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Transparency and Performance in Indian Microfinance 2005

Rapidly growing industries attract the eyes of many – regulators, competitors, investors, clients, and the companies themselves. They may discuss the tactics used in scaling up business, debate the safeguards eschewed in growing at breakneck pace, scrutinize profits made in the face of little competition or marvel in the growth of services offered customers. Whether lauding the accomplishments of the industry or holding it to task for its practices, their analysis relies on accurate, timely and comparable information on the industry, its practices and its performance.

Operating at the margins of the formal and informal economies, the performance of the rapidly growing microfinance sectors in India and across Asia still lies largely in the shadows. Global audiences applaud the scale of microfinance in the region, but know little about its record low transaction costs or the new business models that are quickly blurring the line between microfinance and the formal financial services industry. Two recent publications by the Microfinance Information eXchange, Inc. (MIX) offer a glimpse into the state of the sector, both in what information is available and what light such data shed on this rapidly evolving sector.

Transparency Environment

Asian and, increasingly, Indian microfinance sectors glow by their world renowned scale of service. The light that this outreach casts in turn reflects the fundamental quality of transparency in the sector: an overriding focus on tracking client outreach. India's NABARD (www.nabard.org), doyen of the rapidly growing Self Help Group model, counts loans disbursed by banks to SHGs to monitor the expanding inclusion of isolated groups of poor women into the country's financial sector. The local trade association, Sa-Dhan (www.sa-dhan.org), publishes annual surveys of industry outreach and performance information as reported by local microfinance providers. Despite this focus, it remains difficult to paint an accurate picture of sector outreach. Without nationally recognized client identification or credit bureaus centralizing client data, censuses double count clients in hotly contested markets taking credit from more than one service provider.

Likewise, industry promoters have tracked the SHG movement's massive growth in cumulative outpouring of funds from banks, not in scope of coverage at any given moment in time. The endemic cross-indebtedness that news stories brought to light in Andhra Pradesh in March 2006 highlights how little is known about actual scale and outreach of Indian microfinance.

For all its focus on outreach, the sector offers even less information on financial performance. Subject to regulations from an array of different legal registrations, Indian microfinance epitomizes the difficulty of monitoring actors offering the same services, but viewed as legally dispersed entities. Of all the institutional types practicing in microfinance in India, only non bank finance companies and banks produce audited financial statements that reflect the business model of a financial institution. Financial statements from section 25 companies, societies and others bare little information for decoding their performance as a financial service provider. Apart from leading institutions, MFIs have limited understanding of industry reporting standards, as evidenced by the slow uptake of Sa-Dhan's performance standards among industry practitioners or the fact that MIX rejected a quarter of the respondents to its 2004-05 survey of Indian microfinance for reporting inconsistencies and data inaccuracy.

As the microfinance sector gains media attention in India, several initiatives underway are poised to help overcome these challenges and provide better information to the public on the sector's outreach and financial performance. FINO (www.fino.co.in), a technology and information services company launched in July 2006 and underwritten in part by ICICI Bank – the sector's largest private lender – promises to provide an information backbone to MFIs. Its common information systems platform would provide core banking systems and client level information to subscribing MFIs, offering information and systems that could radically improve data quality, boosting management, investor and other stakeholder insight into institutional performance. With two world-class firms – M-Cril (www.m-cril.com) and CRISIL (www.crisil.com) – offering rating services to microfinance institutions, India also boasts the greatest pool of privately held, quality data on local MFI performance. Given that most of these ratings are publicly funded, a signal from public authorities to open access to a derivative set of this data would radically improve public knowledge of Indian MFI performance.

Clearly, the millions of unreached poor provide the greatest challenge to Indian microfinance. Improved transparency within the sector and its institutions would bolster the enabling environment for MFIs to grow and innovate in order to extend access to financial services to those currently lacking it. The following section highlights how Indian MFIs are performing in meeting this challenge.

