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INDIAN INSTITUTE OF BANKING & FINANCE
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MISSION

The mission of the Institute is to develop professionally qualified and competent bankers and finance professionals primarily through a process of education, training, examination, consultancy / counselling and continuing professional development programs.

ध्येय

संस्थान का ध्येय मूलत: शिक्षण, प्रशिक्षण, परीक्षा, परामर्शिता और निरंतर विशेषज्ञता को बढाने वाले कार्यक्रमों के द्वारा सुयोग्य और सक्षम बैंकरों तथा वित्त विशेषज्ञों को विकसित करना है ।

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The primary theme for this issue of Bank Quest is 'Microfinance and Best Practices in Microfinance'. The text of the 30th Sir PT Memorial lecture and other usual items are also included in the issue.

Dr. Subir Gokarn, Director of Research, Brookings India delivered the 30th Sir Purshotamdas Thakurdas Memorial Lecture on 'Finance and Sustainability : Regulatory and Strategic Dimensions'. The speech begins with the author's involvement in designing a product / index i.e., Environmental-Social-Governance (ESG) metric for emerging economy like India, in 2007. He explains the framework link between finance and sustainability from the perspective of different groups of stakeholders. The lecture explores some of the links in terms of the benefits or trade-offs that materialize when sustainability considerations are brought into financial decisions. He emphasises the need for the sustainability agenda at the micro level, to place a pragmatic framework to guide companies and financial entities to balance between sustainability and financial returns. The article enumerates roles for both the government and corporate leaderships in the area of sustainability and the need for continuous monitoring.

On the theme of microfinance we had sought for some appropriate articles. We observe that some new generation microfinance companies have adopted technology driven innovative delivery strategies to reach the unreached. Some of them have also won some awards recently. We thought it would be appropriate to bring out these experiences in the form 'best practices' .

There are three articles on microfinance. The first article 'Microfinance in India' by Mr. M. Subramaniam, Member of Faculty, Reserve Bank Staff College gives a detailed coverage of NABARD supported SHGs Banks linkage programme and MFIs and their role in microfinance sector. The paper gives a detailed account of the evolution of microfinance sector in India.

'The Crisis and Beyond : Journey of MFIs in India' by Dr. Alok Misra, CEO, M-CRIL is an analytical article on entry and massive growth of MFIs in Indian microfinance sector. The article highlights the pitfalls of sudden high growth, shift in focus from client to profit, Andhra crisis and its impact on Indian MFIs in general and MFI's in A. P. in particular, the resultant high NPAs, the decline in growth and current difficulties faced by the sector. Malegam Committee's recommendations and resultant RBI guidelines on NBFC-MFI have been covered in the article. There is also a brief discussion on the Microfinance Bill.

The third article 'Sustainable Self Help Group Bank Linkage Programme- in Quest of Good Practices' by Dr. Kolandavel Natarajan, Program Manager, Sa-Dhan provides an overview of SHGs Banks Linkage Programme, commonly known as SBLP. The author has given examples of best practices / innovations and sustainability by different banks / institutions under the three models of SBLP. There is also a brief mention about introduction of SHG-II by NABARD introducing concepts of voluntary savings, JLG formation within SHGs and availing cash credit facilities by SHGs from banks.

Under best practices we carry 4 case studies. The first case study 'The Use of Technology for Client Outreach for Small Ticket Loans- the Janalakshmi Story' is written by Mr. N. S. MuthuKumaran, Vice President & Head, Jana Urban Foundation. The case is about Janalakshmi Financial Services Limited serving the urban poor as well as large segment of people around the poverty line who are unable to obtain financial assistance from formal banking / financial sector . The JFSL has successfully adopted advanced technology in microfinance (particularly urban) with multiple applications at reasonable cost which has lead to better operational efficiency and helps in faster decision making. The technology is scalable. JFSL has increased its business using technology for its operations on 3 customer related functions, handled by different sets of people, such as customer relationship, sourcing and collection. In order to reduce the capital costs, it used SaaS model for implementing technology for its operations. Another area of use of technology by JFSL is special analytics to serve the urban poor more efficiently.

The next case study 'Creating Jobs at the Bottom of the Pyramid through Credit plus Microfinance Programme of Hands in Hand (HIH) India' is written by Dr. N. Jeyaseelan, CEO, HIH India. The author explains the activities undertaken by HIH, approach and methodologies and its impact on socio economic life of poor with special emphasis on job creation. HIH is generally involved in SHGs formation, training and capacity building and arranging extension and marketing support to its clients. For credit requirements SHGs / ABG (Activity Based Groups) are linked to banks and MFIs. It is a case study of a successful NGO / Trust for creating new jobs and good socio economic impact on the life of poor through essential credit plus activities, while credit is provided by banks, MFIs, etc.

Mr. John Alex, Vice President and Head-CSR, Equitas Group in the article 'Best Practices in Microfinance : Equitas Story' narrates the journey of Equitas in rendering MFI services with broader mission of improving the quality of life by providing transparent, efficient and trust worthy access of financial services to the unbanked poor. In order to achieve high levels of efficiency, Equitas has adopted innovations such as pre-printed stickers, real-time collections/ monitoring, forms tracking system and automated forms processing. Equitas experience shows that the vision and commitment of the key person conceiving and initiating the process of setting of new MFI is very important. The credit plus activities undertaken by Equitas are also covered in the article.

Mr. S. G. Anil Kumar, Director, IFMR Rural Channels and Services Private Limited in the case study 'Client Engagement in KGFS' explains how KGFS uses the wealth management approach and distinguishes itself from other traditional rural financial service providers. Of particular interest is the way KGFS engages with the larger community in its service area. KGFS is an effort in the private sector to serve the financially excluded clients using shared back end technology which has been made by IFMR Rural Channels and Services Pvt. Ltd, which has established independent KGFS in 6 different regions of the country.

Like this there are many other 'Best Practices'. We will endeavor to capture them in the future issues of Bank Quest. We also hope to bring best practices in rural banking and SME banking as well.

This issue carries a book review 'Barons of Banking - Glimpses of Indian Banking History' by Dr. N. K. Thingalaya.

We welcome your valuable suggestions and feedback for improvement.

Wish you a very Happy New Year, 2014

(Dr. R. Bhaskaran)

Finance and Sustainability : Regulatory and Strategic Dimensions

Dr. Subir Gokarn *

1. Introduction

Good Evening.

It is my great privilege to be delivering the 30th Sir Purshotamdas Thakurdas Memorial Lecture. I follow a long list of very eminent people, who have, by sharing their thoughts at this forum, paid tribute to a very significant personality in India's economic history. As is well known, he was one of the key architects of the Bombay Plan, which, in 1944, in anticipation of independence, provided a broad strategic framework for the country's economic policy. Much has been written and said about that plan, some for, some against, but that is now more a matter of academic than of practical interest. In my view, though, whatever the specifics of that strategy may have been, it was one of the first attempts to think strategically about the long-term trajectory that a newly independent country would need to move along. And, it is significant that this attempt was made not within government circles, but in the private sector. This reflects the shared sense of purpose that different stakeholders had in economic outcomes.

I have to admit that there is no direct connection between the topic I chose to speak on today and the legacy of Sir Purshotamdas Thakurdas. But, in thinking through the issues that I plan to cover today, I believe that the concept of sustainability must have been very much on the minds of the people who formulated the Bombay Plan. The essence of sustainability, after all, is that it is based on the persistent alignment of interests between different stakeholders. We may define the groups and parameters differently these days, but the emphasis on shared purpose that motivated the Bombay Plan is still central to any meaningful discussion of sustainability.

