	4	3
Philippines	2	2
Central Asia	**1**	**1**
Kazakhastan	1	1
Total	**123**	**110**

*including North East States

While cross-sectional data for the 110 organisations covered does not relate to a fixed point of time, it does serve the purpose of providing a broad picture of microfinance in the region as seen through M-CRIL's rating activity. For the purpose of this analysis, the classification of the information in the database has been undertaken by

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

1.1 Regional distribution of MFIs

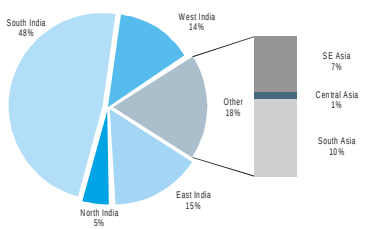
– heavily focussed on south India; a sprinkle across Asia

Regionally, this analysis provides a comprehensive picture of microfinance in India and an impressionistic view of microfinance in Asia. The primary classifications are by sub-continent and, within India, by region. As Table 1.2 shows, the number of Indian MFIs rated is 104 compared with 21 in other Asian countries (11 South Asia, 10 South-East Asia). Within India, microfinance is concentrated in the southern part of

the country. This is reflected in the M-CRIL sample, which has nearly 60% of the Indian MFIs in the sample concentrated in the states of Andhra Pradesh, Tamil Nadu, Karnataka and Kerala. The western and eastern parts of the country have lately seen a growth in microfinance service providers but there are very few MFIs in the north.

Figure 1.1 depicts the broad regional analysis of the sample. To ensure the significance of the analysis for comparative purposes, all non-Indian MFIs have been grouped together into an 'other' category in many cases when regional data has been considered.

Figure 1.1 **Regional distribution of sample MFIs**



1.2 Institutional characteristics of sample MFIs

– disaggregated by model, age

As in the M-CRIL Report 2000, a combination of the age of the organisation and the methodology or model it adopts for implementing its microfinance programme has been used for the main analysis in this report. The models / methodologies are classified here as

- **Self-Help Group** (SHG) – the dominant microfinance methodology in India – which is a version of the village banking model. The operations of (mainly) 15-25 member SHGs are based on the principle of revolving the members' own savings. These resources are often augmented by funds borrowed from MFIs or banks. Savings thus precede borrowing by the members. In many SHG programmes, the volume of individual borrowing is determined either by the volume of member savings or by the savings of the group as a whole. Some charitable non-government organisations (NGOs) operate microfinance programmes by organizing federations of SHGs to act as the MFI which obtains external loan funds in bulk to be channelled to individuals via member SHGs.

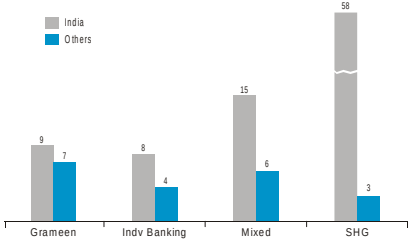
- **Individual Banking** model (IB) – entailing the provision by MFIs of financial services to individual clients – though they may sometimes be organised into joint liability groups, cooperatives or even SHGs. In the case of cooperatives, all borrowers are members of the organisation either directly, or indirectly by being members of primary cooperatives or associations which are members of the apex society. Creditworthiness and loan security are a function of cooperative membership within which member savings and peer pressure are assumed to be a key factor. Though the magnitude and timing of savings and loans are unrelated, in theory, a special effort is made to mobilize savings from members.

- **Grameen** model (G) – a model initially promoted by the Grameen Bank of Bangladesh. Grameen MFIs undertake individual lending but all borrowers are members of 5-member joint liability groups which, in turn, get together with 6-9 other such groups from the same village or neighbourhood to form a centre. Within each group and centre, peer pressure is said to be

the key factor in ensuring repayment. Each borrower's credit-worthiness is determined by the overall credit-worthiness of the group. Savings are a compulsory component of the loan repayment schedule but does not determine the magnitude or timing of the loan.

- **Mixed** model (M) – some of the MFIs started with the Grameen model that embraced the SHG model at a later stage but did not completely do away with the Grameen model and smaller groups. These have roughly an equal mix of SHG and Grameen type groups. Others have chosen to adapt either the Grameen or the SHG model to cater to their markets while a few organisations use a number of delivery channels – including individual banking type products and methodologies to provide financial services. These cannot be clearly classified in any of the above categories.

Figure 1.2 **Distribution of sample MFIs by institutional characteristics**



Model	India	Other	Total
G	9	7	16
IB	8	4	12
M	15	6	21
SHG	58	3	61
Sample	**90**	**20**	**110**
Top10	5	5	10

The distribution of sample MFIs based on this classification system is shown in Figure 1.2. This distribution is a broad reflection of the pattern of microfinance undertaken in Asia. In India, there is a predominance of SHG-based microfinance programmes but there has been a marked increase in the number of mixed model MFIs. This is an indicator of the extent to which Indian MFIs have started to experiment and grow out of the conventional mould of SHG and Grameen operations, to cater to the needs of their markets more effectively.

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

- **New** institutions – less than three years old
- **Young** institutions – 3-5 years old
- **Maturing** institutions – 5-7 years old, and
- **Mature** institutions – more than seven years.

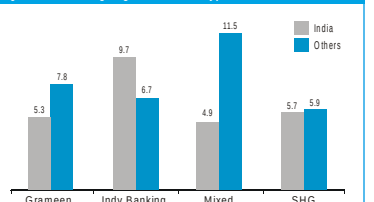
The average age of sample MFIs is apparent from Figure 1.3. In the "universe" of MFIs in India, the early MFIs were all established in the 1970s, when cooperatives were still seen as the most appropriate means of ensuring outreach to the poor in a just and fair manner. It is for this reason that the oldest MFIs in India are all cooperatives, classified here as individual banking models.

The mixed model organisations have the lowest average, particularly in India (4.9 years). This is because more than half of the Indian MFIs that fall in this category are new-age institutions that have broken away from traditional microfinance models. A few are also older institutions that have opted to modify their methodology to suit an increasingly diverse client base.

In a larger context, Figure 1.3 also indicates that within the sample, MFIs outside India have

a higher average age for almost all the methodologies except individual banking (overall average age for others is 8.6 years compared to 5.9 years for India). This could be because, inter-nationally, it is the larger MFIs, seeking external funding that approach M-CRIL for a rating.

Figure 1.3 **Average age of different types of MFIs**



Model	India	Other	Total
G	5.3	7.8	6.4
IB	9.7	6.7	8.8
M	4.9	11.5	7.1
SHG	5.7	5.9	5.7
Sample	**5.9**	**8.6**	**6.4**
Top10	4.0	11.2	7.6
MBB			**8.0**

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

- not-for-profit institutions – societies and trusts in South Asia, NGOs elsewhere
- cooperative institutions – conventional cooperatives (usually apex rather than primary cooperatives), mutually aided credit societies (in India) and, even, a cooperative bank
- formal financial institutions – non-bank companies providing financial services (classified in India as non-bank finance companies or NBFCs) and development or rural banks as in Nepal, Indonesia and the Philippines.

Table 1.3 Distribution of sample MFIs by legal form

Form of registration	India	Other	Total	Top10
Not-for-profit	71	9	80	2
– societies	56			
– trusts	15			
Cooperatives	11	1	12	-
Companies / banks	8	10	18	8
Sample	**90**	**20**	**110**	
Top 10	5	5	10	10

Table 1.3 shows the distribution of sample MFIs across these legal forms. Though there is a trend, Asia-wide, towards for-profit and formal registration as finance companies or rural banks (where the regulatory framework enables this), the table reflects the continued dominance of not-for-profit institutions in the provision of microfinance services.

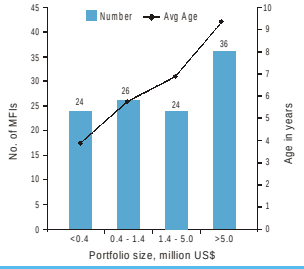
Also interesting in this context is the rural-urban orientation of MFIs. Microfinance activity in Asia is seen more as a rural than an urban activity - quite unlike Latin America in this respect. Only 12 of the 110 MFIs in the sample have a significant urban orientation and just 5 have exclusively urban operations.

1.3 The sample by portfolio size

– many small MFIs but an increasing number of large ones

The MFIs in the M-CRIL sample have been classified by the size of their outstanding portfolios at the close of the last quarter before the latest rating field visit, as shown in Figure 1.4. In spite of the natural bias of the rating exercise towards large MFIs, there are a substantial number of

Figure 1.4 Distribution of sample MFIs by portfolio size



MFIs with a portfolio in the range of US$40,000-140,000 (Rs18-63 lakhs). Particularly in India, about 60% of the organisations have portfolios less than Rs63 lakhs.

Figure 1.4 also shows that there is a strong correlation between portfolio size and the age of an MFI. Following common business sense, as MFIs gain more experience those that continue to operate also tend to expand. As the figure indicates, MFIs tend to grow rapidly at the age of around 6-7 years at which stage their portfolios can range from US$40,000-500,000. The number of commercial sources of funds now available to MFIs further supplements this portfolio expansion. The relationship between funding and age is discussed in subsequent sections of this report.

1.4 Rating grades achieved by MFIs

– relatively few are creditworthy enough to borrow significant sums of money

The rating grades awarded by M-CRIL for individual institutions are described in the Appendix 3. Grades are awarded to reflect the creditworthiness of the institution based on M-CRIL's rating methodology. The distribution of grades achieved by the 123 rated organisations and the sample MFIs of this report are presented in Figure 1.5. The distribution here almost follows the familiar bell shape for normal distributions with the median grade of β which is also the mode of the sample. However, for the universe of MFIs in the region, it is likely that a larger sample would result in an increase in the bars at the lower end and a tendency towards a skewed distribution as the number of MFIs rated increases. A large proportion of MFIs in the region, are unlikely to reach the minimum β grade required for them to be considered creditworthy. These MFIs are presently not rated. Similarly, it is apparent from Figure 1.6, that the non-Indian MFIs rated are amongst the best in the region.

Figure 1.5 Distribution of rating grades over set of rated MFIs

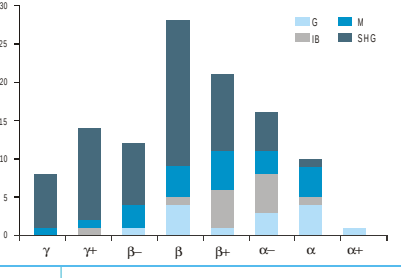
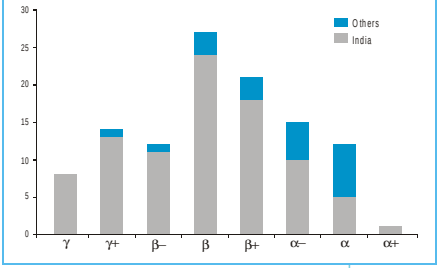


Figure 1.5 also shows the distribution of rating grades across MFI types. The Grameen MFIs rated so far have been amongst the best of all the types with more than 90% of them being above or in the investment grade of β. Though the α+ grade has eluded the MFIs operating with the individual lending model, they too have an overall trend similar to the Grameens. Some of the weakest organisations use the SHG model with only about 55% of them in the

investment grade – though this is also a function of the large number of SHG MFIs rated.

Figure 1.6 **Distribution of rating grades across Indian MFIs and others**



This grade distribution – with the mode at β- is, in fact, somewhat worse than that in the M-CRIL Report 2000 when the mode was β+. This is because the microfinance environment is dynamic and M-CRIL's objective of facilitating the mainstreaming of microfinance entails greater stringency as microfinance institutions become more commercially oriented. As a result, an increasing emphasis on critical performance indicators – particularly those for financial performance – has led to the downgrade of a number of organisations.

The analysis in this report begins with a discussion of client outreach and productivity before going on to issues of efficiency, portfolio management and financial performance. Since the M-CRIL database now has a substantial number of updates of rated MFIs (Table 1.1), comparative data for MFIs with rating updates has been used in Section 6 to assess trends in the growth and performance of microfinance in the region.

However, all the information in this report simply provides an indication of the performance of rated MFIs covering a series of factors – explained in the introduction note at the front of this report. Each of these factors, including its lending methodology, influences an MFI's performance but is not, *per se*, the key factor determining its performance. M-CRIL's rating experience demonstrates that the most important influence on an Asian MFI's performance are institutional considerations which are discussed in Section 7.

2 Client Outreach and Productivity

- coverage is low in relation to the number of poor people in the region but staff productivity is better than the international average

The number and size of microfinance institutions in India is small in relation to the numbers of poor people in the country. MFIs in India (including Self Help Groups) cover no more than 10-15% of the 60-70 million poor families in the country. In Bangladesh, the coverage is higher partly on account of the four large MFIs – Grameen Bank, BRAC, Proshika and ASA – that have 1-3 million members each. None of these large institutions in Bangladesh has been rated by M-CRIL so far and are not part of this sample. Similarly, coverage of low income families is substantially higher in Indonesia where Bank Rakyat Indonesia – a government owned commercial bank – has achieved significant outreach through its Unit Desa system. The outreach of this programme is supplemented by the existence of thousands of village and district level banks (LDKPs, BKKs and BPRs) owned by local government institutions and even private investors.

2.1 Outreach

– significant in membership numbers but not substantial in terms of portfolio size

2.1.1 Membership

The 110 MFIs included in this analysis provide financial services – either loans or savings facilities – to nearly 2.7 million clients. Of these, approximately 72% (1.9 million) are in India, distributed regionally as shown in Table 2.1. As discussed in Section 1, the South is dominant in MFI activity in India accounting for about 79% of Indian clients served by the sample. The M-CRIL Top10 account for roughly 528,000 members – 20% of the total.

Table 2.1 **Regional distribution of MFIs Clients**

Region	Number of clients, '000	% of total clients
South India	1,514	79.2
West India	216	11.3
East & NE India	136	7.1
North India	46	2.4
India	1,911	71.9
South Asia	556	20.9
SE Asia	184	6.9
Kazakhstan	7	0.3
Sample, 110 MFIs	**2,658**	**100.0**
Top 10	528	20.0

The importance of SHG programmes in the sample – 49% of membership – is apparent from Figure 2.1 with the mixed models accounting for 29% and the Grameens another 19% of the members. The significant membership of mixed models is partly a reflection of the move mainly of Grameen programmes away from the pure joint liability group to a more eclectic approach albeit inspired by the Grameen methodology.

In India about 64% of the total membership is serviced by SHGs. Most government initiatives in the country have been through groups – whether it is bank linkages with the support of the National Bank for Agriculture and Rural Development (NABARD), women's development schemes or other rural development programmes such as the Swarnajayanti Gram Swarozgar Yojana (SGSY – golden jubilee village self-employment programme). Due to this government support, a number of MFIs, especially those that started as multi-service organisations, adopted the SHG model. Thus, it is by virtue of the sheer

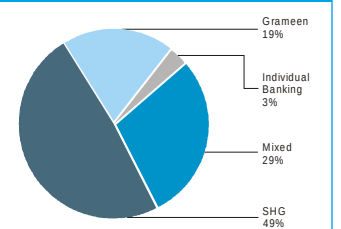
number of organisations in the sample, that the SHG model constitutes a large segment of the "universe" of membership.

Conversely, the Grameen organisations in India tend to have a much larger number of members (average membership ~31,000, Figure 2.2) though the number of organisations in the sample is limited making their contribution in India around 14.5%. The role of the mixed model in the Indian sample has increased over the last few years to about 18% as more and more MFIs are developing unique lending methodologies instead of following traditional systems.

