Analysis of the Double Bottom Line Performance of Microfinance Institutions in India and the Need for Regulation in the Indian MFI Sector

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Abstract

Poverty and Financial exclusion are the greatest challenges facing an emerging economy like India. Many countries, including India, had implemented subsidised credit to irradicate poverty, which only increased the NPA (Non-Performing Assets). MFIs (Microfinance Institutions) were formed to bridge the gap between the formal financial sector and the financially excluded. Social commitment forms one of the basic characteristics of the MFIs, and now its scope is broadening to social performance. However, like any other organisation, to continue their operations in the long run, financial sustainability is a key determinant for MFIs. Thus, the double bottom line commitments imply balancing financial and social performance. Certain developments in recent years brought a fresh focus on the problem of regulation in the field of microfinance. In the present scenario, the Indian MFI sector is largely unregulated. In India, a variety of legal forms of MFIs are found like NBFC-MFIs (Non-Banking Financial Companies-Microfinance Institutions), NBFCs, SHGs (Self Help Groups), Society, NGOs (Non-Governmental Organisations), Trusts, and Sec. 8 Company, etc., among which the lion's share goes to NBFC-MFIs/NBFCs. The paper analyses the double bottom-line performance of MFIs in India using secondary data of Indian MFIs extracted from various reports of Sa-Dhan, the World Bank, and the RBI (Reserve Bank of India). The paper also attempts to highlight the need for a regulatory body to guide, supervise and regulate different players in the Indian MFI sector.

Keywords: Microfinance, Financial Inclusion, Double Bottom Line, Social Performance, Financial Regulation

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1. INTRODUCTION

The Government of India has implemented a large number of poverty alleviation, subsidised rural credit, and priority lending programs over the past few decades to irradicate poverty and financial exclusion in the country. Due to many reasons like failure to reach the target group and gaps in the service delivery mechanism, many such programs failed to meet the expectations. Also, these programs often resulted in high NPAs (Non-Performing Assets). Till the 90s, most of the rural population was unbanked, and they had to look towards informal sources of finance. The poor do not usually own any mortgageable assets. Hence it is important to provide them with collateral-free loans. This will help them access the financial services once not available to them and use them to build their asset base, regularise income flows, smoothen consumption patterns, and avoid shocks to which they would otherwise be vulnerable.

The NABARD (National Bank for Agricultural and Rural Development) task force suggested a working definition of microfinance as "provision of thrift, credit and other financial services and products of very small amounts to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards." The private institutions that undertake microfinance services as their main activity are generally referred to as MFIs (Micro Finance Institutions) in the Indian context. NGOs (Non-Governmental Organisations) also carry out microfinance services in India. Apart from social and political empowerment, financial inclusion imparts formal identity and provides access to the payment system and to saving safety net like deposit insurance. Hence financial inclusion is considered to be critical for achieving inclusive growth (Thorat, 2007).

Microfinance is regarded as an effective tool for financial inclusion for the past few decades, beginning with the success stories of the Grameen Bank in Bangladesh and the financial success of MFIs coming up with IPOs (Initial Public Offerings). MFIs were originally formed with the social goals of increased access to financial services for the poor and excluded people at a lower cost. However, as time passed, commercial considerations have taken over many of these institutions, and their increased urban orientation and lack of non-credit or developmental products came at the cost of the decline in their outreach to poor people.

1.1 Review of literature

Pati, Ambika & Roy, Prasenjit. (2015) stated that the scale of outreach in terms of the number of borrowers generally guides the double-bottom-line commitments of MFIs in India. They found that there is impressive growth in the physical and social performance of Indian MFIs. However, they concluded that it has no linkage with the financial performance of the MFIs. The Debt-to-Equity Ratio shows negative growth, indicating that the MFIs reduce debt and incorporate equity. They also found that NGO MFIs are better at maintaining the depth of outreach, whereas non-NGO MFIs are better at maintaining the breadth. They also anticipated a positive association between the Average Loan Size and sustainability.

Chawla (2013) reviewed Indian MFI literature to see the impact of regulations on MFIs in India post the Andhra crisis. The author states that appropriate regulation shall be imposed on the MFI sector which has a trajectory growth rate. The study highlights the importance of the Microfinance bill 2012 and its provisions, including fixing the interest rate charged by the MFIs.

The author recommends that MFIs bring transparency to the interest rates charged, introduce technology to reduce operating costs, and access alternate sources of funds to reduce the cost of capital.