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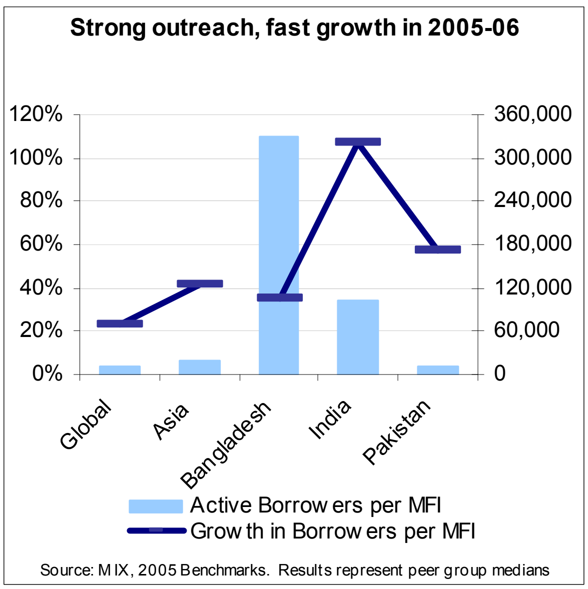
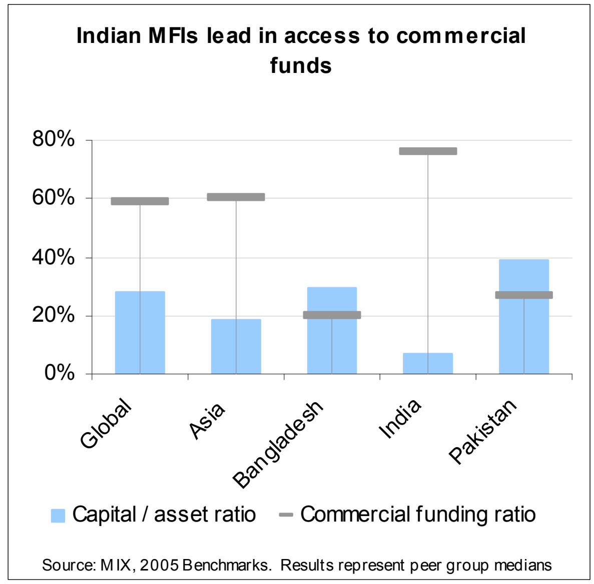
Indian MFI Performance: 2005-06

A 2005-06 survey of India's leading 15 MFIs shows the industry's strength in both size and growth. While MFIs globally and within the region average less than 20,000 clients per institution, well managed Indian microfinance institutions already rank top in outreach, despite their relative young age; with nearly a decade more experience, only Bangladeshi institutions reach more borrowers. Not to be left behind, Indian institutions top the charts of all 78 countries surveyed in 2005 for their phenomenal growth rates, the median leading MFI doubling coverage in a single year. In fact, five of the top 20 fastest growing MFIs in 2005 were Indian, from a survey of nearly 450 institutions worldwide.

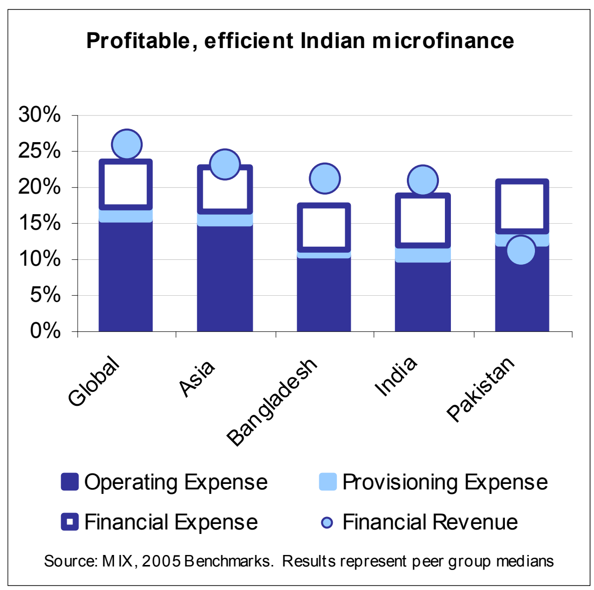


While global microfinance talks about increasing commercial capital available to MFIs and of integrating with local financial markets, Indian microfinance defines the forward lines of this movement. Within Asia and around the globe, Indian MFIs are more leveraged than institutions in any other sector. Compared to other markets in South Asia, the importance of local financial institutions is readily apparent. Bangladeshi and Pakistani MFIs have built large institutions on the backs of soft money. Indian MFIs, on the other hand, deprived of shareholder capital or legal access to public deposits, have funded growth through commercial loans from local banks and development finance institutions. Tapping local financial markets leaves the sector well poised to continue its rapid growth.

Loans to Indian MFIs fulfill more than priority sector lending requirements; they also fulfill the need for returns. Leading MFIs offer slim, but positive margins. Hardly the high returns presented in recent media coverage, leading institutions averaged just under 1% return on assets. While no Indian MFI ranked in the



top 100 most profitable MFIs worldwide, local institutions did lead global rankings in efficiency. This world-class efficiency – 33% less costly than global and regional peers – afforded Indian MFIs the room with which to cover the high financial costs associated with their access to financial markets, while still squeezing out marginal profits.



This report has been produced by the Microfinance Information Exchange, Inc. (MIX) based on its global 2005 sample of 446 leading microfinance service providers, as well as two of its publications: Blaine Stephens and Hind Tazi, "Regional Overview" in Performance and Transparency: A survey of microfinance in South Asia, January 2006; and Scott Gaul, Blaine Stephens and Hind Tazi, "Benchmarking Asian Microfinance 2005", November 2006.