In the rest of Asia (other than Indonesia), microfinance tends to be Grameen-inspired and this is apparent from the coverage of 31% of clients outside India by pure Grameen and another 58% by mixed model (mainly modified Grameen) organisations. Indonesia is strong on microfinance through individual banking programmes but one important large microfinance service provider – Bank Dagang Bali – has been omitted from the sample as an outlier due to its large size, and not many MFIs in other countries follow the individual banking model.

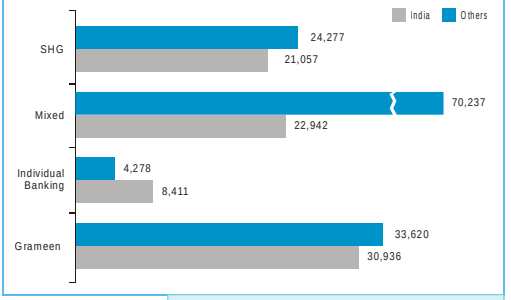
Though there are many MFIs in India using traditional cooperative principles – particularly the Mutually Aided Cooperative Societies (MACS) of the state of Andhra Pradesh – the coverage of individual banking organisations in M-CRIL's rating has been relatively low resulting in a small base in the sample. This is largely because cooperative organisations tend to be savings-based and not significant net borrowers from external sources while rating – as a tool – is intended to facilitate such borrowing. As a result, rating is not necessary for many cooperative-sector MFIs. Another reason for the small membership base in the sample is that – in contrast to Grameen MFIs – the individual banking methodology is relatively risky so MFIs expand cautiously, giving larger loans to fewer people to minimise operating expenses.

Figure 2.1 Membership of sample MFIs



Model	India	Others	Sample
G	278,000	235,000	514,000
IB*	67,000	17,000	84,000
M	344,000	421,000	766,000
SHG	1,221,000	73,000	1,294,000
		M-CRIL: Sample	**2,658,000**
		Top10	528,000
		India	1,911,000

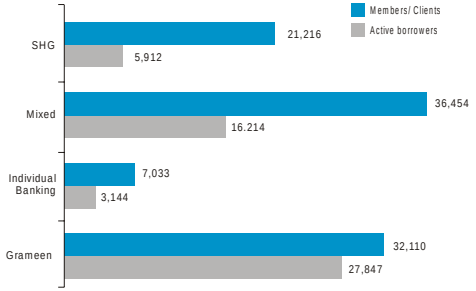
Figure 2.2 Average membership



Model	India	Others	Sample
G	30,900	33,600	32,100
IB*	8,400	4,300	7,000
M	22,900	70,200	36,500
SHG	21,100	24,300	21,200
		M-CRIL: Sample	**24,200**
		Top10	52,800
		India	21,200

* members are those who save with the organisation

Figure 2.3 **Average active borrowers and average membership**



Average active borrowers

Model	India	Others	Sample
G	28,500	27,000	27,800
IB*	3,400	2,500	3,100
M	7,800	37,300	16,200
SHG	5,100	28,100	5,900
		M-CRIL: Sample	**10,800**
		Top10	32,100
		India	7,800
		MBB	**15,553**

For many MFIs in the region, their developmental objectives mean savings services and empowerment through the promotion of governance capabilities are at least as important as lending to their members. This is particularly so for the SHG model with many programmes actually placing greater emphasis on the development and governance implications of the activity than on financial services. For this reason, there is a significant difference between the membership of these institutions and the number of persons participating in their programmes as borrowers. Figure 2.3 provides a comparison between the average active borrowers and the average membership of MFIs in the sample following each methodology.

The ratio of active borrowers to total clients apparent from the information in Figure 2.3 is largely dependent on the extent of dormancy accepted within a methodology. For instance, Grameen organisations have a high average of 87% of members as active borrowers. This is because the conventional Grameen methodology does not allow a member to remain dormant for more than 2 weeks. Members who do not take the next cycle of loan must drop out of the programme. On the other hand, SHG-based MFIs tend to have much lower active borrowers to client ratios (average, 28%) as the focus is on group solidarity and not all members need to be borrowers concurrently.

Not surprisingly, the mixed methodology has a ratio of 44% – somewhere between the Grameen and SHG MFIs. As more organisations adapt to more than one model to find their own niche, a Grameen replicator that moves into the modified model allows greater dormancy resulting in a decline in the "activity ratio". Similarly, if an SHG organisation focuses more on credit services, its activity ratio improves.

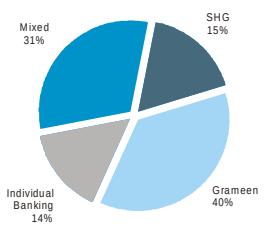
Overall, M-CRIL's sample average of 10,787 active borrowers per MFI is significantly smaller than the MBB average of 15,553 – partly a reflection of the relatively large size of the institutions that are willing to participate in the self-reporting process of the MBB but also an indication of the relatively small size of Indian MFIs. It is interesting to note here that the MBB average of 22,841 active borrowers for 66 financially sustainable MFIs is significantly lower than M-CRIL's Top 10 average of 32,125.

2.1.2 Loans Outstanding

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

MFIs in the database had a total portfolio outstanding of ~US$96 million at the time of M-CRIL's rating with the 90 Indian MFIs having outstandings of nearly $52 million (Rs238 crores). About 40% of this is with MFIs using the Grameen model (Figure 2.4) and the Mixed model MFIs provide another 31%. The Top10 MFIs own 32.8% of the portfolio of sample MFIs – an indication of the polarised nature of the sector in the region – particularly in India and South Asia – in terms of size. There are a small number of large MFIs that are relatively strong and a large number of small and relatively weak organisations. In India, the Grameen organisations continue to service the largest proportion (37%) of the portfolio, though due to their sheer numbers the SHG organisations also have about 28% of the sample portfolio. The mixed model MFIs account for 24% of the portfolio in India and individual banking for 11%.

Figure 2.4 Distribution of outstanding loans by microfinance model



Loans outstanding (million US$)

Model	India	Others	Sample
G	19.3	18.5	37.8
IB	5.3	8.5	13.8
M	12.8	17.3	30.1
SHG	14.4	0.3	14.7
	M-CRIL : Sample		**96.3**
		Top10	32.8
		India	51.8

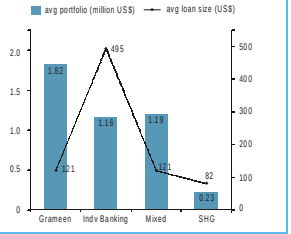
Figure 2.5 provides a better understanding of the average portfolio across MFI models. The figure confirms that SHG model MFIs in India have relatively small portfolios (average $219,000), less than half the country average ($ 477,000). The average portfolio for the SHG models is restricted by the low active client-member ratio as well as by their much smaller loan sizes since this is a savings led model. (Table 2.2)

Table 2.2 also shows that Grameen MFIs have the largest average portfolios of around US$1.5million (Rs7 crores) in India but there is a wide range in the actual portfolio size within this category. The largest organisations have portfolios in excess of US$10 million (around Rs45 crores), while the smaller ones have portfolios around US$140,000 (Rs63 lakhs). While the model has tremendous capacity to be scaled-up it is restricted by the small average loan size (~US$ 115 or Rs5,000 in India); the large portfolio being mainly due to the large number of active clients (Figure 2.3). This is typical of the model all over the world and is also reflected in the overall sample where the average portfolio is around US$1.8 million whereas the average loan size is US$121. Since some of the individual banking programmes are

Table 2.2 Average loan portfolios and loan size,US$

	Average portfolio, '000$			Average loan disbursed, $		
Model	India	Other	Sample	India	Other	Sample
G	1,511	2,878	1,817	115	128	121
IB	810	1,860	1,160	239	1,188	495
M	673	2,490	1,192	147	107	121
SHG	219	401	228	91	36	82
M-CRIL Sample	**477**	**1,953**	**745**	**115**	**129**	**139**
Top10			1,321			165
				Average loan outstanding, $		
Sample				**72**	**80**	**76**
Top10				101	73	92
MBB			**5,348**			**532**

Figure 2.5 Average loan portfolio & loan size



actually constituted as cooperative or rural banks with no specific microfinance mandate, their average loan sizes are significantly higher than those for the other categories on account either of a few large loans made to institutional clients or a mixed client base consisting of low and and not-so-low income clients as in the case of the BPRs in Indonesia and some of the cooperative institutions in India. Even so, the MBB average portfolio of $5.3 million is more than twice the M-CRIL Top 10 average and more than seven times the M-CRIL sample average.

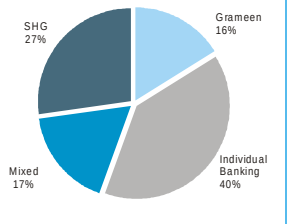
The $532 average outstanding loan size of the MFIs reporting internationally to the MBB is more than six times the $85 M-CRIL sample average.

2.1.3 Member savings

– are not always recorded by MFIs with SHG programmes; an appropriate regulatory framework could enable microfinance to be undertaken largely with client savings

The 110 MFIs covered in this analysis had raised a total of US$52.3 million in deposits at the time of their latest ratings. The 90 Indian MFIs in the sample had raised some $32.9 million (or Rs145 crores). These are the deposits accepted formally – and taken onto their balance sheets – by the sample MFIs from their members / clients.

Figure 2.6 Distribution of member savings



Member savings (million US$)

Model	India	Others	Sample
G	3.9	4.5	8.5
IB*	12.4	8.2	20.6
M	3.0	6.0	9.0
SHG	13.1	1.2	14.3
	M-CRIL : Sample		**52.3**
		Top10	8.0
		India	32.4

The level of member savings with MFIs is mainly a function of three factors

- implementation model (or strategy)
- location of the MFI
- age of the MFI

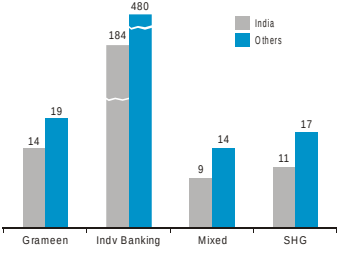
Implementation strategy: Figure 2.6 gives the distribution of aggregate deposits (member savings) across models for the sample MFIs. The high contribution of the SHG model – 27% (about 44% in the Indian sample) – is due to the intrinsic nature of the programme. Savings form the crux of empowerment and are collected to give members the experience of financial transactions as a means of experiencing self-governance.

This analysis understates the amount of savings actually mobilised by SHG MFIs since it does not include the amount that is retained by each self-help group for internal circulation. It is M-CRIL's estimate that the actual level of savings by members of SHG MFIs – both with the MFI and the SHG – is around three times the figure recorded in the MFI's accounts. This would increase the total savings of members of Indian MFIs in the sample to $80 million (Rs360 crores).

In India not all the MFIs are able to offer deposit services – particularly the organisations registered as non-banking finance companies (NBFCs) that are, regulated by the India's central bank, the Reserve Bank of India. Yet, the US$32.2 million (Rs145 crores) of savings formally mobilised by the MFIs in the country amount to about 58% of the total amount outstanding to loan clients.

As Figure 2.7 indicates, all the methodologies have a low average savings per member except for the individual banking model. Each of the bars reflects the methodologies and the legal framework in which the organisations operate. The SHG programmes, usually have voluntary deposit schemes in which the members themselves determine the amount of the recurring savings deposit. This often results in minimalist norms and leads to deposits that are far lower than the members' savings potential. However, savings form about 91% of the average SHG MFIs' portfolio, though this is mainly on account of the small portfolio of such MFIs.[1]

Figure 2.7 **Average savings per member by model, US$**



In the case of the Grameen organisations, on the other hand, the limited savings per member is due to the credit-led nature of the model. This leads Grameen MFIs to fix relatively small (5-20%) proportions of loan amounts as compulsory deposits by borrowers. For the mixed methodologies, low savings per member is mainly due to regulatory restrictions that do not allow non-banking finance companies (NBFCs), especially in India, to mobilise deposits. Interestingly, for the individual banking model, though the average savings per member is high (~US$184 in India, $480 outside) this is mainly on account of larger banking type institutions such as SEWA Bank in India and the BPRs in Indonesia. These organisations tend to have well-developed savings products and the collection of deposits is more a part of their business model than it is for other types of MFIs.

Average savings of $16.50 per MFI client in Asia are minuscule when compared with the average savings balance of $269 for the universe of MFIs reporting to the MBB. Even if the "outliers" – the large banking type MFIs in Asia are included in the M-CRIL calculation, average savings per member amount to no more than $45. Even the savings collected by the M-CRIL Top 10 amount to no more than $15 per member – just one-twentieth of the MBB average. This is, of course, also partly an indication of the low-income levels of Asian MFI clients in nominal dollar terms.

Member Savings by Location: By location, Figure 2.8, the savings of MFI clients in western India (~US$54) are the highest – mainly because of four large cooperative organisations that mobilise member deposits (without these the average falls to just $6). Given that south India

[1]Issues of deposit orientation of MFI models and their relationship with regulation and resource mobilisation are discussed in Section 4.

is the hub of microfinance in the country, the numbers there seem extremely low. This is the result of the predominance of Grameen organisations in south India. The difference between the averages for South and South-east Asia is partly a reflection of the differing income levels (and therefore savings capacities) of the average MFI client in each region but is also impacted by the more regulated – and therefore institutionally sustainable – nature of the rated MFIs in SEAsia.

Figure 2.8 Average savings per member by location, US$

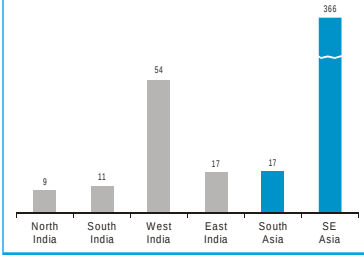
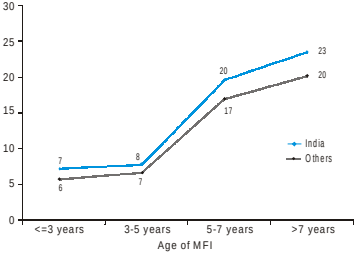


Figure 2.9 Average savings per member by age of MFI, US$



Analysis by Age of the MFI: Analysing average savings per member by the age of the MFI, Figure 2.9 shows that the deposits of members with MFIs do increase with the age of the organisation but the growth is more rapid with increasing client confidence after the MFI has reached a certain level of maturity, 5-7 years of age. Further growth of the MFI beyond this stage usually results in strategic choices that entail greater formalisation to regulated forms (such as NBFCs in India, development banks in Nepal, BPRs in Indonesia, rural banks in the Philippines) and a slowdown in deposit mobilisation during the transition phase.

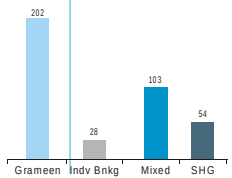
The figure here omits most of the data from a few of the regulated institutions in the sample at least partly because such data skews (and greatly inflates) the results for particular categories.

2.2 Staff Productivity

- Grameen and mixed programmes are the most efficient while the social orientation of SHG programmes results in low member-staff ratios

The 110 MFIs in the sample have a staff strength ranging from 3 to 906. The average number of staff within the sample is about 79 per organisation, which compares well with the MBB average of 95. Within the M-CRIL sample, the largest employer is SHARE Microfin Limited (SML). Overall, as Figure 2.10 shows, it is the Grameen organisations, such as SML in India and BURO Tangail in Bangladesh, that have large complements of staff with an overall average of over 202 but this is inevitable, given that they

Figure 2.10 Average staff in sample MFIs



Model	India	Others	Sample
G	195	212	202
IB	30	24	28
M	56	197	103
SHG	50	134	54
	M-CRIL: Sample		**79**
		Top10	231
		India	62
		MBB	**95**

are also the largest MFIs by number of clients. On the other hand, individual banking MFIs operate with an extremely low staff base. As microfinance in these organisations involves only financial transactions, the loan officers are not required to spend time organising and conducting client meetings. Lower client contact increases risk but, at the same time, also lowers cost. This is feasible partly because a number of the MFIs following this model operate mainly in urban areas.