Before I get into the substance of my talk, let me briefly speak about my own involvement with the issue. In 2006, a group of us in CRISIL and Standard and Poor's submitted a proposal to a competition being conducted by the International Finance Corporation. The objective was to design a product for an emerging market economy that would facilitate "socially responsible investment" into that market. It was a fascinating journey for all of us as we pooled our various skills to propose the development of an index comprising Indian companies selected on the basis of their scores on an Environmental-Social-Governance (ESG) metric.

Many investors in the developed economies used ESG criteria in their portfolio selection and, although it was not really in the mainstream of fund management, it was a growing niche. Most importantly, serious long-term investors like pension funds were building these metrics firmly into their decision processes. We felt that such an index for India would be appealing to foreign investors who would make their global investment decisions based on such criteria.

To cut a long story short, we were one of two winners of the competition and, during 2007, worked on developing what came to be known as the S&P ESG India Index, launched on the NSE in early 2008. In the process of developing this index, my colleagues and I came into contact with a whole range of organizations and individuals who are involved with these issue, typically with a great deal of passion. Over the past few months, I have begun to renew those contacts and revive my activities in this very important knowledge domain. When I was invited to deliver this lecture, I thought that this would be a good opportunity to share some thoughts and perspectives on an issue that would not ordinarily get very much attention. I hope that the topic, even if it is a little off-beat, provokes your interest.

* Director of Research, Brookings India.

Coming to the substance of the lecture, I will divide it up into three broad sections. First, I will lay out a framework, which highlights the close links between finance and sustainability from the perspective of different groups of stakeholders. Then, I will explore some of these links in terms of the benefits or trade-offs that materialize when sustainability considerations are brought into financial decisions. Finally, I will draw some implications, as the title of the lecture indicates, for regulators and company managements. I will conclude by highlighting some key messages from the preceding three sections.

2. A Sustainability Framework

The building blocks of ESG

In my introductory remarks, I used the word "sustainability" a number of times, without really defining it. At one level, it seems a commonsense term' everybody knows what it means without it being formally defined. However, as we begin to think about it in a more structured way, it is useful to have a working definition.

So, let me define sustainability in two dimensions : as an objective and a process. As an objective, it means alignment between the long-term interests of all the stakeholders involved in a particular activity. An activity is sustainable as long as it continues to maintain such alignment. As a process, it refers to the mechanisms that are in place to create and monitor this alignment. The likelihood of an activity being sustainable is enhanced by its having robust mechanisms in place.

Of course, this is all very abstract, so we need to place these definitions in concrete contexts. At a policy level, these concepts play out in what is now understood as "sustainable development". This means that a development strategy needs to take into account the perceptions of interest of the entire range of stakeholders, present and future, while deciding on patterns of investment and technology choices. We have so many examples of narrow and short-term considerations dominating these choices, with some horrendous consequences for air, water and noise pollution, not to mention adverse impacts on communities. In any sense of the term, these are not sustainable because, ultimately, they begin to hurt the interests of the groups that they were intended to benefit. Contemporary global thinking on development policy and strategy emphasizes the value of sustainability both as an outcome and in terms of the choice and administrative processes that are required.

In this lecture, though, I want to focus on the applicability of the concept at a corporate or business level, eventually linking it up to finance. The idea is essentially the same. Corporate sustainability comes from the ability of a company to align the interests of its various stakeholders. A company has two categories of stakeholders. Internal ones are shareholders, employees, suppliers and, most importantly, customers. External ones are the larger communities in which they operate and, the future members of these communities, who are represented mainly by the impact of business operations on the environment.

This is the basis of the ESG framework. The E and S components reflect the interests of external stakeholders, while the G broadly looks at how the company aligns the interests of the internal stakeholders as well as between the internal and external groups. There are both process and outcome dimensions to the framework. Companies can be assessed on the outcomes they achieve with respect to each group of stakeholders as well as on the processes that they put in place to pursue these outcomes. In reality, many outcomes are unobservable. For instance, a company following environmentally shoddy practices may survive for a long time without an accident. This is why the process aspect of the evaluation is so important. Whether a company is actually following good environmental practices is the basis of judgement, implying that if it were, the risks of an accident occurring would be lower. Beyond this, the question is what policies and protocols it has in place to respond to an accident. And so on.

The Finance – Sustainability Architecture

The broad conceptual framework that I described above is the foundation for a comprehensive global institutional architecture that promotes sustainable strategies by companies and gives finance a central role in incentivizing these strategies. The United Nations Organization has played a critical role in creating this architecture. There are four components in it and I want to briefly describe the functioning of each one with reference to the larger objective of sustainability. Of the four, three have a direct link to the financial sector.

Pillar-1 : The United Nations Global Compact (UNGC) : Initiated in the year 2000, this is a structure that encourages companies to build their business strategies and operations in compliance with ten core principles, covering the domains of human rights, labour, environment and anti-corruption. As of 2013, there were over 8000 companies that had signed on to the Compact and this was supplemented by about 4000 civil society organizations, who effectively become monitors of corporate compliance. The compact defines corporate sustainability as "...a company's delivery of long-term value in financial, social, environmental and ethical terms". It treats as equivalent the terms "corporate sustainability" and "corporate responsibility", an issue which I shall come to a little later in the lecture. In effect, the signatories are committing to honour each of the ten principles in the conduct of their business.

The UNGC publishes annually the Global Corporate Sustainability Report (GCSR), which provides a tracking of the signatories' compliance with the principles over time. Clearly, it is a huge challenge for companies to be consistently compliant with all the principles all the time. Compliance is, as is often said, a process, not an event. The importance of the structure, though, lies in the fact that it provides an internal compass for companies as they seek to find the alignment within and between internal and external stakeholders that promotes sustainability. The tracking helps point out the principles which pose the greatest compliance challenges and, over time, can become a useful input for regulators and policymakers, who obviously have a strong interest in corporate sustainability, since it feeds directly into sustainable development.

One interesting issue highlighted by the GCSR of 2013 is that, notwithstanding the willingness of companies, both large and small, to sign on to the Compact, it is extremely difficult to monitor and enforce adherence to the principles along the entire supply chain. Companies always have to deal with the trade-offs in relation to costs, reliability of delivery and so on when they develop their supply chains and it is difficult to enforce the conditionality of compliance with the principles of the Compact once the chain is in place. However, over time, companies that are committed to the principles will presumably nudge and push their suppliers into compliance. Even if not all producers sign on to the Compact, there will be a positive externality from the sustainability viewpoint as more and more producers, particularly small and medium-sized ones, find that it actually helps their businesses do better.

As regards the participation of Indian companies in the structure, India has the 13th largest number of company signatories, above 150, a list which includes both large corporates and SMEs.

Pillar-2 : Global Reporting Initiative (GRI) : A critical requirement for sustainability is information. All stakeholders need to know what the organization is doing with respect to their and other's interests. Every policy decision or action taken by a company can potentially help or hurt the interest of one or the other stakeholder group. GRI is a structure that facilitates this level of transparency and disclosure by companies. It lays out guidelines for sustainability reporting, which allows all stakeholders to compare and contrast across companies, not just within a country, but across them as well.

Sustainability reporting, to put it simply, discloses the company's policies and actions with reference to an ESG template. It can be used in conjunction with standard financial reports to make a comprehensive assessment of the company's overall balancing of stakeholder interests. Since information is the main input into investment decisions, these reports provide the basis for the two financial pillars of the architecture.

Over 5700 institutions globally publish sustainability reports, with about 80 Indian companies now on the list.

Pillar-3 : Principles for Responsible Investment (PRI) : This structure was set up in 2003, as a partnership between the United Nations Environmental Programme Finance Initiative (UNEPFI) and the UNGC. It began signing on members in 2006 and currently has over 1200 signatories.