Psico and Dias (2008) evaluated the Social Performance of seven microfinance institutions in Mozambique. They used the SPI (Social Performance Indicators) model developed by CERISE which had four social dimensions: outreach of the poor and excluded; adaptation of the services and products to the target clients; improvement of the social and political capital of the clients; and social responsibility of the MFI. They found that only two institutions came close to the international MFI average. The study concluded that the MFIs in Mozambique are not concerned with Social Performance as a goal, and they should redefine their strategies to cater to the large section of people who are still excluded from financial services.

Kabeer (2005) states that MFIs have a social impact apart from the economic impact and MFI should be aware of the "full range of changes associated with its efforts and use these to improve its performance". She considers the social impact to relate to human capital such as nutrition, health, and education, as well as social networks. The impact must be assessed on each of these issues if a true picture of the impact of microfinance is to be obtained.

Mayoux (2001) states that the main effects of microfinance on poverty have been: a significant increase in the income of the poor, including women and contributing to smoothing out peaks and troughs in income and expenditure, thereby enabling the poor to cope with volatile situations like drought, death, etc.

1.2 Need for the study

The success of Microfinance Institutions is often represented by their financial performance ignoring the fact that MFIs have to meet the social goals for which they were originally formed. There has been an increased awareness of the social performance management concept in recent years due to the efforts of international organisations like the SPTF (Social Performance Task Force), MIX market and Sa-Dhan, etc. Many Indian MFIs do publicly state that they have a double bottom line to attain. ie, balancing financial performance and social performance. But whether they achieve it, or at least measure it, is often unknown. Also, the governance of MFIs is one thrust area to ensure balancing social and financial goals. Hence it is very appropriate that this study aims to analyse the double-bottom-line commitments of Indian MFIs. Also, the paper attempts to highlight the need to regulate the largely unregulated microfinance sector in India.

1.3 Objectives

The study aims at the following objectives:

- To explore the double bottom-line obligations of MFIs
- To analyse the important indicators of MFI performance
- To analyse the status of self-regulation of MFIs in India
- To highlight the need for MFI regulation in India

1.4 Methodology

The paper is exploratory and descriptive. Available data on 253 Indian MFIs and their performance for the year 2016-17 was collected from reports of Sa-Dhan, World Bank, RBI, etc., and descriptive statistical tools and graphs were used to analyse the data.

2. MICROFINANCE INSTITUTIONS (MFIS) IN INDIA

There are mainly three delivery models of microfinance in India, viz. the SHG (Self Help Group) model, the free-standing MFI model, and the Banks directly providing microfinance services. Among them, the free-standing MFI model consists of different types of organisations such as NBFC-MFIs (Non-Banking Financial Companies-Microfinance Institutions), NBFC (Non-Banking Financial Companies), Society, Trust, Section 8 Companies, Cooperatives, and Local Area Banks, etc. The following figure illustrates different categories of MFIs in India and their number. The largest category of MFIs in India is NBFC-MFIs/NBFCs.