For measuring the efficiency of human resource utilisation, staff productivity ratios – clients per member of staff and outstanding portfolio per member of staff – are the two key indicators. Productivity by models is depicted in Figures 2.11 & 2.12. While individual banking programmes are the most efficient in terms of average portfolio per staff member (~US$ 43,000), it is the mixed models in which the staff service the largest number of clients (~162) but for much smaller loans. This is because a number of mixed model MFIs work partly through SHGs or large joint liability groups that take over some of the functions of loan officers.

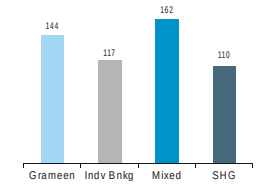
Grameen institutions also have reasonably high productivity in terms of loan clients per staff member. The lower client productivity of the individual banking MFIs results from the large difference between the number of loan clients and the number of members. While members of mixed model MFIs are serviced by federations or village banking institutions, savings services to non-borrowing members of individual banking organisations are provided directly by staff, thus reducing the number of loan clients they are able to work with.

The Asian average productivity of 135 clients per member of staff emerging from the M-CRIL sample is significantly better than the MBB average of 121 though the Indian average (of 123) is lower than the M-CRIL sample on account of the relatively low productivity of the SHG model – which requires intensive staff inputs in the initial years of developing the self-governance capabilities of client groups. On the other hand the 193 clients per staff member average of the M-CRIL Top10 is far better than the 132 of the fully sustainable MFIs in the MBB.

In terms of portfolio managed per member of staff, the M-CRIL averages are far lower than the $44,560 international average reported by the MBB but this is not surprising given the fact that Asian loan sizes are so much lower. Even the M-CRIL Top10 portfolio managed per member of staff ($16,823) is only 37% of the MBB average. The outreach and productivity differences discussed in this section inevitably raise questions about operating costs and the portfolio performance of the M-CRIL sample. These issues are discussed in the next section.

Staff productivity...

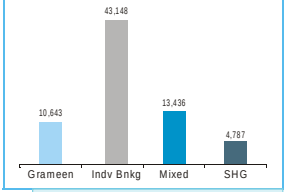
Figure 2.11 ...by clients served



Clients/member of staff

Model	India	Others	Sample
G	146	142	144
IB	120	108	117
M	142	176	162
SHG	104	155	110
		M-CRIL: Sample	**135**
		Top10	193
		India	123
		MBB	**121**

Figure 2.12 ...by quantum of loans serviced



Portfolio/member of staff (US$)

Model	India	Others	Sample
G	10,800	10,400	10,600
IB	24,400	88,800	43,100
M	14,500	12,800	13,400
SHG	5,000	3,600	4,800
		M-CRIL: Sample	**10,300**
		Top10	16,800
		India	8,900
		MBB	**44,560**

3 Operating efficiency & portfolio quality

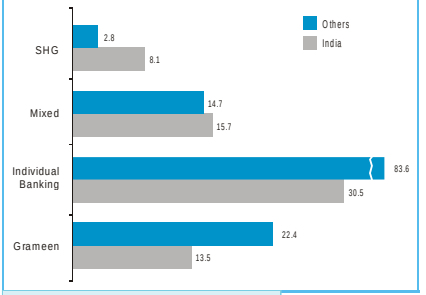
- Efficiency compares well with international best practice norms but quality is still weak

3.1 Operating efficiency

3.1.1 Cost per borrower

- Individual banking spending a lot more per borrower than the SHGs

Figure 3.1 **Cost per borrower (US$)**



Model	India	Others	Sample
G	13.5	22.4	17.2
IB	30.3	83.6	44.7
M	15.7	14.7	15.0
SHG	8.1	2.8	7.1
	M-CRIL: Sample		**14.4**
		Top10	14.7
		India	12.2
		MBB	**65.7**

Personnel expenses usually form the major component of an MFI's expenses since staff provide the main mode of delivery, collection and monitoring of financial services. Staff productivity is, therefore, a most important contributor to MFI efficiency affecting operating expenses and, thereby, cost per client. The average cost per borrower for the different MFI models is depicted in Figure 3.1.

The cost of delivering micro-loans in the region is of the order of US$14.40 – according to the M-CRIL sample average – with the Top10 delivering at a slightly higher $14.70 per borrower. This is just one-quarter of the international average of $66 for all reporting MFIs derived from the MBB. Amongst the MFIs, the SHG model is the most efficient, costing just $7 per loan client.

3.1.2 Operating expense ratio

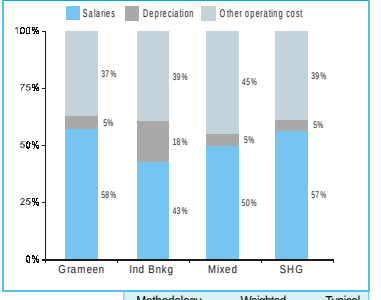
– typically high costs and the absence of cost based pricing results in inefficiencies and a gap between the yield and the OER

For the purpose of analysis, operating expenses include three main components – personnel expenses, other administrative expenses and depreciation – with the **operating expense ratio, measuring the total of these expenses as a proportion of average outstanding portfolio over a given period** (usually one year).

Despite the low cost per client of most MFIs in the region – relative to international costs – the operating expense ratio (OER) for nearly half the rated MFIs in the region is greater than 25%, (*see* Annex Table 3). In India, the average OER of the sample is just under 20% with Grameen MFIs recording a relatively high weighted average over 25% and the more formal individual banking MFIs just over 12%. These figures compare with 19.1% for the international MBB sample. The typical MFI column in the table with Figure 3.2 shows, however, that barring a few good MFIs, performance overall is disappointing and the typical MFI in the region is likely to have an operating expense ratio in excess of 36% with SHG MFIs even going up as high as 64%.

The 22.4% operating expense ratio for the M-CRIL Top10 is within the "best practice" range for microfinance where transaction costs relative to loan sizes are well known to be substantially higher than the 0.5-3.0% range reported by the commercial banking sector in the region. Indeed, the far lower expense ratios typical of the formal banks mean they are able to limit their interest rates on loans well below those of microfinance. This lower interest rate on far larger loans means it is either embarrassing – or simply illegal – for formal banks in South Asia to charge higher rates on small loans (to low income clients). Regrettably, the fact that this low interest rate invariably exceeds the high operating expense ratio on micro-loans also means that banks feel unable to provide financial services to the poor in South Asia – as in most parts of the world.

Figure 3.2 **Cost distribution & Operating expense ratio**



Methodology	Weighted average%	Typical MFI
G	25.2	33.4
IB	12.1	12.8
M	20.5	36.1
SHG	18.5	63.8
M-CRIL: Sample	**20.5**	**36.5**
Top10	22.4	
India	19.9	
MBB	**19.1**	

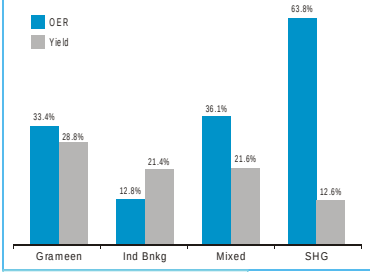
Looking at the three major components of operating expenses – indicated above – while SHG, Grameen and mixed models incur more than half their operating expenses on staff, individual banking programmes incur a lower 43%. This is because individual banking is focussed purely on the delivery of financial services to individual clients. It does not form groups and the time the staff member spends with the client is limited to transaction time. In Grameen and SHG programmes, by contrast, staff spends time forming and attending group meetings as well. This cost break-up in Figure 3.2 along with the low OERs and high cost per borrower for individual banking MFIs, partly, reinforces the well known feature of financial service delivery that average delivery cost has a strong inverse relationship with loan size. IB organisations have large loan sizes and are, therefore, able to allocate more expenses to infrastructure and facilities – resulting in higher depreciation as a proportion of total costs than for the other models – while still delivering credit at a lower cost. It is also an inevitable result of the fact that in the IB organisations generally the client comes to the MFI, translating into a high transaction cost for the client, whereas for most MFIs the staff visit the client resulting in higher operating expenses for the MFIs.

The Grameen organisations tend to have the lowest proportionate expenditure on administration (37%) as their standardised recording systems reduce paperwork, and well-defined servicing strategies reduce travel costs. Staff productivity is a focus for Grameen MFIs – as discussed in Section 2. SHGs usually control their administrative costs (39%) by encouraging groups to maintain individual records while limiting their staff to the maintenance of group level transactions.

Besides looking at the contribution of various components to an MFI's operating expenses it is also instructive to compare OER – the cost incurred on lending money – with the yield (interest income earned from the portfolio outstanding for a given period) to ascertain the margin earned – albeit before accounting for the cost of funds. Figures 3.3 and 3.4 compare the

Typical operating expenses in relation to portfolio yield...

Table 3.3 **...by model**

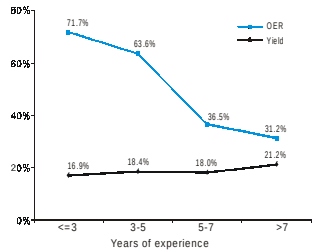


Model	OER (%)	Yield (%)
G	33.4	28.8
IB	12.8	21.4
M	36.1	21.6
SHG	63.8	12.6
M-CRIL:		
Sample	**36.5**	**21.1**
Top10	22.4	33.5
India	38.0	18.7
MBB	**19.1**	**33.6**

OER to the portfolio yield across the various types and ages of MFIs.

In order to neutralise for the dominance of a few well run, large MFIs, the information in the above figures relies on *typical MFI* (simple averages of individual MFI ratios) rather than on weighted averages. It is interesting to note in the figure that only the individual banking MFIs – with a typical yield in excess of 21% are able to recover their operating expenses from earnings on their portfolios. Most Grameen MFIs incur high operating expenses till they reach maturity. However, due to competition and regulation, it is often not possible for them to undertake cost-based pricing. The SHG organisations tend to have the greatest difference between expenses and income largely due to their social work orientation, unrealistically low interest rates and inefficient operations. A possible reason for the gap in the mixed models is that these are experimental or unique methodologies. The absence of any standard modules for them means that they need to incur costs on adapting delivery mechanisms, developing management systems and, possibly even, conducting market assessments in order to serve their clients better. All of these would result in higher costs. However, as these models scale up a significant improvement in the OER could be expected. It is apparent that, as an MFI-type, individual banking institution is likely to be the most attractive to commercial investors.

Table 3.4 **...by age**



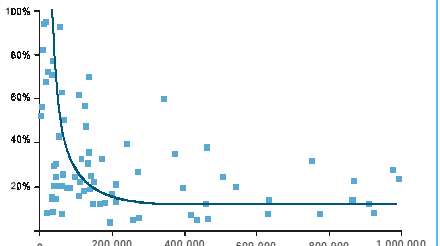
Age (years)	OER (%)	Yield (%)
< 3	71.7	16.9
3-5	63.6	18.4
5-7	36.5	18.0
> 7	31.2	21.2

The trend in OER and yield by age, Figure 3.4, shows that relatively new institutions have a low average yield (16.9%) and a very high OER (71.7%) so they record huge deficits in their operations. Since these MFIs are new, staff productivity is low and they must put significant effort into mobilising and educating clients. At the same time, loan sizes are small relative to the expenses incurred.Gradually the OER improves as MFIs reach economies of scale and the yield improves as collection strategies and cash management systems develop. As the figure shows, the decline in the OER is much faster than the improvement in yield. This is, of course, due to the fact that while the MFI has significant control over expenses, its ability to price loans is affected by external factors such as regulation and even, sometimes, competition.

Since economies of scale are generally expected in any economic activity, the relationship between the operating expense ratio and portfolio size of individual MFIs has been investigated

in Figure 3.5. Though the correlation is not perfect, an inverse relationship between portfolio size and operating expense ratio emerges from the sample information. However, the inverse correlation is stronger for growth on very small outstanding portfolios – up to around $150,000 in South Asia when the OER is around 18-20% – after which it stabilises. It goes down further to a range of 7-15% as the portfolio reaches around US$1million. However, this also depends on the methodology adopted by the organisation.

Figure 3.5 **Relationship of portfolio size to efficiency**



3.2 Portfolio quality

– Grameen programmes are the best performers

While efficiency is important, it would be counter-productive if it were at the cost of portfolio quality. Database analysis indicates that the Grameen organisations in the region are the best performers with an average portfolio at risk (PAR_{60}) of just 2.6% (Figure 3.6) and 12 of the 28 MFIs with PAR_{60} less than 3%. However, this good portfolio quality is often maintained at a high cost (typical OER is 33.4%) and a lower than optimum staff productivity.

Figure 3.7 presents a cross-sectional analysis of the trend in PAR with growth in portfolio size. While methodology is also an important factor, the data confirms the expectation that it is the organisations that are able to control their portfolio qualities that also have the competence to grow. However, for medium sized organisations mis-matches between control systems and growth can affect portfolio quality. Portfolio sizes of $500,000 (Rs2.3 crores) and above are only achieved by organisations that have the ability to develop appropriate systems and keep portfolio quality under control.

The M-CRIL Top10 average of 4.2% PAR_{60} is relatively poor compared with the MBB average PAR_{90} of 1.5%. The M-CRIL sample average of 11.2% is, of

Portfolio at risk (>60 days)

Figure 3.6 ...by model

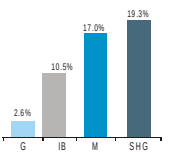
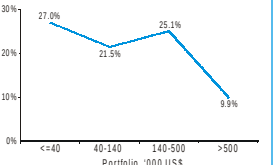


Figure 3.7 ...by portfolio size

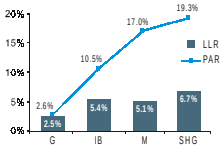


Model	Weighted average					Typical MFI
	Portfolio, '000 US$					
	<=40	40-140	140–500	>500	Total	
G	0.9		6.8	2.6	2.6	4.2
IB	20.0	15.0	40.6	7.9	10.5	21.7
M	0.0	4.3	35.4	16.3	17.0	17.0
SHG	31.8	25.0	17.6	18.5	19.3	27.7
				M-CRIL: Sample	**11.2**	**17.6**
				Top10	4.2	2.8
				India	12.3	19.8
				MBB (>90 days)	2.1	

course, worse and emphasises the impression that MFIs in the region do not pay enough attention to portfolio quality. Typically, most organisations have a PAR_{60} of around 18-19%.

In spite of their high PAR ratios, relatively few MFIs in the M-CRIL sample have a policy of providing for loan losses. As a result, M-CRIL's rating teams have to make adjustments in existing balance sheets in order to determine appropriate loan loss reserves for them.

Figure 3.8 **Loan loss reserve ratios**



Model	Weighted average%	Typical MFI
G	2.5	5.2
IB	5.4	16.6
M	5.1	6.3
SHG	6.7	9.9
M-CRIL: Sample	**4.5**	**9.5**
Top10	1.6	1.8
India	4.8	10.7

Loan loss reserve ratios, therefore, need to be examined in conjunction with their delinquency or PAR. Figure 3.8, shows that Grameen organisations have average reserve rates of (2.5%) almost equal to their PAR_{60} (2.6%). While Grameen MFIs generally have a low PAR_{60}, they continue to make annual provisions as a proportion (often 2%) of total portfolio *a la* Grameen Bank – as a matter of prudence. The gap between the two ratios widens in the other methodologies. As a rule of thumb, the loan loss reserve rate should be about 50% of the PAR_{60}. However, the thumb can be flexed according to the history of recovery of overdues, substitute collateral and any other measures that reduce the risk. As most organisations do not make reserves themselves, the rating team keeps these factors in mind while undertaking the task for them.