The mode of operation is essentially the same as the UNGC, in the sense that the signatories commit to carrying out their business in compliance with some core principles. The difference is in the target group. The signatories to the PRI are essentially fund managers – large, small, long-term, short-term – the whole range of entities that manage money is included. There are six principles in this structure, which essentially require investors put emphasis on ESG criteria while making their portfolio choices. They also agree to take active interest in the practices and compliance with ESG standards by the companies they invest in and encourage them to comply with the reporting standards of the GRI. As a way to broaden the base of responsible investors, they are expected to engage with other investors to persuade them to adopt the six principles.

This is one of two pillars that relate to the actual deployment of funds. It means that as more funds are managed according to the principles, more companies will have an interest and incentive in adhering to the principles laid out by the UNGC and communicating them as transparently as possible through the sustainability reports that the UNGRI supports. Of course, the effectiveness of this mutually reinforcing mechanism depends entirely on how much money is managed by signatories to the agreement. This year, the total amount managed by signatories was about $2.2 trillion, not a very large proportion of the global fund pool, but no small change either.

Pillar-4 : The Equator Principles : This set of principles is the other financial pillar of the sustainability institutional structure. It applies to institutions that lend for business purposes, both banks and non-banks. The signatories to this agreement, referred to as the Equator Principles Financial Institutions, agree to base their lending decisions on the basis of adherence of projects to ten core principles, which cover the now familiar territory of ESG. The principles are not brought into transactions retrospectively and are accepted as being applicable to relatively large projects (above $10 million), which obviously have far more significant risks relating to impacts on communities and the environment. The reason they are called "Equator Principles" is that they were viewed by the founding institutions as applying equally to the northern and southern hemispheres, hence creating a structure of some global uniformity. Currently about 76 lending institutions are signatories, one of which is from India.

So, what does all this add up to? In an idealized state, the four pillars and the platform that they create reflect a "perfect information" framework for sustainability. Under the UNGC, companies make certain commitments to executing their business in full compliance with a set of principles. They then report their levels of compliance with these principles by means of their sustainability reports, based on the common template created by the GRI. These reports are used by investors who have signed on to the PRI to make their portfolio allocations, putting more weight on companies which show higher levels of compliance with the principles. These reports are also used by lending institutions who have signed on to the Equator Principles to decide on which companies and what projects to lend to. The loop between finance and sustainability is thus closed; companies that are achieving higher sustainability standards are able to mobilize more resources, gradually shifting more and more corporate activity up the sustainability scale. Investors and lending institutions are contributing to this virtuous dynamic by allocating their resources based on these criteria.

But, we are obviously not in an idealized state. In reality, as was alluded to in the discussion of the UNGC earlier, compliance is a process, not an event. There are risks of failure and backtracking that both companies and financial channels have to deal with. From the financial perspective, as we saw, significant resources are allocated without reference to ESG benchmarks. This reduces the incentives that companies face to comply with the principles. Investor horizons are particularly important in this regard. A dominance of short horizons in the market tends to penalize companies which are more committed to the sustainability agenda, which are typically preferred by long-term investors, for obvious reasons. So, the entire process needs to be seen in terms of convergence to the objectives that each of the pillars has set for itself.

3. Sustainability and Financial Performance

This convergence is more likely to take place if there is a high degree of alignment between traditional investment motivations. In other words, do companies that put a priority on the sustainability agenda generally do reasonably well on narrower financial metrics?

There is an enormous amount of evidence on this question. Based on this, can one make the case that investors, whatever their motivations, be generally better off by building sustainability criteria into their portfolio allocations?

A recent article[1] categorizes the findings of 159 research papers looking into the correlation between sustainability and financial performance for the period 1972-2008. Keeping in mind the evolving concept and definition of sustainability over this period, the following picture emerges. In studies carried out by practitioners, 78 per cent of the papers show a positive correlation between sustainability and financial performance, while 13 per cent reveal a negative one. The rest are neutral or mixed. In studies carried out by academics, 60 per cent of them show the positive correlation, 15 per cent show a negative one and 28 are neutral or mixed. Presumably, the academic studies control for other factors more effectively, which explains why the positive findings are somewhat lower; however, they are still in the majority.

Of course, as the article itself points out, correlation does not imply causality. It is quite possible that strong financial performance creates the capacity within the organization to make a greater commitment to sustainability. In fact, going back to the ESG India Index that I mentioned earlier, in the first basket selected in 2008, more than 30 companies that were already in the Nifty 50 made the cut for the 50-stock ESG Index. It appears that many of the most prominent companies in the country put some priority on sustainability. In essence, sustainability is already "mainstreamed" as an investment strategy; investors who might invest passively in an index fund are, even if unwittingly, using sustainability metrics to allocate their funds.

So, can one demonstrate, even if in a limited way, a causal link between emphasis on sustainability and good financial performance? The same article goes on to divide the research papers into two categories : those that use accounting metrics to measure financial performance and those that use market metrics. The pattern emerging from the studies using accounting metrics shows a strong positive bias; about 68 per cent of the papers show a positive correlation between the metrics selected and sustainability practices. However, the studies involving market metrics were almost equally divided between positive and negative correlations, suggesting that investors were not unambiguously benefitted by choosing stocks on the basis of explicit sustainability considerations. While not establishing strong causality, this pattern does suggest that following good sustainability practices at least does not hurt financial performance, as measured by traditional accounting metrics.

The analysis of Indian companies on this basis is nascent. A paper that I co-authored with some members of the ESG index team tried to correlate the governance scores of companies with some indicators of financial performance for a sample of almost 400 companies over three years[2]. The analysis indicated a significant positive relationship between the governance score, which, admittedly is only one aspect of sustainability practices, and some important financial parameters. For instance, after controlling for both firm-specific and time-specific factors, the governance score had a strong positive relationship with market capitalization. Also, there was a negative correlation between the governance score and leverage, suggesting that better governed companies were able to raise equity capital more easily. Importantly, there were signs of a threshold effect; companies had to score above a certain level on the governance scale to realize these benefits.

1. Gaspar, Romeu (2013) Sustainability and financial performance: The chicken-egg dilemma Greenbiz.com (http://www.greenbiz.com)
2. Banerjee, A., S. Gokarn, M. Pattanayak and S. Sinha (2010) "Corporate Governance and Market Value : Preliminary Evidence from Indian Companies" in Corporate Governance: An Emerging Scenario; National Stock Exchange, Mumbai.

These results, however preliminary and tentative they may be, are significant because the analysis goes far beyond the NIFTY or SENSEX stocks. They suggest that, even for relatively small and less prominent companies, investors are discriminating them on the basis of at least governance practices. Perhaps this means that good sustainability practices are being rewarded too.

At this point, though, it would be reasonable to conclude that, while there is evidence in favour of commitments to sustsinability having a positive impact on financial performance, it hardly clinches the case. First, there is plenty of evidence that suggests just the contrary. Second, there is no clear sense of causality running in a particular direction. So, is the potential virtuous cycle of corporate sustainability generated by the interaction between the four pillars largely a matter of faith?

The answer is yes, to a certain extent. Companies that signed on to the UNGC and the GRI, investors that signed on to the PRI and lenders that signed on to the Equator Principles surely didn't do it entirely on the basis of expectations or improved financial performance. They did it because they belied that there was some higher purpose being served by pursuing objectives beyond narrowly defined financial benchmarks. In other words, there was a trade-off inherent in their decisions, particularly as far as short-term financial returns went. The true test of the sensibleness of their commitment would have been over a relatively long period; did firms that put a priority on sustainability generate better financial returns over the long haul? It is extremely difficult to answer this, because formally defined sustainability practices are a relatively recent phenomenon and it is difficult to get a large enough set of companies over long periods of time which have been practicing sustainability but didn't quite know it themselves.