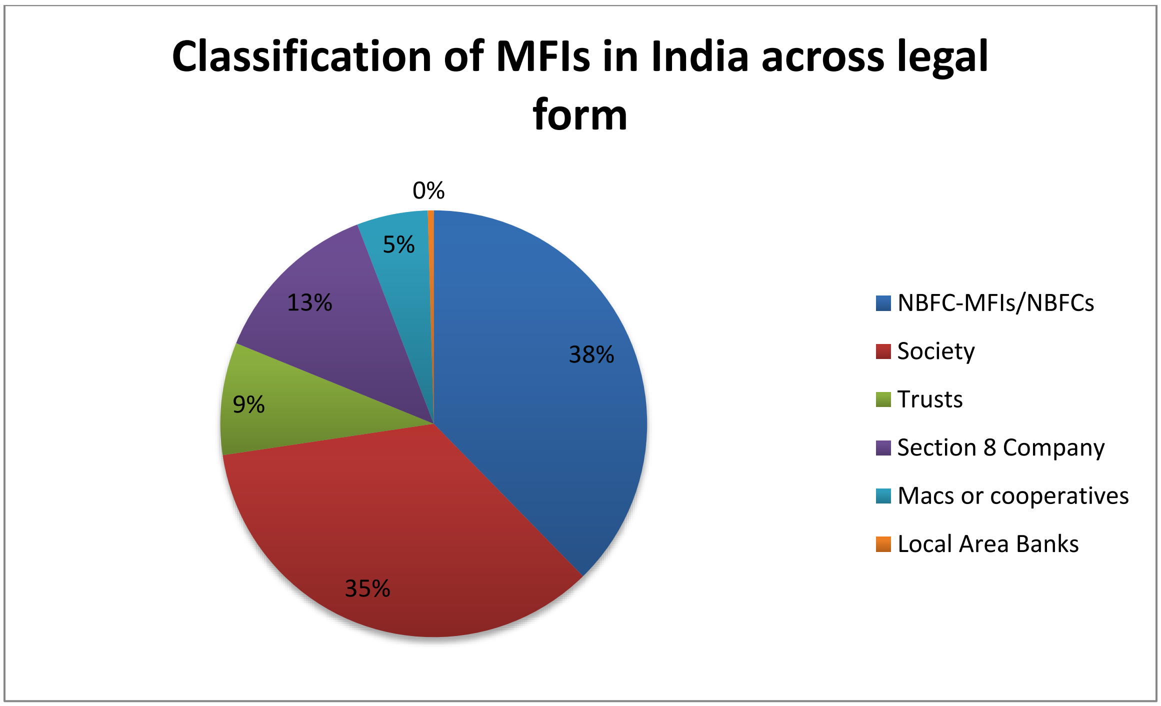

Figure 2.1: Classification of MFIs in India across Legal Form

Source: Data from the MFI Directory 2016, Sa-Dhan

Apart from being important as the largest category of MFIs in India, certain recent developments in the sector have brought a fresh focus on the category of NBFC-MFIs and highlighted the need for closer supervision and regulation of the same. The following table gives a view of the regional spread of NBFC-MFIs in India.

Table 2.1: Region-wise spread of NBFC-MFIs

Headquarters	No. of NBFC-MFIs
West (Ahmedabad, Mumbai)	15
South (Bengaluru, Chennai, Hyderabad, Thiruvananthapuram)	31
North (Chandigarh, Jaipur, New Delhi)	11
East (Bhubaneshwar, Kolkata, Patna)	12
Central (Lucknow)	3
North-East (Guwahati)	6
Total	78

Source: Data from the list of registered NBFC-MFIs, RBI

It is evident from the table that the largest number of NBFC-MFIs is headquartered in the southern region of the country and the least in the central region. The highest share of loans outstanding and outreach belongs to the southern region. However, the growth rates are highest for the Northeastern and Eastern regions (The Bharat Microfinance Report 2017, Sa-Dhan)

An important factor guiding the double-bottom-line commitments of MFIs in India is the outreach in terms of the number of borrowers. The following table shows the classification of MFIs in India into different tiers based on their client base. It is evident from the table that the majority of MFIs in India have a client base lesser than 0.5 lakhs.

Table 2.2: Classification of MFIs in India by Client base

Size Classification	Client Outreach	No. of MFIs
Tier I	Above 2.5 lakhs	28
Tier II	0.5 – 2.5 lakhs	45
Tier III	Below 0.5 lakhs	150
	Total	223

Source: Data from the MFI Directory 2016, Sa-Dhan

3. DOUBLE BOTTOM LINE OBLIGATIONS OF MFIS AND SOCIAL PERFORMANCE MANAGEMENT

There has been a strong call for responsible product features and practices in the financial sector for a long time. Responsible finance can not only help reduce financial exclusion and poverty but can also create a better reputation and client retention, which leads to demand for additional services and sustainable growth for the industry. Measures like ensuring sound loan processes and well-designed products will enhance the efficiency of the system as a whole. Regulators, policymakers, investors, and other stakeholders should consider appropriate steps to support the sector to deliver responsible finance. There are two key dimensions of responsible finance: Client protection and Social Performance Management (SPM). Client Protection applies to all financial institutions, whereas SPM applies to all institutions with a double bottom line. While recognising the challenges faced by the Indian microfinance sector in the short run, the longer-term goal of sustained growth and better outreach can only be achieved if both financial and social goals are balanced.