Part of the reason for high PAR and low loan loss reserve ratios is the reluctance of MFIs in the region to write off unrecoverable loans for fear that clients / members will get the impression that loans remaining unpaid for extended periods of time would simply not be followed up by the organisation. Their concern – not entirely unjustified – is that both field staff and members would regard written off loans as a dole and that this perception would lead to their portfolio quality deteriorating further as more clients would stop repaying loans in the hope that these too would be written off. As a result, MFIs with relatively poor portfolio quality allow their PAR ratios to increase without making any attempt to obtain a realistic picture of their asset profile. This confuses the impression given by their balance sheets, which – as indicated above – often do not even include loan loss reserves and, inevitably, affects the quality of management decision making.

Given the high PAR_{60} in the region, it would not be surprising if most organisations had a reserve rate of about 6-9% while the Top10 could do with just 1-2%. The overall weak portfolio quality and the lack of initiative to provision adequately for delinquency places a number of MFIs in the high risk category. Recognising this, M-CRIL has incorporated in its rating instrument minimum levels of PAR_{60} for rated MFIs to qualify for various grades in its rating system. Thus, for instance, no MFI with a PAR_{60} greater than 12% can be awarded the Alpha grade by M-CRIL.[1]

The following section examines the management of MFI finances – sources of funds and the efficacy of fund utilization for MFIs providing financial services to low income clients.

[1] See **Annex** to **Section 6** for the minimum performance levels required by M-CRIL for the award of the higher grades.

4 Portfolio Financing

- MFIs are increasingly treating debt and savings as the main sources of funds
Equity investment is constrained by image and regulation

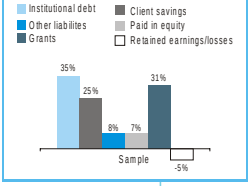
4.1 Sources of Funds for Microfinance

– growing contribution from debt and savings

The distribution of the sources of funds for microfinance is presented in Figure 4.1. This figure is based on a consolidation of information for the sample of 110 MFIs used for this report. As the figure shows, net worth accounts for 33% (around $48 million) of the total liabilities of around $147 million for the sample. The total liabilities and net worth of the 90 Indian MFIs in the sample amount to $83 million (Rs375 crores) with a net worth of $25 million (Rs114 crores).

The aggregate net worth of the sample MFIs is reduced by losses. The actual amount of grant and equity funding that has taken place is approximately $56 million. This indicates an erosion of the net worth by about 14% ($7.8 million). Only 19% of the total net worth is paid-in equity while the rest are donor grants (grants for on-lending and for fixed assets). Microfinance in the region shows a continuing dependence on donors indicated by 31% of grants in MFIs' sources of funds. Though it is significantly lower than the 39% reported three years ago by The M-CRIL Report 2000.

Figure 4.1 **Sources of funds**



Since 80 out of the 110 MFIs in the present sample consist of registered societies or trusts, it is not surprising that, of the overall sources of funds, only 7% is accounted for by paid-in equity. This number is, however, expected to increase, particularly in India, as a number of MFIs are now converting to equity funded Non-Bank Finance Companies (NBFCs).

Loans – mainly soft loans – of usually 3-5 year terms account for another 35% of the funds raised by MFIs for their activities. Such loans come from

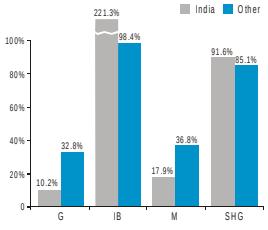
- Development financing agencies – Rashtriya Mahila Kosh (RMK) in India, PCFC in the Philippines, PNM in Indonesia, PKSF in Bangladesh, Rural Microfinance Development Centre (RMDC) in Nepal
- Development banks – SIDBI and NABARD in India
- Commercial banks - the Sonali Bank in Bangladesh, Bank Mandiri in Indonesia and ICICI Bank in India.
- International funding institutions - Blue Orchard Finance and HIVOS.

In the region, contribution to the debt funding from the international funding institutions is generally restricted by the limitations of the legal framework which prohibits MFIs from raising foreign loans – particularly in South Asia (including India).

As pointed out in Section 2, deposit mobilisation by MFIs is also limited by regulatory restrictions in the region – for organisations not registered specifically as financial institutions

by the central bank in the country of operation. Yet, some 25% of the funds deployed in microfinance by sample MFIs could be described as client funds. These consist of both withdrawable and non-withdrawable savings and emergency funds accumulated to cover loan losses that could result from natural or other disasters that might hit MFI clients.

Figure 4.2 **Savings portfolio ratios (%)**

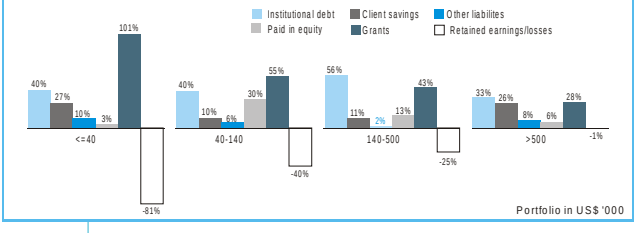


Model	India	Others	Sample
G	10.2	32.8	19.7
IB	221.3	98.4	147.7
M	17.9	17.9	28.8
SHG	91.6	91.6	91.0
	M-CRIL: Sample		**54.6**
		Top10	23.7
		India	58.1

The information in Figure 4.2 also provides an indication of the savings orientation of the various microfinance models. The very high deposit orientation of the IB model is on account of the formal banking or cooperative mode of many of the MFIs – which can legally raise deposits. The sample average of 91% for the SHG model reflects the savings-led nature of this methodology. On the other hand, a 10% savings-portfolio ratio for Indian Grameen MFIs shows their adherence to credit-led Grameen orthodoxy relative to Grameens elsewhere. However, recent trends indicate that this attachment to orthodoxy is changing in India also and the savings orientation of Grameen MFIs is increasing significantly. The very high savings orientation of the cooperative MFIs not only demonstrates the potential for providing saving services to low income clients, but also shows that, if an appropriate regulatory framework were in place, microfinance could be undertaken to a large extent with resources raised from MFI clients.

The pattern of funding sources also varies with the size of the portfolio and, therefore, perhaps with the age of the MFI as well. Figure 4.3 shows that as MFIs grow, they capitalise on economies of scale and reduce their losses significantly. at the time of the rating visit, 17 of the 36 MFIs with a portfolio of >$500,000 had recovered cumulative losses while 21 of the 36 were earning current profits.

Figure 4.3 **Funding pattern by portfolio size (%)**



Interestingly, as the Figure 4.3 shows, the high grant orientation of small MFIs is used mainly to cover their losses. It is apparent that even such MFIs have to rely significantly on borrowing and client savings to finance their portfolios. The lower (28%) grant orientation of the largest MFIs indicates greater sustainability rather than any substantial difference in financing via debt and deposits. The larger organisations also have a component of paid-in equity – unlike the smallest MFIs – but it is only a few

NBFCs and co-operatives that have such equity as part of their net worth.

Portfolio ('000 US$)	Institutional debt	Client Savings	Other liabilities	Paid in equity	Grants for operations	Fixed asset grants	Retained losses/ earnings
<=40	40.2	26.9	9.8	3.5	86.7	14.0	-81.1
40-140	39.5	9.3	5.7	30.3	50.5	4.1	-40.4
140-500	56.2	10.7	2.4	13.5	38.1	4.6	-25.5
>500	33.0	26.5	8.1	5.9	27.1	0.6	-1.0
M-CRIL: sample	35.1	24.6	7.6	7.4	29.5	1.2	-5.3
Top 10	32.8	31.0	2.9	13.7	11.6	0.9	7.0
India	34.4	24.8	7.7	7.2	28.8	1.2	-4.2

M-CRIL's experience shows that the importance of donor funds is declining. MFI management are increasingly becoming aware of the need to obtain more resources from both the members / clients and the various types of institutional lenders. Since most MFIs in the region still do not see themselves as commercially viable entities their preference is to obtain resources from development loan funds on 'soft' terms. This is not an unrealistic expectation. Organisations such as the RMK and various statutory development corporations in India, RMDC in Nepal and PKSF in Bangladesh continue to have substantial resources in relation to present demand.

Figure 4.4 **Funding pattern by form of MFI registration**

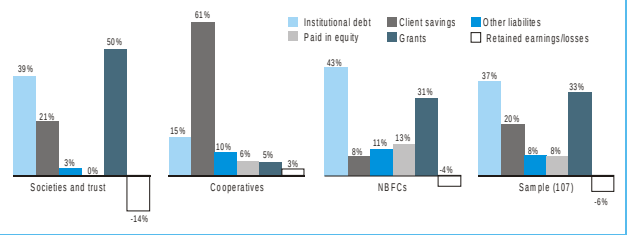


Figure 4.4 depicts the funding pattern of MFIs classified by the form of legal registration. It shows the extent to which legal recognition of deposit taking makes a difference to the fund mobilisation of MFIs. The 12 cooperatives MFIs in the sample generate over 60% of their funds from member savings while deposits in NBFCs account for only 8% of their total funds. NBFCs have to fulfil stringent regulatory requirements before they are allowed to raise deposits. Therefore they rely mainly on cash security as funding from clients.

It is also interesting to note here that the 80 societies and trusts together have accumulated losses equivalent to 14% of total funds while cooperatives have accumulated profits and NBFCs have relatively limited losses. It is apparent here that relative to NBFCs and cooperatives, the societies and trusts have a higher development orientation rather than a commercial orientation.

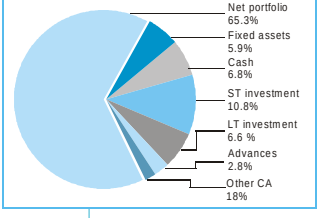
On analysing the 90 Indian organisations by form of legal registration, this orientation becomes even more apparent. Societies and trusts have registered cumulative losses equivalent to 27% of total funds while both cooperatives and NBFCs have at least a small amount of accumulated profits.

4.2 Uses of funds

– sub-optimal deployment of funds in loan portfolio
– a few large MFIs face problems of capital adequacy

Of the total resources of $147 million deployed in microfinance by the sample MFIs, $96 million is invested in loans to clients. The 90 Indian MFIs in the sample have a combined loan portfolio of $52 million (Rs234 crores) out of total assets of $83 million (Rs375 crores). Since 4.5% of the total portfolio has had to be allocated to loan loss reserves, the net loans outstanding for the sample as a whole amount to $93 million. Thus, as Figure 4.5 shows, the productive base accounts for 65% of the resources mobilised (62% for India). Over 17% of resources are held in the form of non-portfolio investments and about 6.8% as cash.

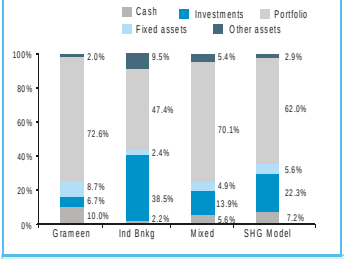
Figure 4.5 **Utilisation of funds (%)**



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

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

Figure 4.6 **Asset allocation (%)**



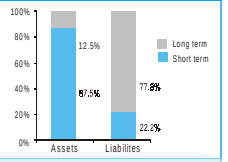
As shown in Figure 4.6, in terms of asset allocation, the individual banking MFIs maintain the lowest cash limits (2.2%) and proportion of funds deployed in fixed assets (2.4%). The liquid cash with these MFIs is in fact much lower than the 7% maintained by the Top10 MFIs. The Grameen organisations maintain the highest cash and fixed asset balances – around 10% and 9% respectively– but at the same time allocate the highest proportion of funds to their portfolio (73%). This is, once again, due to well-established norms, in this case, of cash management. The proportion of funds placed in investments tends to be the highest for individual banking organisations. They also deploy the lowest proportion of resources in loans to clients.

Model	Cash	Invest-ments	Fixed assets	Net Portfolio	Other assets
G	10.0	6.7	8.7	72.6	2.0
IB	2.2	38.5	2.4	47.4	9.5
M	5.6	13.9	4.9	70.1	5.4
SHG	7.2	22.3	5.6	62.0	2.9
M-CRIL: sample	6.8	17.4	5.9	65.3	4.6
Top 10	7.0	9.0	4.4	77.3	2.3
India	5.6	23.5	5.0	62.1	3.8

Overall there is clearly a need to improve the utilisation of assets in MFIs. At present there are only 37 MFIs out of 110 that have 80% or more of their assets deployed in the loan portfolio. Another aspect of good financial management that is often ignored by MFIs is that of asset-liability matching. An analysis of the sample indicates the huge difference between the long term and short term sources and uses of funds. Figure 4.7 depicts this

matching for the overall sample. Most MFIs aim to mobilize long term sources of funds such as long-term loans (repayable in 3-5 years), locked member savings and grants in order to finance their portfolios. On the other hand, the loans they extend are, in Asia, usually for a period of one year, sometimes less, thus becoming short-term assets. As in Figure 4.7 for the sample, this translates into short term assets which account for 88% of the total while 78% of the liabilities are long-term. This is one area in which traditional MFI fund management is actually highly appropriate to their financing structure and has, indeed, contributed to the stability of microfinance in the region. Out of the sample of 110 MFIs, only a handful (mainly in Indonesia) have an asset-liability structure that presents, a priori, a cause for concern.

Figure 4.7 **Asset-liability matching**



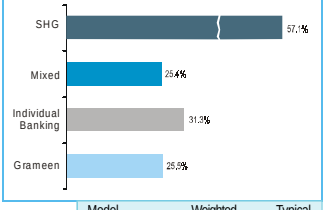
	Assets	Liabilities	
M-CRIL: Sample	87.5	22.2	ST*
	12.5	77.8	LT#
Top10	93.6	16.5	ST*
	6.4	83.5	LT#

*Short Term # Long Term

For ensuring prudential management, banks in the region are expected to maintain capital adequacy ratios (CAR - net worth as a proportion of risk weighted assets) of 8-12%. The relative lack of financial management experience of MFI managers, however, means that, for microfinance, a minimum 20% ratio is generally regarded as more appropriate. Figure 4.8 provides information on the status of the prudential management of sample MFIs.

The aggregate figures suggest that capital adequacy is not a major issue since ratios for MFIs are largely in excess of the 20% level with the typical CAR averaging as much as 33% (Top10: 37.0%). It is mainly some of the larger MFIs in the region and heavy loss making MFIs that face a problem in this respect. In moving to the more commercial structure of an NBFC or development bank, large institutions have to deal with the less evolved equity market for investments in microfinance. Essentially, even social or ethical investors continue to regard loans to poor as inherently risky and are, therefore, unwilling to make equity investments in MFIs. Overall, some 40% of the MFIs in the sample (47) have CARs less than the 20% level – Annex Table 4 – and 14 have negative net worth meaning that their current losses are actually eating into their borrowed funds.

Figure 4.8 **Capital adequacy ratios of sample MFIs**



Model	Weighted CAR (%)	Typical MFI
G	38.7	25.5
IB	15.1	31.3
M	38.4	25.4
SHG	58.3	57.1
M-CRIL: Sample	**36.7**	**33.1**
Top10	35.0	37.1
India	33.1	31.1

Examining the model-wise performance on capital adequacy more closely in terms of cash management, for instance, as Figure 4.6 indicates, one of the reasons why Grameen organizations may have a relatively high CAR may be because they also have higher cash balances and fixed assets – 10% and 8% respectively in the sample – and, therefore, lower risk assets. Similarly, for the SHG organizations, a relatively low portfolio and high investments, on the one hand, and a substantial quantum of grants, on the other, appear to be the reason for a high CAR. In the long run, for an MFI to be sustainable, grants should ideally be replaced by internally accrued profits and equity investments. While there has been some progress in this direction, overall microfinance in the region is still far from maintaining reasonable capital adequacy without grants. In this context, the next section undertakes a closer examination of the sector's profitability and sustainability.