What the empirical evidence cited tells us, though, is that the anticipated trade-off may not be particularly strong, even in the short run. If one is to buy into the evidence of positive correlations between sustainability and financial performance, it would be like having your cake and eating it too. The evidence of zero or negative correlations dilutes the enthusiasm somewhat, but the bottom line is that a combination of faith and empirical evidence is driving the move towards sustainable practices. Either one follows them because they are intrinsically good or because they have tangible financial returns. The trick for companies, perhaps, is to adopt sustainability as an agenda, but to do it smartly, in terms of the goals and instruments, with an eye always on the financial dashboard.

4. Regulatory and Strategic Dimensions

Is there any role for public policy in this process? Clearly, for all companies to put a priority on sustainability is entirely consistent with the larger policy goal of sustainable development. The latter is not going to take place at a macro level unless all individual agents – consumers and producers – go about their daily activities in a consistent manner. However, these objectives are already embedded in statutes and instruments such as the environmental laws and regulations, labour welfare and occupational health and safety regulations, consumer protection, corporate governance and so on. Most countries, and India is certainly one of them, have elaborate legislative and regulatory frameworks, which impose boundaries on corporate behaviour.

However, as I stated a little earlier, these frameworks have been in place for a long time, and yet, the entities who came together to put the four pillars into place did so because of a shared perception that regulation simply wasn't enough to achieve the objective.

In this sense, the sustainability architecture is a supplement to formal legal structures across countries. At one level, it obliges companies to carefully monitor their internal processes, product quality and external stakeholder engagement to ensure that there is across-the-board compliance with all laws. But, this is only a minimum standard, which, theoretically, all companies should be doing whether they are signatories to any compact or not. What the sustainability architect aspires to is for companies to go beyond mere compliance and actively seek ways in which stakeholder interests can be advanced even while improving financial performance. It is the aggregation of these efforts that could have benefits at the macro level and, here, there may be a role for some regulatory initiative.

First, at a very basic level, there might be value in an overall review of the regulatory architecture to see whether it in its own way is consistent with the sustainability principles. As was indicated earlier in the lecture, the broad principles on which all four pillars of the sustainability architecture are based are quite similar. And, if we look carefully at any legislative and regulatory framework, it is not very hard to see that the same principles are very much at work here.

Yet, we get the feeling that, for whatever reason, the intrinsic desire for businesses to comply is not a good enough guarantee that this will happen; supplementary forces are required. One obvious reason for this is that the costs of compliance are so high that there is always going to be an incentive for profit-oriented businesses to minimize these, which often leads to non-compliance. The question is: can the regulatory framework be designed in such a way as to incorporate all the core principles and yet significantly reduce compliance costs? The less it costs businesses to adopt good sustainability practices, the more alignment there will be between micro behaviour and macro outcomes.

Second, one point that emerged from the compliance tracking of the UNGC was the difficulty that even committed companies had in monitoring and enforcing the Compact through their supply chains. Here, the cost factor is central. Large companies can afford to adopt sustainability agendas but smaller ones find the responsibilities that come with them onerous. Since there is a potentially significant macro outcome from large numbers of SMEs increasing their adoption of sustainability practices, there may be a rationale for the government to incentivize these businesses to adopt these practices. Tax breaks and other fiscal instruments, for example, time-bound subsidies to implement certain changes in process could be considered, though, in the Indian context, the overall fiscal situation needs to be kept in mind. But, short of explicit fiscal commitments, many other ways of incentivizing sustainability practices can be thought of.

Enhancing training and capacity building through the existing service infrastructure for industry could be one of these. On other fronts, for example, the revival of the Industrial Training Institutes (ITIs), the government is partnering with industry to re-orient an outdated training model to what industry actually needs in these times. Similarly, organizations that are committed to the sustainability agenda and have succeeded in implementing it while preserving or enhancing financial performance could be brought in as partners in reviving public channels of knowledge transmission.

To reinforce the value of these new capacities, public procurement systems could give some weight to the adoption of sustainability practices. At the very least, they should take into account the overall compliance record of potential vendors and, once they do this, adding on a few points for going above and beyond shouldn't be too difficult. As always, the challenge is in the monitoring and verification and, here again, SMEs find it extremely difficult and expensive to provide all the information typically sought in a sustainability questionnaire. To link this back to an earlier point, the costs of compliance, which include the cost of disclosure and verification, need to be brought down significantly.

In this overall context, I want to briefly address the issue of Corporate Social Responsibility (CSR) spending. The recent amendments to the Companies Act introduced a mandatory spending on CSR of two per cent of profits on companies. There was some debate on whether this was just a tax by another name and also whether the government was in effect abdicating its responsibilities in providing public services and passing the buck on to the corporate sector. Be that as it may, the mandate is now in place and it is up to everybody to make the best of it.

To refer back to a point I made earlier, the UNGC treats the terms “corporate sustainability” and “corporate responsibility” as equivalent. I personally do not think this is valid, certainly in the Indian context, but, regardless, the mandate provides an opportunity to bring these two concepts into alignment.

We have to think about whether independent and un-coordinated efforts by companies, however sincere, are going to be the most effective way to fulfil this mandate. They will do so in the letter, but what we should be aspiring to is the spirit. Can we aggregate the resources from a large number of organizations in ways that provide a powerful impetus to some key social priorities? And, I do not view this as a mere arms-length contribution of the mandated amount to some third party who then assumes the responsibility of execution. The spirit of CSR requires companies to bring some of their organizational capabilities and values to the activity that they sponsor.

This train of thought leads me to a concept of CSR partnerships or consortia, which brings companies with shared CSR priorities together to create initiatives of significant scale, which in turn justifies efforts in design and monitoring. Companies may spontaneously come to this conclusion and initiate such partnerships, but I think the government has a role in one, signalling some priority areas in which such scaling up could yield significant benefits and two, bringing potential partners together.

Let me now turn to the strategic dimension of sustainability. Do companies have an intrinsic incentive to adopt a sustainability agenda and good sustainability practices? In the contemporary business environment, there are strong reasons why this is so. For many businesses, reputation is a significant asset and the loss of reputation resulting from a governance failure or an environmental accident or a conflict with local communities can create a huge business setback. This is a direct bottom line impact and any good management would be sensitive to it and take the precautions necessary to avoid it. This means doing many things that the sustainability architecture would recommend.

One has to be conscious now of the enormous effort companies are now making to obtain customer feedback; beyond that, companies pride themselves on their rankings on the "best employer" or "best place to work" surveys. These reflect an ongoing change in the overall management paradigm, which is putting more and more weight on the perceptions and assessments of stakeholders other than the owners. This is an unmistakable trend towards sustainability practices and, I think, it will only gain momentum as more stakeholders are formally brought into these feedback loops. However, this is only a beginning. The challenge is to put the feedback to good use, which is often extremely difficult. How many of us, as long-time customers of one or the other company, despair that our constructive suggestions for service improvement are never acted upon? There is a risk that the mere act of getting feedback is seen as an end in itself, whereas it is only the first step in a sustainability strategy.

The point I want to make is that companies are increasingly realizing the value in doing things that are an integral part of a sustainability agenda. This is happening regardless of whether they have formally signed on to any commitments. This is a welcome trend and, as it spreads, will begin to have macro impacts. But, there is no reason why it cannot be reinforced by a few factors.

One, even as sustainability practices are adopted by companies in the interests of their business, the articulation and championing of a corporate sustainability agenda is very much the responsibility of the leadership. It is only when all the little things that are being done are given legitimacy by such an agenda that they become institutionalized and also expanded to other applications. Without this, they risk being victims of personnel changes or financial pressures. The leadership needs to elevate such practices to a status of permanence.