Many Indian microfinance providers publicly claim to have a double bottom line and are therefore concerned with achieving both their financial sustainability and social goals. In recent years, the SPM concept has become more popular. In the year 2011, the global microfinance industry agreed upon a set of Universal Standards for Social Performance Management (USSPM) that set out actionable management practices related to setting strategy, building employee buy-in, and putting clients first. SPM is a strategic institutional approach to define and monitor social goals, ensure client protection, etc. In simple words, SPM aims to convert social goals into successful practice by the organisation. Following are the six dimensions of USSPM:

- Define and monitor social goals
- Ensure Board, Management, and employee commitment to social goals
- Design products, services, delivery models, and channels that meet clients' needs and preferences
- Treat Clients responsibly
- Treat Employees responsibly
- Balance Financial and Social Performance (Social Performance Task Force, 2018)

Social performance management and reporting are on the rise in the microfinance industry as a whole, and the exercise of tracking such information is already impacting the daily existence of MFIs around the world. Many providers have made progress in designing and delivering appropriate financial services that meet client needs. A large number of institutions are creating social performance positions or departments within their organisations and setting work plans based on the SPTF's social performance framework. (MIX Market, 2018)

4. PERFORMANCE ANALYSIS OF MFIS

As with any other institution, the ability of MFI to cover its expenses from the revenue it generates, otherwise termed financial sustainability, is a must for the successful long-term operation of the institution. Hence it is important to analyse the financial performance of MFI. However, Strong financial performance alone may not translate into a social benefit which is the basic aim of MFI formation. Hence it would be appropriate to analyse social performance factors like outreach, Gross Loan Portfolio, Average Loan Size, etc.

4.1 Growth and Outreach Indicators

In the past two decades, the microfinance industry has grown tremendously. As of 31st March 2017, the Microfinance sector has a Gross Loan Portfolio of Rs 106,916 crores (MFIN India, 2018). The average loan outstanding per borrower increased to Rs. 12,751, and 85% of loans were used for income generation purposes which are lower than the previous year (94%).

Outreach of MFIs fell by 26%, and loan outstanding grew by 27% in 2016-17. The proportion of rural clients has increased to 61%, and that of urban clientele has decreased significantly when compared to the rural population. The following figure illustrates the share of different players in client outreach and classification based on the portfolio size of MFIs during the year 2016-17.

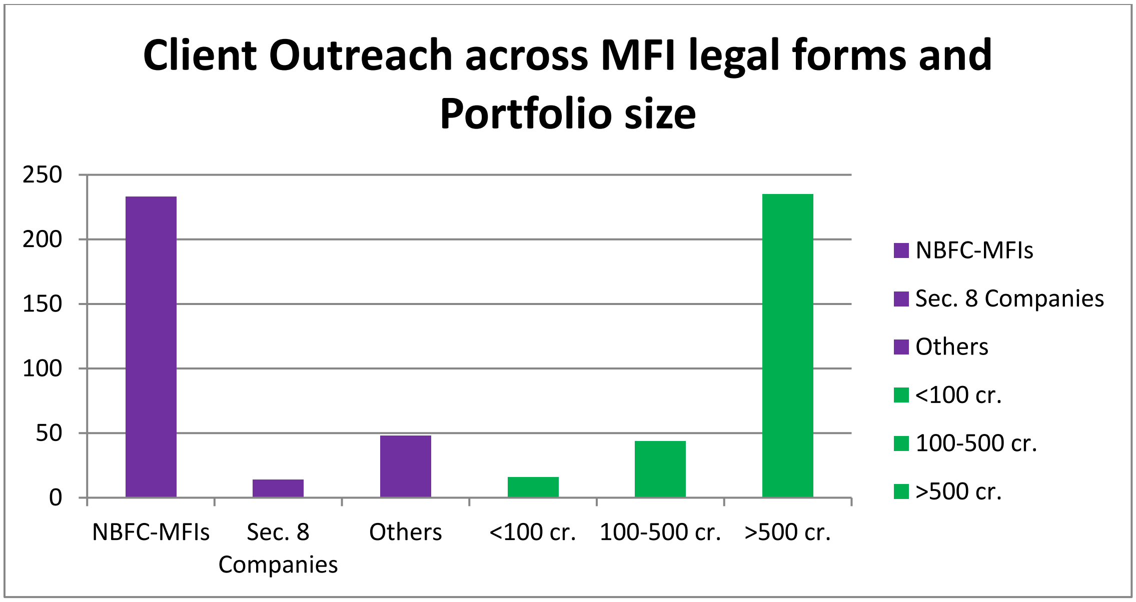

Figure 4.1.1 Client Outreach across MFI legal forms and Portfolio size

Source: Data from the Bharat Microfinance Report 2016, Sa-Dhan

The above graph depicts that the lion's share of client outreach goes to NBFC/NBFC-MFI. This may be due to the vast physical presence of NBFC-MFIs through their large number of branches. Another important indicator of outreach is the GLP (Gross Loan Portfolio). The following figure shows the organization-wise and portfolio size-wise breakup of GLP.