5 Financial Performance

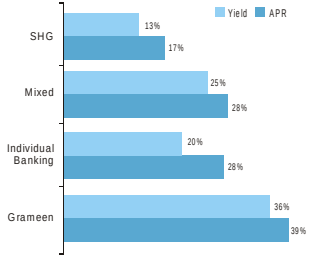
– is creditable within the constraints of the operating environment

5.1 Portfolio income

– the yield gap is still high but the better performers show the way

The income earned by an organisation's major asset – in the case of MFIs the outstanding portfolio – should be its main means of attaining viability. An analysis of the sample indicates that portfolio yields are an average of 35.6% for Grameen MFIs down to just 13.0% for SHG-based MFIs (Figure 5.1). Across the sample the range varies from as high as 50.1% to as low as 0.9%. The data also indicates that the yields obtained by MFIs in the region (25.9%) are well below the international average of 39.8% reported in the MBB. Even the M-CRIL Top10 only achieve an average yield of 33.5%.

Figure 5.1 Portfolio yield relative to APR



The yields achieved are significantly different from the annual percentage rates (APRs) charged by MFIs in the region. The APR is the highest income or yield that an organisation can earn from its portfolio based on the terms of its loans. The APR depends on the interest, fees and other charges, the loan term and the frequency of repayment. A comparison of the APR and yield for the various microfinance models in the sample is presented in Figure 5.1. The adjoining table records the yield to APR ratio across models.

Model	Yield (%)	APR (%)	Yield/APR (%)
G	35.6	38.8	91.9
IB	20.4	27.7	73.6
M	24.8	28.4	87.6
SHG	13.0	17.4	74.6
M-CRIL			
Sample	**25.9**	**30.1**	**86.1**
Top10	33.5	36.8	91.1
India	22.2	24.3	91.3
MBB	**33.6**		

The APR-yield mismatch in the figure is partly a reflection of relatively poor portfolio management. The Grameen MFIs are the most effective in realising their APRs from their portfolios – the yield-APR ratio being nearly 92%. Grameen's relatively rigid loan terms and high focus of the rated Grameen MFIs on collection of repayments ensures the maximisation of portfolio productivity. On the other hand, both individual banking and SHG MFIs realise less than 75% of their planned interest income. This is both because of relatively poor portfolio quality, and ineffective / irregular collection systems of a number of MFIs following these two models.[1]

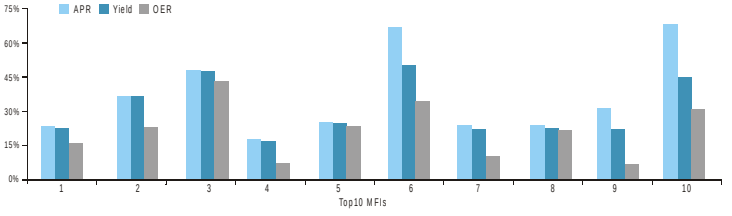
The M-CRIL Top10 has a good yield to APR ratio of 91.1%. Figure 5.2 compares the APR and yield of these ten top performers to provide a better idea of the reasons for the yield gap. It also relates these income ratios to the Operating Expense Ratio.

The difference between the yield and the APR is the greatest for two MFIs in South-east Asia with APRs of more than 65% while in the same sample the highest APR for the Indian organisations is no more than 32% – a huge difference. The nominal interest rate in India is

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

kept low sometimes formally by financial institutions and donors and informally by the market. In any case, it is not possible for MFIs to lend at 60% in most of the country, as the local moneylender is likely to be lending at a similar rate, defeating the basic objective of microfinance.

Figure 5.2 **Yield, APR and OER for the Top 10**



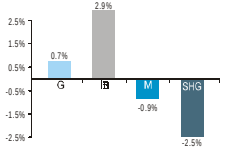
Another interesting aspect of Figure 5.2 is that the yield gap is more or less the same for all organisations except when the APR reaches very high levels – the bars are almost the same height for all MFIs except for the two extremely high APRs and MFI9 (which had a pre-payment problem at the time of the rating). This relates to the question of the need for setting high interest rates: most practitioners would argue that a sustainable interest rate is required – one that covers cost rather than a high rate per se. For most of the Top10 MFIs, the figure also shows that the OER is much lower than the yield. This is, of course, important as the interest charged should cover all the costs of MFI operations, though it is apparent that the argument of sustainability should not become an excuse for passing on the costs of inefficiency to the low income families that are the clients of MFIs.

5.2 Returns to microfinance

– in a disappointing scenario the mature Grameen and newer Individual Banking MFIs provide some hope

The lack of commercial viability of microfinance institutions in the region becomes clear in considering the returns they earn net of all costs – operating and financial. Figure 5.3 provides a fair indication of the situation. The management performance of SHG programmes has been shown, throughout this study to be quite poor. Across the sample, the mixed model MFIs and the SHG-based organisations register overall losses. As the information for *typical* MFIs indicates here, there are a large number of loss making organisations and relatively few, if large, viable ones. The disaggregated information in ***Annex Table 4*** shows that only 27 MFIs in the M-CRIL sample are making profits and just five of these have returns greater than 5% of their total assets. Essentially, it is only the mature Grameen, the formally constituted individual banking

Figure 5.3 **Return on total assets of MFIs**



Model	Weighted ROA (%)	Typical MFI (%)
G	0.7	-16.2
IB	2.9	-2.5
M	-0.9	-12.1
SHG	-2.5	-27.6
M-CRIL: Sample	**-0.2**	**-15.8**
Top10	2.1	2.26
India	-1.5	-13.6
MBB	**0.1**	**FSS=5.7**

programmes and a couple of large mixed model MFIs that have achieved commercial viability so far.

As we know, the Return on Assets (RoA) is a reflection of a number of parameters including well allocated assets – Grameen organisations invest more of their funds in the portfolio (Section 4) and earn a higher yield (Figure 5.1). Though they tend to have higher operating costs, a comparison with their yield indicates (Figure 3.3) that the difference between the two is relatively small. All these factors contribute to the relatively better profitability performance of the Grameen MFIs.

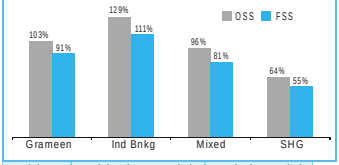
The Top10 average of 2.1% RoA indicates the ground that MFIs in the region still have to cover in comparison with the MBB average adjusted return on assets of 5.7% for fully sustainable institutions. For the sample, the average of –0.2% RoA is not substantially worse than the (July 2003) MBB average of 0.1% but MFIs *typically* losing around 16% of their assets on an annual basis is somewhat disappointing.

5.3 Dependence on subsidies

– much greater than the international average with SHG MFIs performing poorly

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

Figure 5.4 **Sustainability performance by model**



Model	Weighted average (%)		Typical MFI (%)	
	OSS	FSS	OSS	FSS
G	103	91	85	76
IB	130	111	110	98
M	96	81	73	63
SHG	64	55	48	42
M-CRIL Sample	**99**	**85**	**79**	**70**
Top10	109	129	97	96
India	88	77	74	61
MBB	**115**	**104**		

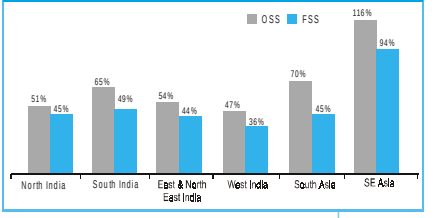
As expected from the above discussion, Figure 5.4 shows that the Grameen and the individual banking models as a group are operationally self-sufficient – with the mixed model MFIs coming a close third. Though the weighted average OSS does represent the trend that the sustainability ratios are taking, the *typical* MFI figures are representative of the current status of most of the MFIs in the sample. Typically, individual banking organisations are operationally sustainable mainly because of their low OERs. Though the Grameen MFIs as a group are sustainable, for the typical Grameen organisation in the sample, OSS is likely to be around 85%.

The poor performance of the SHG model continues with MFIs covering only about 64% of their costs from operating incomes. The rest is covered by grants for operations and cross-subsidies from other activities undertaken by such organisations. Typical, SHG MFIs have even lower operational self-sufficiency as is indicated by the sample average of 48%.

The effect of the subsidies received by the organisation is reflected in the FSS which, in all cases, is lower than the OSS. The ratio for the SHG model continues to be alarming, the 42% simple average indicating that without grants and subsidised funds, the organisations are effectively able to cover only less than half their costs. Unfortunately, this is still an optimistic picture since many SHG MFIs are multi-service organisations for which it is extremely difficult to separate the cost of financial services from their other activities.

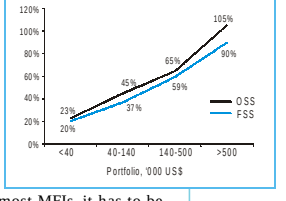
Figure 5.5 presents the regional variation in the sustainability of MFIs. For all practical purposes, this figure presents a good picture of the relative performance of MFIs within India by region. Thus, it is well known that a number of MFIs in south India are relatively close to operational sustainability but those elsewhere are quite far from it. As discussed elsewhere in this report the performance of MFIs in North and East India is affected by the relatively unsatisfactory organisational culture in those regions. The picture for south Asia as well as south-east Asia is biased by the 'natural' selection of only the best MFIs for rating and is not, therefore, strictly comparable with the regional picture for India.

Figure 5.5 Sustainability performance by region



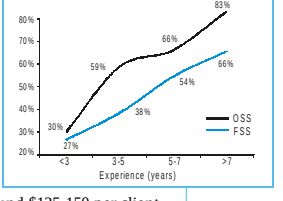
Comparing the trend of OSS and FSS across portfolio size – Figure 5.6 – predictably shows that, as portfolio size increases, MFIs become more capable of covering their costs through revenues and their dependence on grants and other subsidies tends to decrease. This was discussed in Section 4 (Figure 4.3) which highlighted the changing sources of funds with the size of the portfolio. Similarly there is the (expected) positive correlation between sustainability and the age of the MFI (Figure 5.7).

Figure 5.6 Sustainability and portfolio size



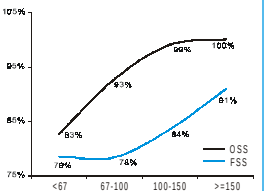
At the same time, in the context of the developmental mission of most MFIs, it has to be recognised that there is an inherent contradiction between the small size of loans generally appropriate for the poorest client groups and the achievement of sustainability at relatively low interest rates. It has been emphasized elsewhere in this report that staff productivity is one of the most important contributors to MFI sustainability and the smaller the loan size, the more difficult it is to achieve sustainability. Economies of scale in relation to loan size are an important reason why the commercial banking system is unable and unwilling to provide microfinance services at its normal rates of interest. Yet it is apparent from the cross-sectional analysis in Figure 5.8 that there are such economies even in the provision of microfinance services and (at least in south Asia) it is the MFIs with average loan disbursements of around $125-150 per client

Figure 5.7 Sustainability and age of MFI



that are able to achieve sustainability. MFIs with smaller loans may be reaching poorer clients but they have generally been unable to achieve sustainability – at the 18-24% APRs typically charged by such MFIs.

Figure 5.8 **Sustainability and loan size**



It is apparent that the financial performance of MFIs in the region is somewhat behind some of the better international MFIs which report to the MicroBanking Bulletin. But, the performance of much of South Asian microfinance (if not South-East Asian) is constrained by political and social if not legal restrictions on setting interest rates. Yet, the M-CRIL sample as a whole has been able to limit its negative return on assets to –0.2% (Figure 5.3) on a yield of just 25.9% (Figure 5.1) compared to the MBB sample average return on assets of 0.1% on a yield of 39.8%. In this context, the overall performance of the microfinance sector actually appears to be quite creditable.

Table 5.1 **Outreach of efficient microfinance institutions**

OSS	Sample		India	
	Clients,%	Borrowers,%	Clients,%	Borrowers,%
>100%	38	55	33	50
90-100%	13	12	18	20
80-90%	12	12	3	7
<80%	37	21	46	23
Total	100	100	100	100

Indeed, the impression of a creditable performance is reinforced by the information in Table 5.1 which shows that 51% of client members and some 67% of borrowers of M-CRIL's sample MFIs are served by institutions with OSS in excess of 90%. For India taken separately, the figures are equally good. It is apparent that the outreach of MFIs functioning effciently is becoming quite substantial in relation to the sector as a whole; a matter for celebration in the context of the avilability of microfinance services to low-income families. By the same token, the coverage of over 20% of borrowers and around 40% of clients by inefficient MFIs is a sobering aspect of the performance of the sector as a whole.

The following section uses information from rating updates to examine trends in the performance of the M-CRIL sample.

6 The changing face of Asian microfinance

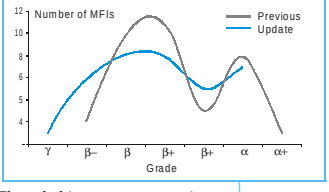
– a distinctly positive trend in the performance of microfinance in the region

Until June 2003, 37 organisations had undergone rating updates with 8 of these being updated twice and one updated three times over the past five years (Table 1.1). M-CRIL's revenue model for MFI ratings does not incorporate automatic updates; rather rating clients commission updates based on their needs. The table below presents the distribution of the 35 MFIs with rating updates (that were included in the M-CRIL sample) across microfinance methodologies.

Model	Number of MFIs with rating updates
G	8
IB	4
M	6
SHG	17
Total	**35**

Generally, rating updates take place after between one and two years of the previous rating. Not surprisingly, it is some of the best MFIs in the M-CRIL sample that have requested – usually at the initiative of their funders but also, in a few cases, on their own – second (and even third) assessments. This section analyses trends in the performance of the M-CRIL sample based on a comparison of the latest rating information with that of the previous rating for all except one of the MFIs with rating updates.[1] Since the time between rating updates is usually 1-3 years (average for the sample, 21 months), all growth rates have been annualised.

Figure 6.1 **Change in the distribution of rating grades**



An analysis of the distribution of grades (Figure 6.1) between the previous (usually the first) ratings and their updates shows a shift in the curve, but not for the better. This is partly because M-CRIL's concern to keep up with the dynamics of the microfinance sector, has resulted in a strengthening of its rating tool and the introduction of minimum performance level on critical indicators for achieving particular grades. [These conditions are listed in Annex 6.1 at the end of this section]. The stricter conditions applied in the update ratings have resulted in a downgrade for a number of rated MFIs *often despite an improvement in some of their performance indicators.* Though this presents a negative first impression, the detailed analysis of the trends in performance ratios in this section shows the significant extent to which there has actually been an improvement in the performance of the updated MFIs suggesting a positive overall trend in the quality of microfinance practice in the region.

6.1 Outreach

– significant growth as larger numbers of low income clients are served

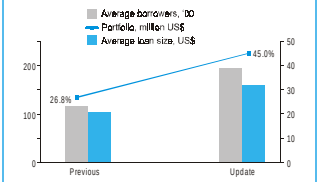
As is the trend all over the world, the 35 MFIs in this sample have grown rapidly in terms of outreach – both in the number of borrowers and of clients.[2] The number of borrowers has increased more rapidly (33.9% annually) than clients (15.7% per annum) resulting in a significant increase in the aggregate borrower-to-client ratio from 49% to 63% (Figure 6.2).

[1] Again, FWWB, an apex institution has been excluded to avoid double counting of portfolios and clients.
[2] Reminder: Borrowers are those with outstanding loans; clients are those who participate in the programme in any way – saving with the MFI or MFI-formed group or even attending group meetings regularly.