Two, while we have referred to some general evidence that sustainability practices and financial performance are positively correlated, each business has to be conscious of the fact that this may not hold in its case. It is necessary for the leadership to emphasize to the organization that financial performance remains as important as ever, even as a sustainability agenda is being put into place. Cost consciousness must not be sacrificed as an excuse for the transition. In this context, practices that achieve both objectives, such as conserving on paper or electricity, reinforce the message that financial performance and sustainability are entirely compatible with each other.

Three, a sustainability agenda could potentially be a source of competitive advantage. There may, therefore, be an incentive to keep it hidden for fear that competitors could replicate it to their advantage. However, from a macro perspective, the more that is known about what individual companies are doing successfully, the more likely it is that the adoption of such practices will spread, to good effect. This demonstration effect is an important objective of the architecture through the GRI. Disseminating lessons from successful and unsuccessful experiences in implementing a sustainability agenda is also part of the sustainability agenda.

Four, from a financial perspective, the adoption of such practices may or may not make a company more attractive or a project more viable over relatively short time horizons. However, over longer periods of time, given the nature of the risks involved, there is likely to be a convergence between finance and sustainability. To the extent that long-term considerations are built into financial allocations, resources should flow into companies and projects which have better sustainability attributes.

5. Concluding Thoughts

Let me now conclude with four key messages.

First, sustainable development as a macro strategy requires the adoption of sustainability agendas at the micro level. The first is not going to be achieved unless the people who actually produce, and consume, goods and services do so in a sustainable way.

Second, there is a pragmatic framework in place, based on some unexceptionable principles, comprising both principles and agreements that provide guidelines to companies and financial entities. This framework creates the capacity for financial resources to be deployed in a manner which balances sustainability and financial returns.

Third, both the government and corporate leaderships have important roles to play in furthering the agenda. From the government perspective, thought needs to be given to how to reduce the costs of compliance with laws and regulations promoting sustainability, incentivizing SMEs to adopt the agenda and, in the immediate context, effectively leveraging the CSR mandate to obtain the maximum benefit. Corporate leadership needs to articulate and champion sustainability agendas and emphasize areas in which sustainability and financial performance are most compatible. This, in turn, brings about an alignment between the interests of companies and their investors and lenders.

Finally, sustainability is best seen as a process rather than an outcome; one which brings more and more into alignment the interests of multiple stakeholders. The process needs to be continuously monitored, compliance rewarded and non-compliance reversed. The financial system is an integral part of the monitoring, reward and correction mechanism.

Let me end by thanking the Indian Institute of Banking and Finance for inviting me to deliver this lecture, Mr. Kamath, Chairman and Managing Director of Punjab National Bank and the current President of IIBF for chairing the session and, of course, to all of you for being here and participating. Thank you.

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Microfinance in India

M. Subramaniam *

The nationalization of banks and various poverty alleviation programmes failed to make much dent into the poverty scene in India. Despite the vast expansion of the formal credit system in the country, the dependence of the rural poor on moneylenders continues in many areas, especially for meeting emergent requirements. Such dependence is pronounced in the case of marginal farmers, landless labourers, petty traders and rural artisans belonging to socially and economically backward classes and tribes whose propensity to save is limited or too small to be mopped up by the banks. For various reasons, credit to these sections of the population has not been institutionalized. The studies conducted by NABARD and ILO on the informal groups promoted by Non-Governmental Organizations (NGOs) brought out that Self-Help Savings and Credit Groups have the potential to bring together the formal banking structure and the rural poor for mutual benefit and that their working has been encouraging. It was, therefore, realized that further direct efforts were needed to address the credit needs of the poor. In response to this long felt need, the micro finance movement started in India with the introduction of Self Help Group (SHG) – Bank Linkage scheme in the early 1990s.

The proposed Microfinance Services Regulation Bill defines microfinance services as “providing financial assistance to an individual or an eligible client, either directly or through a group mechanism for :

i. an amount, not exceeding rupees fifty thousand in aggregate per individual, for small and tiny enterprise, agriculture, allied activities (including for consumption purposes of such individual); or

ii. an amount not exceeding rupees one lakh fifty thousand in aggregate per individual for housing purpose; or

iii. such other amounts, for any of the purposes mentioned at items (i) and (ii) above or other purposes, as may be prescribed.

The proposed regulations further define an MFI as an organization or association of individuals including the following if it is established for the purpose of carrying on the business of extending microfinance services :

i. a society registered under the Societies Registration Act, 1860;

ii. a trust created under the Indian Trusts Act, 1882;

iii. a co-operative society / mutual benefit society / mutually aided society registered under any state enactment, or any multi state co-operative society registered under Multi State Co-operative Societies Act, 2002, but not including; (a) a co-operative bank as defined in Section 5 of the B.R Act, 1949, or (b) a co-operative society engaged in agricultural operations or industrial activity or purchase or sale of any goods and services.

The basic principles of micro finance that distinguish it from earlier modes of credit delivery are small amounts of loan, lack of physical collateral but emphasis on social collateral or peer monitoring and focus on women borrowers. The involvement of the entire group at each stage of seeking the loan and its repayment is essential for peer monitoring. In several countries across the world, micro finance originated from the activity of Non-Governmental Organisations (NGOs) that were aided largely or partly by foreign donors for their lending operations. The micro finance experiment in India can be described as relationship banking rather than parallel

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banking elsewhere in the world. In this experiment, there exists a link between SHGs, NGOs and banks. The SHGs are formed and nurtured by the NGOs and only after accomplishing a certain level of maturity in terms of their internal thrift and credit operations, they are entitled to seek credit from the banks. Thus, there is an involvement of the respective NGO before and even after the SHG-Bank Linkage. This variant of microfinance is most popular in India.

The Indian microfinance sector is dominated by two operational approaches : (i) Self Help Groups (SHGs); and (ii) Micro Finance Institutional Model, with each approach employing a particular model for provision of micro credit in India.

The first operational approach involving SHGs came to be implemented under two models. Firstly, the people's movement led by NGOs which has existed outside the government schemes and banks. This model has emerged by organizing people to sort out their financial mismatches without intervention of the government or banks or external agencies. The second model involves active intervention by the government and its agencies including banks and implemented through the mechanism of SHGs.

The second operational approach, which is adopted by the MFIs looks at the poor as market and accordingly developed a mechanism to deliver credit efficiently.

A SHG both by definition and practice is a group of individual members who by free association come together for a common collective purpose. They have membership of 10 to 25 members with certain homogeneity. The beginning of the micro finance movement in India could be traced to the SHG – Bank Linkage Programme (SBLP) started as pilot project in 1992 by NABARD. This programme not only proved to be successful, but has also emerged as the most popular model of micro finance in India. Today the SHG model, which links informal groups of women with the mainstream banking system, has the largest outreach to microfinance clients in the world. Under the SBLP, three models have emerged :

i) SHGs promoted, guided and financed by banks;

ii) SHGs promoted by NGOs / Government agencies and financed by banks; and

iii) SHGs promoted by NGOs and financed by banks using NGOs / formal agencies as financial intermediaries.

The SHG model is most popular model (SBLP programme) involving commercial banks, co-operative banks and the regional rural banks. The SBLP continues to be dominant, given the wide reach of the banks. As of March 2009, around 86 million poor households through six million SHGs had placed their savings of about ₹5,500 crore with the public sector banks.

The following criteria are broadly adopted by NABARD for selecting SHGs for linkage with bank loans.

i. The group should be in existence for at least six months.

ii. The group should have actively promoted the savings habit.

iii. Groups could be formal (registered) or informal (unregistered).