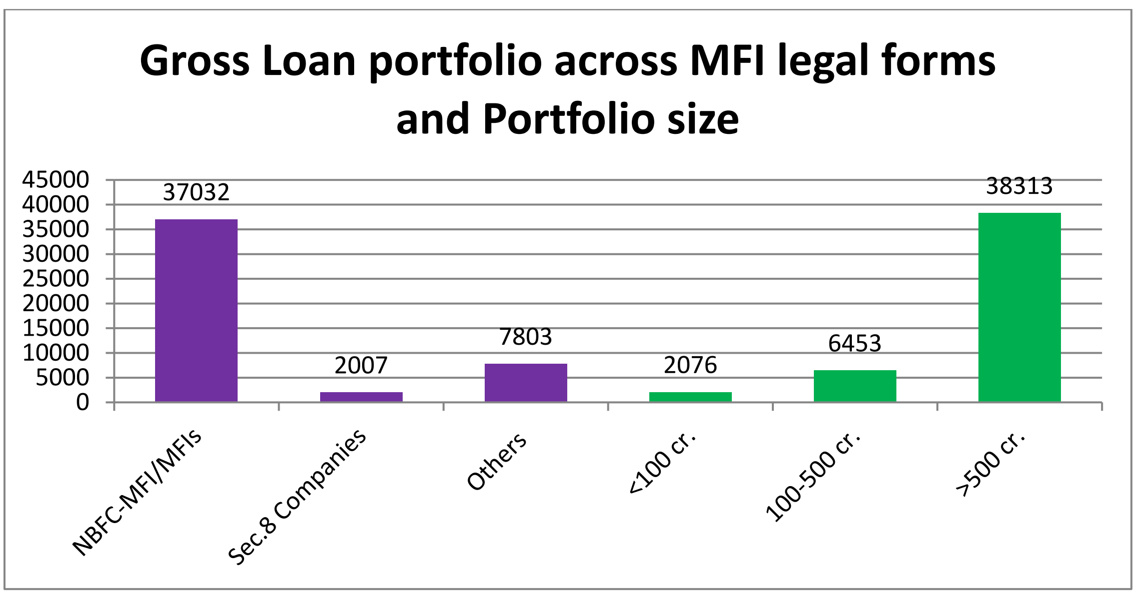

Figure 4.1.2 Gross Loan Portfolio across MFI legal forms and Portfolio size

Source: Data from the Bharat Microfinance Report 2016, Sa-Dhan

From the Client outreach and GLP analysis, For-Profit MFIs (NBFC/NBFC-MFIs) contribute to 79% of clients' outreach and outstanding portfolio. MFIs with a portfolio size of more than 500 crores contribute significantly to the total outreach (80%) and loan outstanding (82%) of the sector.

The following chart analyses the trend in the growth of outreach and loan portfolio of Indian MFIs over the past ten years