Figure 6.2 Growth of borrowers and Clients

Rating	Borrowers	Clients
First	405,000	824,000
Update	675,000	1,068,000

Figure 6.3 Growth of loan size and portfolio



Rating	Average borrowers	Loan Size, US$	Portfolio '000 US$
First	11,572	103	26,813
Update	19,281	159	45,032

It is apparent that as these MFIs have grown they have placed greater emphasis on increasing portfolio concentration amongst their members – an important measure of cost control enabling better progress towards sustainability.

As Figure 6.3 shows, the aggregate loan portfolio of these MFIs taken together has grown by about 34% per year while the average loan size (loans disbursed) has increased from $103 to $159, 21 months later (at the annual rate of 28%) though the average outstanding balance per loan client has remained virtually constant at around $67. Thus, MFI managements appear to be demonstrating their institutional commitment to their mission by providing small loans to larger number of low-income people. However, in a few cases (particularly the Grameen MFIs), this could also be due to an inflexible approach that does not permit a significant increase in the loan size with each cycle.

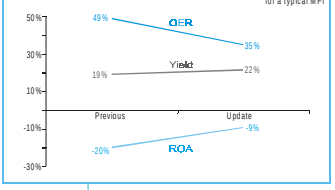
6.2 Costs and returns

– MFIs focus on cost control but yield does not improve so significantly

As discussed in Sections 3 & 5, the extent of outreach has a clear impact on the profitability performance of MFIs. Overall, the Return on Assets of the updated MFIs has improved by about 35% each year from a –20% average to –9%. Looking at both expenses and income more closely this improvement occurs more due to the effect of cost reductions than an improvement in yields. Figure 6.4 shows that the OER of the typical updated MFI has decreased more rapidly (by about 17% per year) than the improvement in yield (annualised at 7%). As discussed in Section 3, this improvement in yields is largely due to the operating conditions which, partly for competitive but mainly for political reasons, make it all but impossible to raise interest rates. Though the average interest rate (*typical* APR) across the database has increased marginally over the past few years from 23.8% to 24.6%, some MFIs have had to reduce rates as a strategic move to manage competition. Such competition occurs in some parts of south India, in Bangladesh and Indonesia, where micro-finance is intensive and the operational areas of MFIs often overlap.

Figure 6.4 Operating expenses, yield and returns

for a typical MFI



Elsewhere, in south India and Nepal, in particular, MFIs are under political and government pressure to reduce interest rates. The increase in yields has, therefore, been mainly through better management of the portfolio. The huge, if narrowing gap between OER and yield– with its obvious implications for improved sustainability– is also apparent from Tables 6.2 & 6.3.

Examining the profitability performance of MFIs in more detail, **Figure 6.5** shows the contribution of interest and other income, on the one hand, and the allocation of expenses to major cost heads on the other. Overall the change is relatively small. While the weighted average interest income has increased from 26.3% to 27.6% of average portfolio,[3] other income has also increased perhaps due to an improvement in the placement of idle funds in investments. Financial costs have also marginally increased as most institutions are moving away from grant based funding to loans and some are even adding more expensive commercial lenders to their sources of funds. The payment of interest on member savings is also becoming increasingly common. Over time, it is likely that this would increase further as commercial equity investments, on which dividends have to be paid, increase. However it is encouraging to note that operating expenses have decreased significantly. It is apparent that, as these MFIs have grown, they have become more conscious of costs and have made some effort to control them.

Table 6.1 Return on Assets

ROA	Previous	Update
> 10%	1	1
5 to10%	2	0
0 to 5%	5	15
-10 to 0%	13	6
-20 to –10%	4	6
-30 to –20%	5	2
-40 to –30%	5	5
Total	**35**	**35**

Table 6.2 Operating Expense Ratio

OER	Previous	Update
<15%	8	9
15-25%	8	10
25-35%	3	7
>35%	16	9
Total	**35**	**35**

Table 6.3 Yield

Yield	Previous	Update
<15%	16	9
15-25%	11	15
25-35%	6	8
>35%	2	3
Total	**35**	**35**

6.3 Sources and utilisation of funds

–an increasing reliance on savings & better management of funds

An analysis of the sources of funds for updated MFIs, presented in Figure 6.6, shows the extent of improvement in the practice of microfinance in the region. Even as their portfolios have expanded, the sample MFIs have reduced the proportion of external debt in their sources of funds and actually increased the proportion of client savings and paid in equity. Reliance on grants has also decreased as accumulated deficits have been reduced to a negligible amount for the sample as a whole. The increased interest in savings is partly the result of a concern to reduce costs, since MFIs with well established collection systems find savings a cheaper source of commercial funds than loans and – in the current situation internationally – can even be cheaper than subsidised loans.

Figure 6.5 ...as a proportion of average portfolio

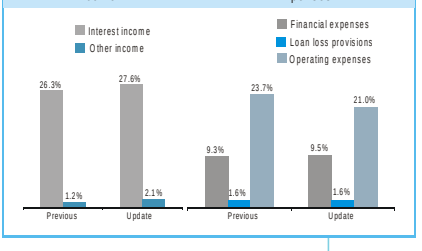
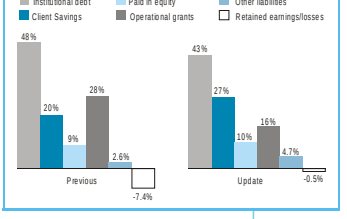
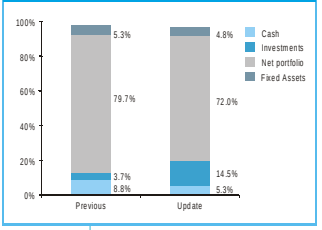


Figure 6.6 Changing sources of funds for programmes



[3] The difference between interest income on average portfolio (reported here) and the yield discussed in the previous paragraph is that, as an aggregate, the figure here represents a weighted average as opposed to the *typical* updated MFI yield shown in **Figure 6.4**.

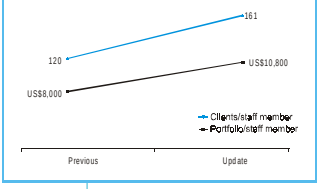
Figure 6.7 **Distribution of assets**



For this reason, many MFIs now treat savings as an important product that requires client-friendly design and professional management.

Asset utilisation also shows some interesting changes over the 21-month average period between the previous rating and the latest update (Figure 6.7). As a proportion of total assets cash reduces significantly reflecting an improvement in management as the industry matures. The figure shows that the proportion of investments has increased. This increase, coupled with the reduction in the proportionate deployment of funds in the loan portfolio is a function of the high growth of such MFIs. A number of the MFIs with rating updates received additional funds just before the rating and these were placed in short-term deposits. The proportion of fixed assets has decreased marginally.

Figure 6.8 **Staff productivity**

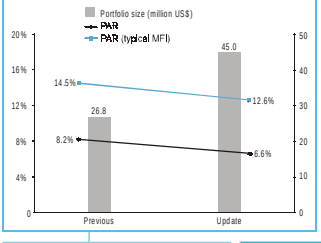


6.4 Productivity

– Improvement in staff productivity … shows organisations are maturing

As discussed earlier in this report, staff productivity in terms of the number of clients serviced and the portfolio handled are important for MFIs since productivity has a direct impact on the efficiency and cost of the programme. M-CRIL's rating updates show an increase in both the number of clients serviced and the portfolio handled by staff (Figure 6.8). There is a marked improvement in the number of clients served by staff from 120 to 161 – significantly higher than the MBB average of 121 and the average portfolio outstanding per staff member has also increased substantially to $10,800. As indicated by the discussion in Section 2, this improvement is directly related to the growing maturity of these MFIs.

Figure 6.9 **PAR in relation to portfolio size**



6.5 Portfolio Quality

– a significant reduction in risk indicates greater management concern with portfolio tracking

Table 6.4 **Portfolio Size**

(in '000 US$)	Previous	Update
<=40	5	3
40 -140	8	6
140 - 500	12	8
>=500	10	18
Total	**35**	**35**

Table 6.5 **Portfolio at Risk**

PAR	Previous	Update
<=5%	13	16
5-10%	5	6
10-20%	7	5
>20%	10	8
Total	**35**	**35**

The impression of better MFI performance is reinforced by the improvement in portfolio quality for the updated MFIs (Figure 6.9). Thus, though portfolio size has increased by as much 68% over the average 21-month period

between ratings, PAR_{60} for the sample has actually declined from 14.5% to 12.6% for the typical MFI (and from 8.2% to 6.6% as a weighted average). This provides an encouraging indication of increased MFI commitment to the monitoring of loans and the tracking of overdues.

6.6 Sustainability and prudential performance

– Self sufficiency improves but there is a decline in capital adequacy

The trend in sustainability depicted in Figure 6.10 provides an indication of the extent of improvement in performance since Operational Self Sufficiency (OSS) and Financial Self Sufficiency (FSS) have increased very substantially (by 17% and 25% respectively for the *typical* updated MFI).[4] Indeed, compared to the situation a few years ago – when the OSS was just 73%[5] – it is almost surprising to see that the updated sample taken together is now operationally self-sufficient (with a weighted average in excess of 100%).

The decline in net worth as a proportion of total assets is largely responsible for the decline in CAR of a *typical* MFI from 39% to 36% (with the weighted average declining from 33% to 28%, Figure 6.10. This is a common phenomenon in fast growing financial institutions and is specifically related to the changing nature of the funds of MFIs. As discussed earlier, while grant funds are gradually being replaced this is not happening as fast as the growth in savings and external borrowings for financing the portfolio. Thus, risky assets grow faster than the net worth of the MFI reducing the CAR. One way to improve net worth would be for MFIs to mobilise share capital.

For most MFIs, registered as societies and trusts (non-profit, charitable institutions) mobilising share capital is not possible on account of their legal framework. Accepting equity through registration as NBFCs in which members can hold shares is a possibility that many are

Figure 6.10 **Sustainability and Prudential Indicators**

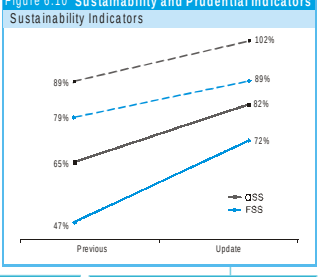


Table 6.6 **Operational Self Sufficiency**

OSS	Previous	Update
<=50%	14	10
50-80%	10	4
80-100%	4	5
>100%	7	16
Total	**35**	**35**

Table 6.7 **Financial Self Sufficiency**

FSS	Previous	Update
<=50%	20	9
50-80%	8	11
80-100%	5	8
>100%	2	7
Total	**35**	**35**

Table 6.8 **Capital Adequacy Ratio**

CAR	Previous	Update
0%	3	3
0-20%	14	13
20-50%	8	9
>50%	10	10
Total	**35**	**35**

Table 6.9 **Loan Loss Reserve**

LLR	Previous	Update
<=3%	15	15
3-5%	7	4
5-10%	6	7
>10%	7	9
Total	**35**	**35**

[4] Discontinuous lines in Figure 6.10 show the change in OSS and FSS as a weighted average across the sample of 35 updated MFIs.

[5] For the full sample of 52 MFIs – see M-CRIL Report, 2000.

exploring but, in the short term, in India this imposes a limitation on their ability to offer savings services. In the long term, a change in the institutional framework for microfinance that enables MFIs in India to register and operate more easily as companies that are allowed to raise deposits at least from their loan clients would be required to enable MFIs to mobilise more commercial equity. This would help to maintain CARs at reasonable levels.

As shown by Figure 6.10, the improvement in portfolio quality of the updated MFIs has resulted in a reduction in the need to maintain loan loss reserves, typical LLRs declining from 6.3% of the portfolio to just 3.3%. As the improving portfolio quality demonstrates, since the introduction of rating, many MFIs subject to ratings have become more conscious of their portfolio quality and their overall financial performance. Thus, rating not only helps in better information dissemination within the sector but also, by raising the level of concern about performance, helps to introduce greater professionalisation into the delivery of microfinance services.

The encouraging findings of this analysis of M-CRIL's rating updates presents a picture of a maturing and increasingly professional microfinance sector. This appears to presage the emergence of the microfinance sector as a significant part of the overall financial system, meeting and serving the needs of a segment of (low income) clients who were previously neglected by formal institutions. However, M-CRIL's rating experience demonstrates that the most important influence on an Asian MFI's performance are institutional considerations – issues of leadership and the perception of microfinance as financial service provision rather than poverty lending. The final section (Section 7) completes the picture of microfinance as seen through M-CRIL's ratings by summarising some institutional issues in financial service provision in Asia.

Annex 6.1 Minimum performance levels for the higher grades awarded by M-CRIL

Grades	Parameters					
	Organisational score (> than)	Management score (> than)	Financial score(> than)	Portfolio at risk (< than)	Capital adequacy ratio (> than)	ROA (> than)
Alpha+++	75%	75%	75%	4%	20%	5%
Alpha++	70%	70%	70%	6%	20%	3%
Alpha+	65%	65%	65%	8%	15%	1%
Alpha	60%	60%	60%	12%	10%	0%
Alpha –	55%	55%	55%	20%	4%	-
Beta+	50%	50%	50%	30%	0%	-

7 Institutional Assessment

– MFIs must choose between poverty lending and financial services if microfinance is to play a significant role in the financial system

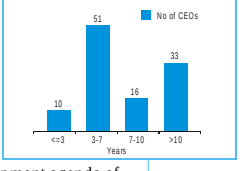
As discussed in the previous section, the financial performance of microfinance institutions in the region is still relatively weak. Though systematic information on sectoral trends is not presently available, the experience of M-CRIL's team with the performance of MFIs in the region over the past five years shows that the message of sustainability is increasingly accepted by the microfinance sector. Consequently, there is an improving trend in overall performance in terms of sustainability while largely maintaining growth. The institutional and systemic issues arising in this process are summarised in *Annex 5* and are discussed in this section.

7.1 Human resources

– considerable NGO management experience but a shortage of competent staff

The considerable experience of Chief Executive Officers (CEOs) of MFIs is apparent from the information in Figure 7.1. With as many as 33 CEOs of the full sample of 110 having more than ten years and another 16 between 7 and 10 years of experience of running microfinance programmes, the relatively poor performance of the sector is almost surprising.

Figure 7.1 **Micro-finance experience of CEOs**



Most MFIs in India as well as in other countries of Asia, have either evolved from non-government organisations (NGOs) undertaking a wide range of development activities or continue to be divisions of such institutions. In this situation, discussion with CEOs during rating / assessment visits reveals that there is an increasing recognition of the need for sustainability, though the welfare orientation of many microfinance leaders tends to be strong. Sustainability is an over-riding priority in the practice of microfinance in a relatively small proportion (~25%) of cases.

While understanding of the need for sustainability is growing, the development agenda of NGO parent institutions engenders a conflict that many in the sector have been unable to overcome. At the same time, there are notable exceptions, even amongst institutions with a clear history of a development-focus. Such examples provide grounds for optimism about the future.

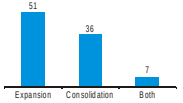
Like all development activities in the region, the disease of mediocrity amongst the staff also plagues microfinance. By and large, remuneration in the sector remains uncompetitive with the public sector and is substantially lower than that of much of the private commercial sector. This results in a high turnover of competent junior staff and mediocrity at supervisory levels. M-CRIL has recommended intensive staff training – in addition to exposure to good microfinance programmes – in the case of the staff of 75 of the 110 sample organisations for which this information is available. At the same time, the issue of remuneration and incentive systems is important and only a few MFIs have started to address it. Those that have introduced appropriate systems successfully are also the best functioning MFIs in the region.