The second operational approach, *viz.* Micro Finance Institution Model has also gained popularity, although the SHG model remains the most popular.

With a view to effect major policy initiatives on micro finance sector, RBI set up the Micro Credit Special Cell to suggest measures for augmenting flow of micro credit as announced in Governor's Monetary and Credit Policy for the year 1999-2000. RBI also issued comprehensive guidelines to banks in February 2000 which stipulated that micro credit extended by banks to individual borrowers directly or through any intermediary (say MFI) would be reckoned as part of their priority sector lending. Banks were advised to follow the under noted guidelines for mainstreaming micro credit and enhancing the outreach of micro credit providers :

i) The banks may formulate their own model(s) or choose any conduit / intermediary for extending micro credit.

ii) Banks may prescribe their own lending norms keeping in view the ground realities.

iii) Micro credit should be included in branch credit plan, block credit plan and state credit plan of each bank.

iv) A simple system requiring minimum procedures and documentation is a pre-condition for augmenting flow of micro credit.

In April 2008, banks were advised by RBI to meet the entire credit needs of SHG members as envisaged in the Union Budget for the year 2008-09.

NABARD has been playing a crucial developmental role for the micro finance sector in India. The "Micro-Enterprise Development Programme" (MEDP) launched by NABARD was for skill development of the SHG members. The Micro Finance Development Equity Fund (MFDEF), maintained by NABARD, (corpus of ₹200 crore) is used for promotion of micro finance through scaling up SBLP, extending Revolving Fund Assistance (RFA) and capital support to MFIs as well as other promotional initiatives. NABARD also launched the linking of post offices with SHG under which loans are given at 9% to SHGs, wherein post offices would be allowed to retain an interest margin of 3%. At end March 2008, an aggregate of 1963 post offices or sub post offices were linked to SHGs.

The MFIs in India, exist in a variety of forms like trusts (regd), societies (regd), Co-operative Societies and Non-Banking Finance Companies (NBFCs, which can be registered under section 25 of Companies Act or Registered with DNBS, RBI). Banks use MFI as their agent for handling credit, monitoring, supervision and recovery. In this model, the bank is the lender and MFI, the agent. Another variation of this model is where the MFI, an NBFC, holds the individual loans on its books for a while, before selling them to the bank. Such refinancing through securitization enables the MFI – NBFC, a greater access to funds. As more and more NBFCs started entering the micro finance sector, recognizing the potential in the sector, RBI, in January 2000 announced that those NBFCs which were engaged in micro financing activities licensed under Section 25 of the Companies Act, 1956 and which were not accepting public deposits were exempted from the purview of Registration (Section 45 – IA) and maintenance of liquid assets (Section 45- IC).

Indian MFIs range from Grameen–replicator NGOs to for–profit entrepreneurial ventures to developmental NGOs which moved from SHG promotion to direct financial intermediation. Based on their asset sizes MFIs can be divided into three categories :

Category-1 : About 5-6 institutions which have attracted commercial capital and scaled up dramatically over last 5 years. These MFIs, which include SKS, SHARE and Spandana, were initiated in the 1990s as NGOs promoting SHGs or Grameen – Style programmes, but after 2000, converted into for-profit regulated entities mostly NBFCs.

Category-2 : Around 10-15 institutions with high growth rates, including both NGOs and recently formed for-profit MFIs (mostly NBFCs). Many NGOs have transformed into regulated, for-profit structures recently and seeked commercial equity investments. Examples include Grameen Koota, Bandhan and ESAF.

Category-3 : The bulk of India's 1000 MFIs are NGOs struggling to achieve significant growth. Most continue to offer multiple developmental activities in addition to microfinance and have difficulty in accessing growth funds.

MFI Mainstreaming and Commercialization

While SHGs tend to have a multi-sectoral development approach and are challenged by sustainability, most MFIs focus on scaling up microcredit operations while creating a sustainable legal structure and business model. The MFI approach is generally more attractive to commercial capital and mainstream market players.

A discerning trend has emerged over the last three years. MFIs have widened their network and have absorbed a higher share of banks' disbursements. Similarly, banks also consider the MFIs as a beneficial conduit for scaling up their volumes. Some of the MFIs also accept deposits since MFIs operate under different legal structures and many of them do not come under the purview of the RBI. Hence, in the context of regulation, timely approval and passage of the Micro Financial Sector (Development and Regulation) Bill would give more recognition to the sector, and in turn, would facilitate its orderly growth.

Summary of Rangarajan Committee on Financial Inclusion (Jan 2008).

"Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost."

1. National Rural Financial Inclusion Plan (NRFIP)

Looking at the enormity of the task involved, financial inclusion must be taken up in a mission mode as a Financial Inclusion Plan at the national level. The target for NRFIP could be to provide access to comprehensive financial services to at least 50% (55.77 million) of the excluded rural cultivator and non-cultivator households, across different States by 2012 through rural / semi urban branches of CBs and RRBs. The remaining households, with such shifts as may occur in the rural / urban population, have to be covered by 2015. Semi-urban and rural branches of commercial banks and RRBs may set for themselves a minimum target of covering 250 new cultivator and non-cultivator households per branch per annum, aggregating 11.15 mn. households p.a., with clear emphasis on financing marginal farmers, tenant cultivators and poor non-cultivator households.

2. Two funds to be constituted – A Financial Inclusion Promotion & Development Fund, with NABARD, for meeting the cost of developmental and promotional interventions and a Financial Inclusion Technology Fund, with NABARD to meet the costs of technology adoption. Each Fund will have an initial corpus of ₹500 crore, with a start up funding of ₹250 crore each, to be contributed equally by GoI / RBI / NABARD and annual accretions thereto. Banks will be eligible for support from the Funds on a matching contribution of 50% from the Fund in regard to districts other than tribal districts and 75% in case of branches located in tribal districts identified under the Tribal Sub Plan. This recommendation has already been implemented.

3. Deepening the outreach of microfinance programme through financing of SHG / JLGs and setting up of a risk mitigation mechanism for lending to small / marginal farmers / share croppers / tenant farmers through JLGs.

4. Use of PACSs as Business Facilitators and Correspondents

5. Micro finance – Non Banking Finance Companies (MF-NBFCs) to be permitted to provide thrift, credit, micro-insurance, remittances and other financial services up to a specified amount to the poor in rural, semi-urban and urban areas. Such MF-NBFCs may also be recognized as Business Correspondents of banks for providing only savings and remittance services and also act as micro insurance agents.

6. Opening of specialised microfinance branches / cells in potential urban centers for exclusively catering to Microfinance and SHG - bank linkages requirements of the urban poor. An enabling provision to be made in the NABARD Act, 1981 permitting NABARD to provide micro finance services to the urban poor.

7. SHGs to provide alternative savings products. Most of the SHGs encourage compulsory savings with equal small amounts by members on a regular basis. SHGs need to offer a wide range of savings products so as to capture the huge potential of savings that remains untapped. Groups should be free to design savings products suiting to members' requirements. Certain level of experimentation could be attempted by the Resource Centres in designing new saving products and NABARD should encourage and support such experiments.

8. Stamp duty may be waived in respect of loans for small / marginal farmers, tenant cultivators and oral lessees

9. Expand the scope of BCs : In addition to the institutions presently allowed by RBI to function as BCs, individuals like locally settled retired Government servants like postmasters, school teachers, ex-servicemen and ex-bank staff, whose relationship with the banking system through a pension account has already been established, may be permitted to act as BCs. Further, MF-NBFCs may be allowed to act as limited BCs of banks for only providing savings and remittance services.

10. SHGs which are operating as thrift and credit groups may, in future, evolve to a higher level of commercial enterprise. The question of providing a simplified legal status to the SHGs may have to be examined in full, This would also facilitate their becoming members of PACS.