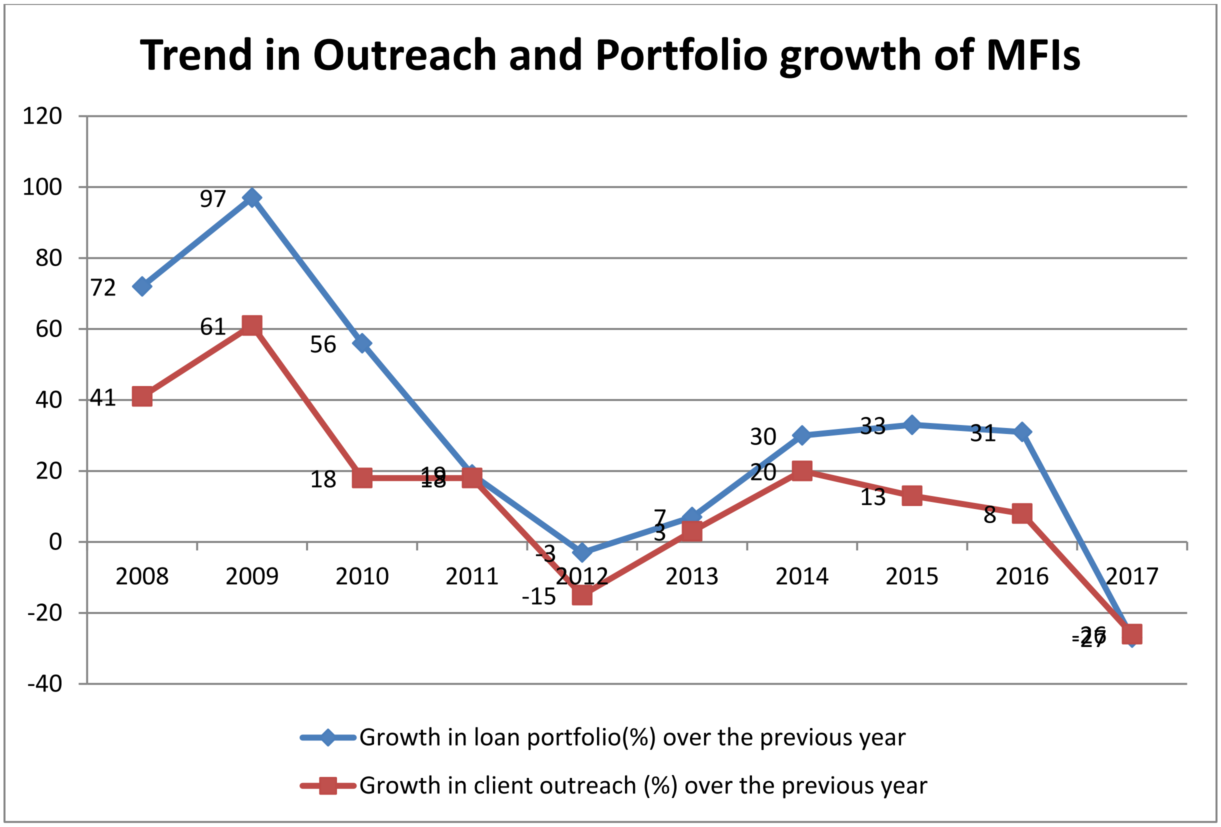

Figure 4.1.3 Trend in Outreach and Portfolio growth of MFIs

Source: Data from the Bharat Microfinance Report 2016, Sa-Dhan

It can be understood from the figure that the percentage growth rate in both Outreach and Portfolio has been declining since 2010, which may be attributed to the crisis in the microfinance sector during the period. In 2011 and 2017, the growth rates of the loan portfolio and client outreach were almost equal. In all other years, the growth rate in the loan portfolio is higher than the growth rate in client outreach. From 2012, there was a recovery in growth rates, but after 2014 there has been relatively stagnant growth. Again after 2016, the growth slumped again to a negative growth rate in 2017, which is to be watched with caution.

4.2 Operational and Financial Aspects

MFI sector employs 89,785 personnel, out of which 12% are women. The proportion of women staff has declined by 3% than the previous year. The ABCO (number of Active Borrowers per Credit Officer) is 426, which is lower than the previous year, which may indicate a higher focus on service quality.

The major share (48%) of expenses incurred by MFIs is financial expenses. Personnel expenses and other administrative expenses contribute 24% and 28%, respectively. Median OER (Operating Expense Ratio) and FCR (Finance Cost Ratio) increased to 10.5% and 14.8% compared to the previous year's figures of 10.22% and 13.83%, respectively. The Yield of the sector for the year was 22%. Median OSS (Operational Self Sufficiency) is 114%. Median ROA and ROE increased to 2.4% and 13.31%, respectively. The total outstanding borrowing of MFIs stood at `33923 crore, which denotes leverage of 2.9.

The following table illustrates the highlights of growth, outreach, operational and financial aspects of the microfinance sector for the year ending 31st March 2017

Table 4.2.1: Performance highlights of MFIs

Indicator	**2017**	**2016**	**Change**
Client Outreach	295 lakhs	399 lakhs	Decrease
Women Clients	96%	97%	Decrease
Scheduled Caste /Scheduled Tribe (SC/ST) Clients	20%	30%	Decrease
Rural Clients	61%	38%	Increase
Gross Outstanding Loan Portfolio	46,842 Cr.	63,853 Cr.	Decrease
Avg. Loan per Borrower	Rs. 12,751	Rs. 11,425	Increase
Female Staff in MFIs	12%	15%	Decrease
Income Generation Loans	85%	94%	Decrease
ABCO	426	440	Decrease
OER	10.50%	10.22%	Increase
OSS	114%	113%	Increase
ROA	2.4%	2.2%	Increase
ROE	13.31%	11.6%	Increase
NPA	0.69%	0.15%	Increase