7.2 Operational size/spread

– for small organisations, extensive geographical spread fosters inefficiency

The average membership of sample MFIs is around 24,000 and the number of borrowers less than 10,800. Excluding some of the larger MFIs in the region, the typical rated MFI – particularly in India – has around 6,000 borrowers. With typical loan sizes of just around $110, this results in typical outstanding portfolios in the range $300,000 to $750,000. M-CRIL is convinced that scale is not the only cause of low operational efficiencies of MFIs. However, it is certainly also a factor and, for this reason, 51 (47%) of the 110 MFIs in the sample have been urged to expand their operations (Figure 7.2).

Figure 7.2 M-CRIL's recommendations
Size and spread of MFI operations



At the same time, in many cases, there is a concern that the geographical spread of programmes affects their operational efficiency. Many MFI leaders, in their concern, to work with particular communities or reach especially poor regions spread their programmes over distances – often in excess of a 100 km radius – which, for small organisations, substantially adds to the cost of operations and hampers managerial supervision. M-CRIL has recommended consolidation of operations in 36 (33%) cases. Seven of the sample MFIs, found to be both small and spread thinly over a wide geographical area, were urged to consolidate their operations but also to expand within a more limited radius.

7.3 Management information systems and the tracking of portfolio quality

– inadequate systems, poor understanding of the concept of portfolio quality

Though there has been a considerable amount of improvement in the quality of management information systems (MIS), it still remains amongst the least satisfactory aspects of MFI operations in the region. A number of organisations do not have adequate systems even to track basic member / clients and borrower information in a manner that will enable an accurate enumeration of clients served. Others suffer from inconsistencies at various levels of operation so that appropriate information is either not available at the head office or at branch level. Many do not even collate information on portfolio quality. Only 31 (28%) of the sample MFIs were found by M-CRIL to have a reasonably good MIS and as many as 79 of the 110 MFIs were given specific recommendations for upgrading their systems.

Figure 7.3 **Quality of MIS**

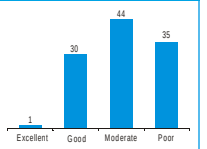
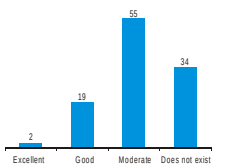


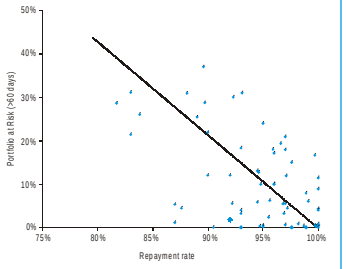
Figure 7.4 **Quality of tracking systems for overdues**



Indeed, only 21 (19% of the total) have adequate systems for tracking portfolio quality and as many as 34 (31%) of the sample MFIs have no tracking system at all (Figure 7.4). Unfortunately, this is partly related to the predominant (and continuing) use of the cumulative repayment rate as a portfolio quality indicator. In this scenario, greater than 90% repayment rates are regarded as satisfactory and breed complacency on the part of MFI managements. The actual relationship between repayment rate and

portfolio at risk (>60 days) is depicted for sample MFIs in Figure 7.5 below. As this shows, for sample MFIs, even a 95% repayment rate could be associated with PARs as high as 15-24% and, even for the average MFI, a 90% repayment rate is associated with a 22-30% PAR (>60 days). Such high levels of portfolio at risk represent dangerously high levels of delinquency for financial institutions.

Figure 7.5 Relationship between PAR and repayment rate

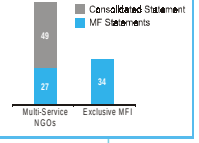


7.4 Financial control and accounts

– welfare orientation hampers microfinance management

Overall accounting systems in sample MFIs have been found to be reasonably satisfactory. However, relatively few (36, 33%) have internal audit mechanisms in place. This is a risky situation in the context of the failure of most (60, 55%) even to undertake any formal budgeting or cash planning. In many cases such systems have been introduced following the recommendations of M-CRIL. Further, as discussed in Sections 3 & 4, liquidity management is an area of concern in the operations of many MFIs with inefficiencies in the sourcing of funds from lenders / donors, in the transfer of cash between branches and head office and, despite recent improvements in some MFIs, their slackness related to the placing of idle funds in short term investments.

Figure 7.6 Financial statements for microfinance activities



This approach to microfinance management is, of course, largely a reflection of the welfare orientation of most MFI CEOs who continue to see the activity as poverty lending and are yet to recognise the potential of microfinance as a commercially viable business proposition, albeit one with a social purpose. Inevitably, in this situation, as many as 49 (64%) of the 76 sample MFIs that undertake microfinance as divisions of multi-service NGOs – do not even prepare separate financial statements for the activity. M-CRIL undertakes cost allocation with such organisations and, often, this represent the first assessment to have been undertaken of the financial viability of any of their operations. An increasing number of MFIs undertake microfinance as their sole activity but 34 (31% of the sample) is still a relatively small proportion of the total, Figure 7.6.

7.5 Conclusion

– a significant and substantial microfinance sector is starting to emerge…

It is apparent that on institutional issues as much as in terms of financial performance, the microfinance sector in the region continues to have more ground to cover. The clear conclusion emerging from M-CRIL's rating experience – not just in India and Nepal but also in other Asian countries including Bangladesh, Cambodia and the Philippines (but not so much in

Indonesia) – is that microfinance is generally regarded as poverty lending rather than the provision of financial services to low income clients. Yet, detailed impact studies in recent years have clearly demonstrated that, in practice, microfinance is able to reach and be suitable for not just poor people but also the not-so-poor (or 'borderline') and non-poor low income families.[1] Indeed, it is now generally accepted that microfinance is not suitable in most circumstances for the poorest sections of the populations of developing countries. As a result, microfinance is increasingly being seen as a facilitation of the economic lives of low income families rather than as a panacea for poverty.

In this context, it is apparent that resources can be drawn into microfinance and outreach expanded significantly only if greater sustainability of microfinance can be demonstrated. For this, MFIs interested in expanding outreach need to choose directly between the poverty lending paradigm and a more direct concern to provide financial services to low income families. The former clearly entails a perpetually grant-funded operation, which has its own challenges. Financial service provision to low income families, on the other hand, is increasingly seen as an integral part of the overall financial system in many countries with related regulatory frameworks and growing links with financial markets. Some of the more professionally run MFIs in the Asian region have started to integrate with formal commercial markets in this way, others are moving in this direction. The conclusion of this report is that microfinance in Asia is growing and is progressing significantly towards professionalising operations to meet the financial needs of low income families…a few more years could see the emergence of a significant and substantial microfinance sector in most of the poorer countries of the region.

[1] See EDA, 2002. **The Maturing of Indian Microfinance: A Longitudinal Study,** *Impact Monitoring and Assessment Report 1 [Baseline].* Gurgaon, India: EDA Rural Systems Pvt Ltd

Annex 1 Sample totals

	Grameen model	Individual Banking	Mixed model	SHG model	M-CRIL Sample	M-CRIL India	M-CRIL Others	M-CRIL Top10
Sample size	16	12	21	61	110	90	20	10
Membership no.	513,766	84,396	765,544	1,294,146	2657852	1,911,150	746702	528,000
loans outstanding								
in Rs	1,701,184,480	619,602,187	1,353,036,369	661,477,717	4,335,300,753	2,333,094,560	2,002,206,193	1,474,333,456
in $	37,804,100	13,768,937	30,067,475	14,699,505	96,340,017	51,846,546	44,493,471	32,762,966
Member Savings								
in Rs	382,050,677	926,417,500	403,735,302	643,675,302	2,355,878,952	1,456,974,426	898,904,526	360,135,373
in $	8,490,015	20,587,056	8,971,896	14,303,899	52,352,866	32,377,209	19,975,656	8,003,008
Staff no.	3,091	323	2,096	3,283	8,793	5,689	3,104	2,314
Branches no.	300	20	175	363	858	596	262	215
Cumulative disbursements								
in Rs	7,126,424,964	886,620,000	6,081,924,681	2,522,695,802	16,617,665,447	7,486,905,730	9,130,759,717	7,452,948,109
in $	158,364,999	19,702,667	135,153,882	56,059,907	369,281,454	166,375,683	202,905,771	165,621,069

Annex 2 Institutional characteristics and outreach indicators

frequencies : no of MFIs

	Grameen model	Individual banking	Mixed model	SHG model	M-CRIL Sample	M-CRIL India	M-CRIL Others	M-CRIL Top10	MBB
Age	**6.4**	**8.9**	**7.2**	**5.7**	**6.4**	**6.6**	**8.0**	**7.6**	**8**
<=3 years	2	1	5	15	23	21	2	1	
3-5 years	6		4	15	25	18	7	3	
5-7 years	4	5	5	21	35	32	4	2	
>7 years	4	6	7	10	27	19	7	4	
	16	12	21	61	110	90	20	10	
Membership	**32,110**	**7,033**	**36,454**	**21,216**	**24,203**	**21,202**	**33,103**	**52,800**	
<=5000	3	7	4	22	36	30	6		
- 5,000-10,000	2	2	5	18	27	20	7	1	
10,000-25,000	5	2	3	10	20	15	5	1	
>25,000	6	1	9	11	27	25	2	8	
	16	12	21	61	110	90	20	10	
Active borrowers	**27,847**	**3,144**	**16,214**	**5,912**	**13,279**	**10,811**	**21,904**	**32,100**	**15,553**
<=3000	3	6	10	43	62	51	11	1	
3,000-5,000	1	4	1	6	12	10	4	-	
5000-10,000	2	2	2	5	11	8	1	-	
>10,000	10	-	8	7	25	21	4	9	
	16	12	21	61	110	90	20	10	
loan portfolio									
in Rs	81,767,133	52,195,862	53,639,734	10,274,760	33,539,355	21,471,750	87,906,195	59,465,520	
in $	1,817,047	1,159,908	1,191,994	228,328	745,319	477,150	1,953,471	1,321,456	5,348,000
Average Loan Size									
Rs/client	**5,439**	**22,257**	**5,431**	**3,690**	**6,255**	**5,175**	**5,805**	**7,245**	
$/client	**121**	**495**	**121**	**82**	**139**	**115**	**129**	**165**	**532**
<=Rs3,000 (>=$65)	1	3	9	9	22	51	11	1	
Rs3,000-4,500 ($65-100)	10	1	5	18	34	8	4	0	
Rs4,500-7,000 ($100-150)	4	2	4	15	25	10	1	7	
>Rs7,000 (>$150)	1	6	3	19	29	21	4	2	
	16	12	21	61	110	90	20	10	

	Grameen model	Individual banking	Mixed model	SHG model	M-CRIL				MBB
					Sample	India	Others	Top10	
Savings deposits									
in Rs	18,259,417	77,201,458	17,373,110	10,552,057	30,846,511	23,963,987	46,263,547	36,013,537	
in $	405,765	1,715,588	386,069	234,490	685,478	532,533	1,028,079	800,301	
Savings balance									
Rs / client	**569**	**10,997**	**477**	**497**	**4,815**	**2,780**	**3,352**	**4,381**	
$ / client	**13**	**244**	**11**	**11**	**107**	**62**	**74**	**97**	
<Rs225 (US$ 5)	2	-	7	18	27	25	4	1	
Rs225-450 (US$5-10)	3	1	3	16	23	22	1	0	
Rs450-675 (US$10-20)	9	3	6	13	31	20	9	3	
>Rs675 (US$20)	2	8	5	14	29	23	6	6	
	16	12	21	61	110	90	20	10	
Average number of staff	**193**	**27**	**100**	**54**	**93**	**82**	**140**	**231**	**95**
Staff producitivity									
Active borrowers per staff member	**144**	**117**	**162**	**110**	**135**	**123**	**156**	**193**	**121**
Loan portfolio per staff member									
in Rs	478,922	1,941,673	604,614	215,412	464,230	402,131	578,045	757,035	
in $	10,643	43,148	13,436	4,787	10,316	8,936	12,845	16,823	**44,560**

Annex 3 Operating Expense and Fund Management Indicators

frequencies : no of MFIs

	Grameen model	Individual banking	Mixed model	SHG model	M-CRIL Sample	M-CRIL India	M-CRIL Others	M-CRIL Top10	MBB
Cost per borrower									
In Rs	**775**	**2010**	**677**	**322**	**645**	**549**	**791**	**662**	
In US$	**17.2**	**44.7**	**15.0**	**7.1**	**14.4**	**12.2**	**17.6**	**14.7**	**65.7**
Operating expense ratio	**25.2%**	**12.1%**	**20.5%**	**18.5%**	**20.5%**	**19.9%**	**21.80%**	**22.4%**	**19.1%**
<=15%	2	7	8	14	31	23	8	3	
15-25%	5	5	3	14	27	21	5	3	
25-50%	5	-	7	8	20	17	3	3	
>50%	4	-	3	25	32	29	4	1	
	16	12	21	61	110	90	20	10	
Yield on average portfolio	**35.6%**	**20.4%**	**24.8%**	**13.0%**	**25.9%**	**22.2%**	**29.9%**	**33.5%**	**33.6%**
<=10%	2	4	6	38	50	39	11	-	
10-15%	5	5	10	17	37	32	5	-	
15-25%	5	1	2	6	14	11	3	6	
>25%	4	2	3	-	9	8	1	4	
	16	12	21	61	110	90	20	10	
Portfolio at Risk >=60 days	**2.6%**	**10.5%**	**17.0%**	**19.3%**	**11.2%**	**12.3%**	**9.8%**	**4.0%**	**2.1%**
<=5%	12	4	7	12	35	32	3	7	
5-10%	2	1	3	11	17	13	4	3	
10-20%	1	3	5	10	19	15	4		
>20%	1	4	6	28	39	30	9		
	16	12	21	61	110	90	20	10	
Loan loss provision ratio	1.7%	1.4%	2.00%	3.00%	2.00%	2.50%	1.40%	1.42%	
Loan loss reserve ratio	**2.5%**	**5.4%**	**5.1%**	**6.7%**	**4.5%**	**4.8%**	**4.1**	**1.6%**	
<=3%	11	3	7	23	44	36	8	6	
3-5%	2	2	3	6	13	10	3	2	
5-10%	-	2	5	16	23	18	5	-	
>10%	3	5	6	16	30	26	4	2	
	16	12	21	61	110	90	20	10	

	Grameen model	Individual banking	Mixed model	SHG model	M-CRIL				MBB
					Sample	India	Others	Top10	
Repayment rate	**97.2%**	**89.9%**	**89.9%**	**85.2%**	**90.6%**	**89.2%**	**95.6%**	**98.3%**	
<=85%	1	2	4	19	26	21	5	0	
85-90%	1	-	3	7	11	8	3	0	
90-95%	0	5	5	13	23	17	6	1	
>95%	14	5	9	22	50	44	6	9	
	16	12	21	61	110	90	20	10	
Capital adequacy	**38.7%**	**15.1%**	**38.4%**	**58.3%**	**36.5%**	**33.1%**	**41.8%**	**35.0%**	
0%	4	-	4	6	14	12	2	-	
0-25%	4	6	6	17	33	24	9	3	
25-65%	5	3	7	12	27	25	2	5	
>65%	3	3	4	26	36	29	7	2	
	16	12	21	61	110	90	20	10	
Deposit-credit ratio	19.7%	147.7%	28.8%	91.0%	54.6%	58.1%	50.1%	23.7%	
Cash to total assets	10.0%	2.2%	5.6%	7.2%	6.8%	5.6%	8.5%	7.0%	
Portfolio to total assets	72.6%	47.4%	70.1%	62.0%	65.3%	62.1%	69.6%	77.3%	
Fixed assets to total assets	8.7%	2.4%	4.9%	5.6%	5.9%	5.0%	7.1%	4.4%	