11. Interest Subsidy by states to be examined : Certain States are reportedly providing a subsidy on interest rates being charged by banks to the SHGs. The margin available to SHGs is sufficient to take care of operational costs, even after considering the small amounts of loan provided to members. Thus, a subsidy on interest rates cuts at the very root of the self help character of SHGs. The subsidy could be re-directed towards capacity building efforts or in providing input supplies and marketing support to the SHGs.

12. Resource centres to be set up by various stakeholders such as NGOs, banks, Government departments, NABARD at the State / district level to play an important role in preparing training modules, developing a cadre of trainers, conduct of field studies and in promoting interface between SHG members and service providers.

13. Amendment to NABARD Act. - At present, NABARD is permitted, as per its Act and Mandate, to support micro finance activities in rural and semi-urban areas only. An enabling provision be made in the NABARD Act, 1981 permitting NABARD to provide micro finance services to the urban poor.

14. Recognising MF-NBFCs. - There is a need to recognize a separate category of Micro finance – Non Banking Finance Companies (MF–NBFCs), without any relaxation on start-up capital and subject to the regulatory prescriptions applicable for NBFCs. Such MF-NBFCs could be defined as companies that provide thrift, credit, micro-insurance, remittances and other financial services up to a specified amount to the poor in rural, semi-urban and urban areas.

15. Relaxation in FIPB guidelines. - Current guidelines used by FIPB (Foreign Investment Promotion Board) require a minimum of US $500,000 equity investment from a foreign entity. MFNBFCs' initial capital needs may not be very large and the Committee is of the view that the minimum amount of foreign equity for MF-NBFCs may be reduced to a level of US $100,000/-.

16. Unifying regulatory oversight. - RBI may consider bringing all regulatory aspects of microfinance under a single mechanism. Further, supervision of MF-NBFCs could be delegated to NABARD by RBI.

17. Micro Finance Bill. - While Section 25 Companies could be covered by the Micro Financial Sector (Development and Regulation) Bill, 2007, cooperatives can be taken out of the purview of the proposed Bill

18. Creation of National Database. - The creation of a national data-base, sectoral, geographic and demographic reports, and also a payment system benefiting the card holders from the underprivileged / unbanked population will not be possible without the extensive use of IT. This alone can bring down the costs of the small ticket transactions of the poor and make nationwide financial inclusion a reality.

As recommended by the Rangarajan Committee, two Funds have been set up with NABARD, viz., 'Financial Inclusion Fund' (FIF) for meeting the cost of developmental and promotional interventions of financial inclusion and 'Financial Inclusion Technology Fund' (FITF), for meeting the cost of technology adoption. Each Fund consists of an overall corpus of 500 crore, to be contributed by the Government of India (GoI), Reserve Bank and NABARD in the ratio of 40:40:20 in a phased manner over five years, depending upon utilisation of funds. In the Union Budget for the year 2010-11, the corpus of each of these funds has been enhanced by another 100 crore. The guidelines for these two funds have been formulated and circulated among stakeholders. As on March 31, 2012, 74,199 villages were covered under financial inclusion through FIF and FITF. During 2010-11, the Swabhiman campaign was launched to extent banking facilities either through brick and mortar branch or Business Correspondents (BC) in habitations with population over 2000 (In N.E states, population limit is over 1000).

Progress of Micro Finance in India

The micro finance movement has come a long way since its inception in the early 1990s and has assumed enormous significance in the delivery of credit to the hitherto excluded section of the population. While the

(SBLP) has emerged as the most dominant model, as can be seen from the table below, the MFI model has also been gaining importance.

Particulars	Self Help Groups as on 31.03.2011		Self Help Groups as on 31.03.2012	
	Number (in lakh)	Amount (₹ in crore)	Number (in lakh)	Amount (₹ in crore)
Loans disbursed during the year	11.96	14,547.73	11.48	16,534.77
Loans outstanding	47.87	31,221.16	43.54	36,340.00
Savings a/cs with banks	74.62	7,016.30	79.60	6,551.41
Source : NABARD Annual Report : 2012-13				

Particulars	Micro Finance Institutions as on 31.03.2011		Micro Finance Institutions as on 31.03.2012	
	Number	Amount (₹ in crore)	Number	Amount (₹ in crore)
Loans disbursed during the year	471	8,448.96	465	5,205.28
Loans outstanding	2315	13,730.62	1960	11,450.35
Source : NABARD Annual Report : 2012-13				

Studies have revealed that the SBLP model of micro finance has had a positive impact on the income and employment situation of the poor. A study carried out by Puhalendi and Satyasal in 2000 revealed that about 74 percent of the sample households were below the annual income of ₹22,500 during the pre-SHG situation. The position improved to 57 percent in the post-SHG situation indicating improved income levels. It was also revealed that availing loan from money lenders and other informal sources at very high interest rates also reduced correspondingly. It was also revealed that wherever the loan amount were given for very small amounts, it was utilized for consumption purposes, thus highlighting the need to move away from giving very small amounts as loan. Studies have also revealed the need to train the SHGs in account keeping as most SHGs were not able to provide information on profits earned or loan outstanding to banks. As already stated in the Para above, studies have shown that there has been an improvement in the living standards between pre-SHG and post-SHG situation. It must be understood that the SHG model of credit delivery is at one level rooted in the community and at another level was integrated with the larger banking system with dealings entirely based on mutuality. Consequently, such a credit delivery system, is time consuming and has to go through many phases until stabilization. This can happen only through a long process of community intervention. It is, therefore, important that the progress, even if slow, will enable the poor, over a period of time, to not only take control of their resources, but as these resources grow, can hire professional help to manage their resources.

Ultimately, to determine whether a micro finance programme has been successful or not depends on the answer to the issues given below :

1. Has there been a significant improvement in the living standards of the poorer sections in the region?
2. Has there been development of a sustainable micro finance institution following the best management practices in the SHG locations?
3. How reasonable are the rates of interest charged to the SHG members or other small borrowers ?
4. Are coercive methods used by MFIs for recovery of loans from the borrowers or SHG members?
5. What is the element of government subsidy and how much has really gone to the end borrower?
6. How are the groups functioning after the programme is closed or after support is withdrawn after a certain period?

Issues and concerns

The micro finance segment albeit its expansion has remained a miniscule of bank credit in India. In 2012, almost 15 years of the inception of the SHG - Bank Linkage Scheme, credit to SHG formed less than one percent of the total bank credit from scheduled commercial banks. Further, the data available in the last 10 years evidences only a marginal rise (from 0.54% to 0.75%) in the percentage share of bank credit to and loan accounts held by SHGs.

Further, there has been considerable regional disparity in terms of the spread of micro finance in India. South India is way ahead of the other regions not just in terms of the absolute number of SHGs formed and the bank credit supplied to these SHGs but also in terms of

Percentage share of credit outstanding to SHGs in total credit outstanding of scheduled commercial banks (including RRBs)			
Year (as on)	Amount of credit outstanding to SHGs (in ₹ crore)	Total credit outstanding (in ₹ crore)	% of SHG credit to total bank credit
31.3.2002	2,909.04	5,30,344.08	0.54
31.3.2012	36,340.00*	48,03,266.90*	0.75

**Source :Basic Statistical Returns of Scheduled Commercial Banks in India -Volume 41 and Nabard Annual Report 2011-12*

its coverage of poor persons residing in this region. Southern states, as of March 2012, account for 54.3% of the total number of cumulative number of SHGs and 75.2% of the cumulative amount of bank credit availed by all SHGs. Since southern region is one of the better banked regions of India, concentration of micro finance in one region will undoubtedly lead to regional disparity.