Source: The Bharat Microfinance Report 2016, Sa-Dhan

An analysis of the performance of Indian MFIs for the period 2016-17 reveals that the MFIs have been faring well in terms of their financials. Though the Operating Expense Ratio (OER) and Finance Cost Ratio (FCR) etc. show an increasing trend, the Operational Self Sufficiency (OSS) shows a healthy 114%. This indicates that, as a sector, the income from the operations of the MFIs is sufficient to meet their expenses. Also, Return on Assets (ROA) and Return on Equity (ROE) show an increasing trend over the last year. However, social concerns such as the proportion of women clients and SC/ST clients have declined over the period. The number-wise client outreach has declined from 399 lakhs to 295 lakhs, but this major decline is due to the graduation of major MFIs to Small Finance Banks (SFBs). Client Outreach grew by 10% relative to the previous year calculated without SFBs, which indicates a sound growth of MFI outreach. The average Loan Per Borrower has increased and the Gross Loan Portfolio has declined which may indicate a preference for better-off clientele over the poorest.

5. REGULATION OF MICROFINANCE IN INDIA

As the customers of microfinance are poor and vulnerable, it is the responsibility of the government to ensure adequate regulation for client protection. On the other side, the Indian MFIs have been struggling to gain legal recognition and approval to enter the deposit-taking activity for a long time. There are mainly 3 delivery models of microfinance in India viz., the SHG model, the free-standing MFI model, and the Banks directly providing microfinance services. Among them, the free-standing MFI model is the category that faces the pressing need for regulation because it consists of a wide variety of institutions such as NGOs, NBFC-MFIs, Trusts, Society, Sec. 8 Company, etc. and some of them are regulated, but others are partly or not regulated.

Regulatory measures for MFIs in India can be rightly classified as Pre and Post Andhra crises. Before the 2010 Andhra Crisis, the issue of regulation of the microfinance sector was not widely debated, and the MFIs used to be under the regulatory purview of the respective acts under which they were incorporated. In 2010, many cases of MFI client suicides were reported due to excessive interest charges and the high-handedness of recovery agents. The issues of client abuse, high profiteering, investor greed, and insider manipulations precipitated the crisis of MFIs in the country, especially in the state of Andhra Pradesh, which led to a decline in MFI outreach and portfolio growth rates also.

Post-Andhra crisis, the Reserve Bank of India notified guidelines for the lending operations of MFIs based on the Malegam Committee recommendations. A new class of financial organisations named NBFC–MFIs have been created subject to satisfying certain conditions regarding the capital to be employed, lending to members, the cap on the rate of interest to be charged and margin to be retained, etc. (NABARD, 2017). While NBFCs were brought under regulation by RBI, a lot of unregulated entities, registered but unregulated, like Trust, Societies, and section 8 companies, were left out of the regulatory ambit.

The Government of India introduced Micro Finance Institutions (Development and Regulation) Bill 2011 on May 22, 2012, to establish a Microfinance Development Council under RBI to regulate and supervise the activities of NGOs and MFIs and for redressal of grievances for beneficiaries of microfinance services. The Bill requires all MFIs to obtain a certificate of registration from RBI. The RBI has the authority to set the maximum annual percentage rate charged by MFIs and set a maximum limit on the margin they can make.

Later again, in 2016, the Microfinance Institutions (Regulation of Money lending) bill was introduced in the Loksabha. The broad objective of the regulation was to regulate the MFIs based on activity rather than the form of organisation. However, none of the bills was passed by the parliament of India as of July 2018.

The following table discusses the important existing regulatory provisions regarding Microfinance in India:

Table 5.1: Existing Regulatory provisions for Microfinance in India

Legal Provisions	Yes/No	Remarks
Provisions for interest rate caps or pricing limits	Yes	Interest rate caps apply only to certain segments or products
Law or regulation regarding the cost of customer accounts	No	
Provisions to Restrict Excessive Borrowings by Individuals	Yes	regulations require lending institutions to assess borrower ability to repay the loan, but no specific limits are set
Provisions to Prohibit/Restrict Unfair Practices	Yes	
Provisions to prohibit discrimination of certain segments	Yes	Provisions prohibit discriminating against certain segments, such as women, indigenous populations, or based on faith, political affiliation, the manner a consumer dresses
Provisions to prohibit restriction on consumer choices	Yes	Bundling and tying services and products in a manner that unduly restricts the choice of consumers are prohibited

Source: Data from the 2017 Global FICP Survey, World Bank

From the table, it is evident that the initiatives for regulating the different issues relating to microfinance are being taken by the government, but not in a specific manner. E.g. There is no specific regulatory provision regarding client protection in the financial sector, but only a general law of consumer protection for the country. India's national financial inclusion strategy is still in the development phase, and the country still does not have a microfinance strategy in place. The level of access to financial services in India is largely monitored through surveys involving households or individuals, and not much effort has been made to survey the financial service providers to measure the extent of financial inclusion. Presently regulation of MFIs in India is largely carried out through a process of self-regulation.