Annex 4 Financial management and performance

frequencies : no of MFIs

	Grameen model	Individual banking	Mixed model	SHG model	M-CRIL				MBB
					Sample	India	Others	Top10	
Return on assets	**0.7%**	**2.9%**	**-0.9%**	**-2.5%**	**-0.2%**	**-1.5%**	**2.1%**	**2.1%**	**0.1%**
<=-15%	4	2	6	29	41	35	6	-	
-15--5%	3	2	3	12	20	18	2	1	
-5-0%	2	1	5	14	22	15	7	-	
>0%	7	7	7	6	27	22	5	9	
	16	12	21	61	110	90	20	10	
Operational Self Sufficiency	**103%**	**129%**	**96%**	**64%**	**99%**	**88%**	**110%**	**109%**	**115%**
<=50%	4	1	7	39	51	45	6	-	
50-80%	3	3	5	6	17	12	5	1	
80-100%	2	1	2	9	14	10	4	-	
>100%	7	7	7	7	28	23	5	9	
	16	12	21	61	110	90	20	10	
Financial Self Sufficiency	**90%**	**110%**	**81%**	**55%**	**85%**	**77%**	**94%**	**97%**	**104%**
<=50%	5	3	8	43	59	49	10	1	
50-80%	4	1	6	13	24	19	5	1	
80-100%	5	3	5	1	14	12	2	6	
>100%	2	5	2	4	13	10	3	2	
	16	12	21	61	110	90	20	10	

Annex 5 Institutional assessment of rated MFIs

Parameters	Findings	Top10	India	Others	Sample	%
Human resources						
CEO's experience (years)						
	<=3	0	10	0	10	9%
	3-7	1	45	6	51	46%
	7-9	2	13	3	16	15%
	>10	7	22	11	33	30%
	Total	10	90	20	110	
MIS						
Quality of system	Excellent	-	1	0	1	1%
	Good	5	23	7	30	27%
	Moderate	2	37	7	44	40%
	Poor	3	29	6	35	32%
	Total	10	90	20	110	
Portfolio quality						
Formal tracking system for overdues						
	Excellent	2	1	1	2	2%
	Good	5	14	5	19	17%
	Moderate	3	42	13	55	50%
	Does Not exist	0	33	1	34	31%
	Total	10	90	20	110	
Financial control						
Formal internal audits						
	Excellent	1	3	-	3	3%
	Good	3	8	3	11	10%
	Moderate	5	28	11	39	35%
	Poor	1	51	6	57	52%
	Total	10	90	20	110	
Formal budgeting and cash planning						
	Excellent	1	2	-	2	2%
	Good	5	8	12	20	18%
	Moderate	3	32	6	38	35%
	Does not exist	1	48	2	50	45%
	Total	10	90	20	110	

Financial statements		
Separate statements for microfinance	MF Statements	Consolidated Statements
Multi-Service NGOs	27	49
Exclusive MFI	34	-
Total	110	49

Annex 6 Comparison between previous ratings and updates

frequencies : no of MFIs

Time lag between previous rating and update

<=12 months	3
13-24 months	22
>24 months	10
Total	**35**

		Previous Rating	Update rating
Age			
	<=3 years	7	3
	3-5 years	10	7
	5-7 years	10	15
	>7 years	8	10
	Total	35	35
Membership		**23,530**	**30,513**
	<=5,000	11	5
	5,000-10,000	6	9
	10,000-25,000	7	7
	>25,000	11	14
	Total	35	35
Active borrowers		**11,572**	**19,281**
	<=3,000	16	15
	3,000-5,000	4	2
	5000-10,000	7	4
	>10,000	8	14
	Total	35	35
loan portfolio	in Rs	1,206,585	2,026,440
	in $	**26,813**	**45,032**
	<=40,000	5	3
	40,000-140,000	8	6
	140,000-500,000	12	8
	>500,000	10	18
	Total	35	35

		Previous Rating	Update rating
Loan size			
	Rs/client	4,635	7155
	$/client	**103**	**159**
	<=Rs3,000 (>=$65)	6	3
	Rs3,000-4,500 ($65-100)	12	7
	Rs4,500-7,000 ($100-150)	9	14
	>Rs7,000 (>$150)	8	11
	Total	35	35
Member's Savings			
	in Rs	18,456,822	1,167,296,158
	in $	**410,152**	**25,939,915**
	Savings per client		
	<US$ 5	3	9
	US$5-10	9	4
	US$10-20	12	11
	>US$20	11	11
	Total	35	35
Average number of staff		96	119
Staff producitivity			
Active borrowers per staff member		120	161
Loan portfolio per staff member			
	in Rs	358353	484,906
	in $	7,963	10,776

	Previous Rating	Update rating
Operating expense ratio		
<=15%	8	9
15-25%	8	10
25-35%	3	7
>35%	16	9
Total	35	35
Yield on average portfolio		
<=15%	16	9
15-25%	11	15
25-35%	6	8
>35%	2	3
Total	35	35
Annual percentage rate		
<=15%	8	3
15-25%	14	19
25-35%	7	6
>35%	6	7
Total	35	35
Portfolio at risk >=60 days		
<=5%	13	16
5-10%	5	6
10-20%	7	5
>20%	10	8
Total	35	35
Loan loss reserve		
<=3%	15	15
3-5%	7	4
5-10%	6	7
>10%	7	9
Total	35	35

	Previous Rating	Update rating
Capital adequacy		
0	3	3
0-20%	14	13
20-50%	8	9
>50%	10	10
Total	35	35
Return on assets		
> 10%	1	0
5 to10%	2	0
0 to 5%	5	16
-10 to 0%	13	6
-20 to -10%	4	6
-30 to -20%	5	2
-40 to -30%	5	5
Total	35	35
Operatational self sufficiency		
<=50%	14	10
50-80%	10	4
80-100%	4	5
>100%	7	16
Total	35	35
Financial self sufficiency		
<=50%	20	9
50-80%	8	11
80-100%	5	8
>100%	2	7
Total	35	35

Appendix 1 The M-CRIL Sample

Bangladesh
- ASHRAI, Rajshahi
- Bangladesh Extension Education Services, Dhaka
- BURO, Tangail
- Shakti Foundation for Disadvantaged Women, Dhaka
- Voluntary Association for Rural Development, Sylhet
- Youth Power in Social Action, Chittagong

Cambodia
- Cambodia Entrepreneur Building Ltd., Phnom Penh
- Ennatien Moulethan Tchonnebat, Phnom Penh

East Timor
- Moris Rasik, Maliana

India-North
- Bhutti Weaver's Cooperative Society Limited, Himachal Pradesh
- Cashpor Financial and Technical services Pvt Ltd, Uttar Prasesh
- Centre for Community Economics and Development Consultants Society, Rajasthan
- Grameen Kosh (Grameen Development Services) Uttar Pradesh
- Integrated National Development Centre for Advancements Reforms and Education Trust, Delhi
- Nav Bharat Jagriti Kendra, Jharkhand
- Rural Litigation and Entitlement Kendra, Uttaranchal
- Shramik Bharti, Uttar Pradesh
- Social Centre for Rural Initiative and Advancement, Haryana

India-East
- Bandhan, West Bengal
- Council of Professional Social Workers, Orissa
- Centre for Youth and Social Development, Orissa
- Deshabandhu Club, Assam
- Malipukur Samaj Unnayan Samity, West Bengal
- Peoples Rural Education Movement, Orissa
- Rashtriya Gramin Vikas Nidhi, Orissa
- Rashtriya Gram Vikas Nidhi - Credit and Savings Programme, Assam
- South Asia Research Society, West Bengal
- Seba Sangha, West Bengal
- Southern Health Improvement Samity, West Bengal
- Sunderban Khadi & Village Industrial Society, West Bengal
- Sreema Mahila Samity, West Bengal
- Srijan Mahila Vikas Sahyog Samity Ltd, Bihar
- Vivekananda Sevakendra O Sishu Udyan, West Bengal
- Village Welfare Society, West Bengal
- Youth Volunteer's Union, Manipur

India-West
- Annapurna Mahila Credit Cooperative Society Ltd., Maharashtra
- ACIL-Navasarjan Foundation for Rural Development, Maharashtra
- Banaskantha DWCRAA Mahila SEWA Association, Gujarat
- Dharampur Utthan Vahini (BAIF-DHURVA), Gujarat.
- Friend's of women's world banking - India, Gujarat
- International Centre for Entrpreneurship and Career Development, Gujarat
- Indian Institute for Youth Welfare , Maharashtra
- Junagadh Mahila Sharafi Sahakari Mandli Ltd, Gujarat
- Lupin Human Welfare and Research Foundation, Rajasthan
- Mata Shree Gomti Devi Jan Seva Nidhi, Rajasthan
- Pune District Agriculture Development Foundation, Maharashtra
- Pushtikar Laghu Vyaparik Pratishthan Bachat evam Sakh Sahakari Samiti Limited, Rajasthan
- Society for Action in Creative Education and Development, Maharashtra
- Shri Mahila SEWA Sahakari Bank Ltd. (SEWA Bank), Gujarat
- Society for Promotion of Area Resource Centre, Maharashtra
- Watershed Organisation Trust, Maharashtra
- Youth for Unity and Voluntary Action, Maharashtra

India-South
- Ankuram Sangamam Poram, Andhra Pradesh
- Academy of Rural Children's Health and Integrated Educational Society, Andhra Pradesh
- Activists for Social Alternatives (ASA)-Grama Vidiyal, Tamil Nadu
- Association of Sarva Seva Farms, Tamil Nadu
- ASSIST, Andhra Pradesh
- Bharatiya Samruddhi Finance Ltd., Andhra Pradesh
- Bharat Sevak Samaj, Kerala
- Bullockcart Workers' Development Association, Tamil Nadu
- Community Action for Rural Development – Puddokottai, Tamil Nadu
- Creative Action For Rural Development, Andhra Pradesh
- The Covenant Centre for Development, Madurai, Tamil Nadu
- Chaitanya Institute of Youth and Rural Development, Karnataka
- Centre for Rural Systems and Development, Tamil Nadu
- District Central Co-operative Bank - Bidar, Karnataka
- Grameen Koota, Karnataka
- Gramasiri, Andhra Pradesh
- Grama Siri Rural Awareness for Social Service, Andhra Pradesh
- Grama Siri Unit for Integral Leadership Development, Andhra Pradesh
- Indian Association for Savings and Credit, Tamil Nadu
- Indian Cooperative Network for Women Limited, Tamil Nadu
- Indian Institute of Women and Child Health Trust, Tamil Nadu
- Janodaya Trust, Karnataka

India- South Contd...

- Karimangalam Onriya Pengal Semipu Amaippu Limited, Tamil Nadu
- Sarva Jana Seva Kosh, Tamil Nadu
- League for Education and Development, Tamil Nadu
- Mahalir Association for Literacy, Awareness and Rights, Tamil Nadu
- Mission to Encourage Rural Development in Backward Areas, Andhra Pradesh
- Mahasemam Trust, Tamil Nadu
- New Life, Tamil Nadu
- Organisation for Development of People, Karnataka
- Opportunity Microfinance India Limited, Karnataka
- OUTREACH, Karnataka
- PACS of DCC Bank, Bidar, Karnataka
- Payakaraopeta Women's MACTS Ltd, Andhra Pradesh
- Rastriya Seva Samanthi, Andhra Pradesh
- Rural Development Organisation, Tamil Nadu
- Rural Integrated Development Organisation, Tamil Nadu
- SABALA, Karnataka
- Saint Ann's Social Service Society, Andhra Pradesh
- Society for Helping, Awakening of Rural Poor through Education, Andhra Pradesh
- Self Help Promotion for Health and Rural Development, Tamil Nadu
- South Indian Federation of Fishermen Societies, Kerala
- Shree Kshetra Dharmasthala Rural Development Project, Karnataka
- Swayam Krishi Sangam, Andhra Pradesh
- Share Mutually Aided Cooperative Society Limited, Andhra Pradesh
- SHARE Microfin Limited, Andhra Pradesh
- Sneha Women's MACTS, Andhra Pradesh
- Sarvodaya Nano Finance Ltd., Tamil Nadu
- Spandana, Andhra Pradesh
- Swayamkrushi Women's Development Mutually Aided Cooperative Thrift Society, Andhra Pradesh
- Star Youth Association, Andhra Pradesh
- The Bridge Foundation, Karnataka
- Treatment for Rural Environmental Educational Society, Andhra Pradesh
- Tiruvalla Social Service Society, Kerala
- Vikasa Mutually Aided Cooperative Thrift Society, Andhra Pradesh
- Sri Vijayavisakha District Milk Producers' Mutually aided Cooperative Union Ltd., Andhra Pradesh
- Visakha Jilla Nava Nirmana Samiti, Andhra Pradesh
- Vasavya Mahila Mandali, Andhra Pradesh
- Youth Charitable Organisation, Andhra Pradesh

Indonesia

- Bank Dagang Bali, Bali
- PT BPR Delta Artha, Surabaya
- PT BPR Duta Pakuan Mandiri, West Java
- PT BPR Gunung Kawi, Central Java

Kazakhstan

- Kazakhstan Community Loan Fund, Almaty

Nepal

- Nirdhan Utthan Bank Limited, Bhairahawan
- Neighbourhood Society Service Centre, Kathmandu
- Rural Reconstruction Nepal, Chitwan
- VYCCU Savings and Credit Cooperative Ltd, NawalPrasi

Philippines

- Negros Women for Tomorrow Foundation, Bacolod City
- Taytay Sa Kauswagan Inc., Iloilo city

Sri Lanka

- Sarvodaya Economic Enterprise Development Services (Guarantee) Ltd.

Appendix 3 Glossary of terms

1 Financial spread

Portfolio yield minus financial costs (interest paid on borrowings, interest paid on deposits and loan loss provision expenses)

2 Loan loss provisioning ratio

Total loan loss provision expense for the year divided by the average portfolio

3 Operating expense ratio

Ratio of staff, travel, administration costs, other overheads and depreciation charges of the MFI (non- financial costs) to the average loan portfolio for the year

4 Operational Self-Sufficiency

Ratio of total income to total expenses for the year

5 Financial Self-Sufficiency

Ratio of total income to total adjusted expenses for the year. Adjustments are made for subsidised cost of funds (relative to market interest rate), equity (with respect to inflation) and in-kind donations.

6 Portfolio at risk (>=60 days)

Ratio of the principal balance outstanding on all loans with overdues greater than or equal to 60 days to the total loans outstanding on a given date

7 Repayment rate (cumulative)

Ratio of cumulative principal recovered (net of pre-payments) to the cumulative principal due till the date of measurement

8 Yield on portfolio

Interest and fee income from loans to clients divided by the average loan portfolio for the year

9 Risk weighted capital adequacy ratio

Ratio of net worth to risk weighted assets (Risk weights: 100% for all assets except fixed assets & interest bearing deposits: 50%; cash 0%).

Appendix 4 M-CRIL rating grades

Rating Symbols	Description
α+++ alpha triple plus	Highest safety - excellent systems - most highly recommended
α++ alpha double plus	Highest safety - very good systems - most highly recommended
α+ alpha single plus	Very high safety - good systems - highly recommeded
α alpha	High safety - good systems - highly recommended
α– alpha minus	Reasonable safety - good systems - recommended
β+ beta plus	Reasonable safety - reasonable systems - recommended, needs monitoring
β beta	Moderate safety - moderate systems - acceptable, needs improvement to handle large volumes
β– beta minus	Significant risk - poor to moderate systems - acceptable only after improvement
γ+ gamma plus	Substantial risk - poor systems - needs considerable improvement
γ gamma	Highest risk - poor systems - not worth considering