5.1 Self-Regulation of MFIs in India

The Reserve Bank of India (RBI) 's Malegam Committee Report recommended the formation of Self-Regulatory Organisations (SRO) for the MFIs. In June 2014, it formally recognised MFIN as the first SRO. MFIN is an association of MFIs operating as non-banking financial companies (NBFCs). Sa-Dhan was the second organisation to get SRO status from RBI in 2015. Sa-Dhan has members across the NBFC-MFI category as well as trusts, section 8 companies, and not-for-profit organisations. Sa-Dhan and MFIN evolved a unified code of conduct (CoC) for their members. Industry-developed standards, such as those in the Code of Conduct, can play an important role in ensuring that microfinance delivers the intended benefits to clients by making transparent pricing and terms, grievance redressal mechanisms, etc.

RBI's continuing interest in the sector is reflected in its engagement with both the SROs of the Microfinance sector-Sa-Dhan and MFIN, coming out with modifications and improvements in guidelines whenever required and support to the sector in the aftermath of demonetisation (Sa-Dhan, 2017). However, self-regulation on its own is not sufficient, and formalising self-regulation is not the solution as the SROs themselves are industry associations and are supported by the subscription of MFIs. Thus, they may not always act independently as expected. Especially for deposit-taking activities, self-regulation is not sufficient. It requires prudential regulation and supervision by a qualified independent regulator.

6. DISCUSSION AND CONCLUSION

The analysis of MFI performance makes it clear that Indian MFIs are faring quite well in their financials. However, there are social concerns of declining outreach, portfolio growth, women clients and backward class clients, etc., which have to be taken care of. On the other side, the graduation of major MFIs to SFBs is a big opportunity for the MFIs as they get to enter the thrift and deposit-taking function, and such institutions move to the category of mainstream finance providers. With few large MFIs becoming Banks, over 50% of the total MFI portfolio has moved out of the sector (Inclusive Finance India Report, 2015).

A positive aspect of the double-bottom line performance of Indian MFIs is that more MFIs have come forward to implement universally accepted social performance guidelines, and social performance management is on the rise. But merely stating social objectives as their mission is not sufficient. Reporting tangible results related to the MFI's mission is more challenging: very few MFIs can state whether their social goals are being met. An example is poverty reduction. This was defined as a goal by 84 per cent of MFIs, but when it came to reporting client progress out of poverty, only 10 per cent of MFIs could provide this information (Microbanking Bulletin, 2011). Another example is that MFIs citing employment generation and entrepreneurship development as their social goals do not commonly track such outcomes. Management information systems (MIS) often do not capture this type of data. Thus, if the industry wants social benefits to accrue to the deserving people, it has to constantly keep track of its social performance, and then only it makes sense to say that they are committed to achieving double the bottom line of social and financial performance.

With the advent of new-generation organisations like Small Finance Banks (SFBs), Payment Banks, and NBFC-MFIs, the regulatory ambit of the Indian MFI sector has become more diversified. Interestingly, of the 10 SFBs that were given in-principal licenses by the RBI, 8 are large MFIs. Regarding the regulatory changes made for the sector during the past few years, it can be observed that the provisions often bluntly check the excesses of some MFIs, and at times suppress client-centred innovation. E.g. While regulations bring checks on usurious interest rates, profiteering, multiple lending, over-borrowing, coercive recovery, etc. provisions like restrictions on margins, the composition of MFI loan portfolios, caps on loan size, tenure, and the number of loans per borrower may become constraints to customised service delivery. Future regulatory provisions might seek to make adjustments that establish a more balanced view that allows for dynamic growth of the sector and some checks to ensure client protection.

Isolated efforts to regulate will lead only to cost inefficiency and wastage of resources. The Government of India has recognised its role in global financial inclusion by joining CGAP (Consultative Group to Assist the Poor) as a member in 2012. It can be suggested that the regulatory efforts can be made in line with internationally accepted practices like the Universal Standards of Social Performance Management (USSPM) and Client Protection Principles etc. The creation of an independent agency at the national level to coordinate the sector is recommended, as it can overcome the limitations of self-regulation. To conclude, the problem of regulation is not the only pressing problem of the microfinance sector. Other constraints, such as limited institutional capacity and lack of appropriate financing etc., must also be given adequate care to ensure the best utilisation of MFI strengths and opportunities.

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