The MFI model of micro credit, which is a product of the market forces (where the poor is viewed as market) is based on the inherent belief that with the expansion of the market and the consequent competition between the players the poor will reap the benefit of a good deal in credit delivery. While predictably the market expanded attracting more players in micro credit finance segment, the players became more standardized in their products. The individual identity of each MFI is vanishing owing to which there is little difference between one MFI and the other. A standardized model closes innovation and prevents customization of the cultural and economic peculiarities of each region.

The anxiety in a standardized model of credit delivery by MFI is more for growth and returns leading to zero tolerance for loan defaults. The general belief in a standardized model is that 100% recovery alone is sufficient for a successful model. While zero tolerance for default brought in discipline, it often failed to probe deep in to the reason for the impairment of the ability to pay. The new generation of MFIs perhaps did not give importance to this aspect and instead focused more on recovery, reportedly employing even coercive methods, leading to adverse publicity and the consequent punitive action by the government.

The business model of the MFIs (usually NBFCs taking loan from banks at 14% and deploying at rates between 24% and 36%) perhaps aimed to balance the demands of its social mission with those of their share holders' maximization of net worth necessitating zero tolerance for defaults. The Yunus model, however, suggests that the MFIs should work towards converting themselves into banks so that their cost of funds would be lower.

Malegam Committee on Micro Finance sector

In the wake of the Andhra Pradesh micro finance crisis in 2010, the need was felt for more rigorous regulation of Non-Banking Financial Companies (NBFCs) functioning as Micro Finance Institutions (MFIs). Accordingly, a Sub-Committee of the Central Board of the Reserve Bank (Chairman : Shri Y. H. Malegam) was constituted to study issues and concerns in the MFI sector. The Committee which submitted its report in January 2011, *inter alia*, recommended (i) creation of a separate category of NBFC-MFIs; (ii) a margin cap and an interest rate cap on individual loans; (iii) transparency in interest charges; (iv) lending by not more than two MFIs to individual borrowers; (v) creation of one or more credit information bureaus; (vi) establishment of a proper system of grievance redressal procedure by MFIs; (vii) creation of one or more “social capital funds”; and (viii) continuation of categorisation of bank loans to MFIs, complying with the regulation laid down for NBFC-MFIs, under the priority sector.

The recommendations of the Committee were discussed with all stakeholders, including the Government of India, select State Governments, major NBFCs working as MFIs, industry associations of MFIs working in the country, other smaller MFIs, and major banks. In the light of the feedback received, RBI accepted the broad framework of regulations recommended by the Committee.

Based on the recommendation of the Committee, RBI issued detailed guidelines permitting categorization of bank credit to eligible MFIs as priority sector advance. Such eligibility has been linked to core features of micro finance such as, lending of small amounts to borrowers belonging to low income groups, without collaterals, flexible repayment schedules, etc.

Margin caps (not more than 10%) and interest caps (not more than 26%) have been stipulated to ensure protection of borrowers. In December 2011, RBI issued guidelines for creation of a separate category of NBFCs dealing in micro finance with minimum NOF of ₹5.00 crore.

Bank loans to all MFIs, including NBFCs working as MFIs on or after April 1, 2011, will be eligible for classification as priority sector loans under respective category of indirect finance only if the prescribed percentage of their total assets are in the nature of "qualifying assets" and they adhere to the "pricing of interest" guidelines to be issued in this regard;

- that a “qualifying asset" is required to satisfy the criteria of (i) loan disbursed by an MFI to a borrower with a rural household annual income not exceeding ₹60,000 or urban and semi-urban household income not exceeding ₹1,20,000; (ii) loan amount not to exceed ₹35,000 in the first cycle and ₹50,000 in subsequent cycles; (iii) total indebtedness of the borrower not to exceed ₹50,000; (iv) tenure of loan not to be less than 24 months for loan amount in excess of ₹15,000 without prepayment penalty; (iv) loan to be extended without collateral; (v) aggregate amount of loan, given for income generation, not to be less than 75 per cent of the total loans given by the MFIs; and (vi) loan to be repayable by weekly, fortnightly or monthly instalments at the choice of the borrower;
- that banks should ensure a margin cap of 12 per cent (or 10% for larger MFIs with loan portfolios exceeding ₹100 cr) and an interest rate cap of 26 per cent for their lending to be eligible to be classified as priority sector loans;
- that loans by MFIs can also be extended to individuals outside the Self-Help Group (SHG) / Joint Liability Group (JLG) mechanism;

Redefining the Priority Sector

The Malegam Committee also recommended that the existing guidelines on bank lending to the priority sector be revisited. Based on requests received from various quarters to relook at the definition of the priority sector, especially when bank finance was being routed through other agencies, a committee under Shri M. V. Nair, Chairman Union Bank of India was appointed to re-examine existing classification of priority sector advances. The revised guidelines based on the Committee's recommendations were issued by RBI in July 2012.

Micro Finance Development and Regulation Bill (Draft)

The Government has proposed a regulatory framework for the microfinance industry that provides protection to the consumer, makes the Reserve Bank of India the sole regulator and puts industry under a strict watch. The draft Micro Finance Bill gives sweeping power to the RBI by bringing all aspect of microfinance under its oversight.

The bill has proposed that any entity, except banks, which provides microfinance services, would be treated as a Micro Finance Institution (MFI) and come under the RBI's regulatory oversight.

Every MFI, including the existing ones, will have to register with the RBI within three months of the commencement of the Act, which will allow for better regulation. The bill has not put any cap on the interest rates charged by the MFIs, but gives the RBI sweeping powers to regulate lending rates and margins apart from fixing prudential norms. A microfinance development council, one of two advisory bodies proposed to be set up under the bill, will set the policy agenda. While the union cabinet has approved the bill in May 2012, it is yet to be passed as a legislation by the Parliament, due to reservations of RBI on the suitability of its organizational structure in regulating such vast number of entities located in remote parts of the country.

In October, 2013, the RBI Governor and other top Officials of RBI made it clear that the organizational set up of the central bank is not suited for regulating and supervising such entities. Effective regulation of such entities would only be possible by authorities who have the necessary reach and wherewithal to cover remote areas. The regulation of such entities by the RBI or any central authority, which does not have a local presence, could prove to be both ineffective and expensive. Given this and other reservations over the proposed Bill, it is likely that the Standing Committee (headed by former Finance Minister Mr. Yashwant Sinha) would seek changes to the Bill.

While Parliament has the power to enact laws for regulating and winding up corporations in the banking, insurance and financial sector under entry 43 of the first list of the VII Schedule of the Constitution, a separate entry 32 of the second list provides states the power to make laws to regulate and wind up corporations other than those mentioned in the first list. In addition, money lending is a state subject under entry 30 of the second list. Since MFIs are micro lenders, the power to make laws to regulate lending by entities which are not covered by the first list, is only with the states. It was this power that Andhra Pradesh exercised in late 2010 when it enacted a law on MFIs, which also covered non-banking financial companies. The latter entities are regulated by the RBI. Many NBFC's have since challenged the law. On its part, the RBI told the Courts that the state does not have the competence to enact such a law. It adopted the same stance in similar matters before the Supreme Court and High Courts of Gujarat and Karnataka. It is thus that the RBI is of the considered view that if MFIs, which are not companies, are covered by a central law, a question mark over the legislative competence of Parliament would arise in this regard. The RBI's submission is that Parliament does not have the legislative competence under Article 246 of the Constitution read with entries 30 and 32 of the second list to make a law for MFIs that are not companies. The RBI has also made it clear that if the intention of the central government is to have a uniform law for MFIs operating in different states, the power of Parliament to enact a law for states under Article 252 will have to be invoked. It would be appropriate to enact a model law on MFIs and give the discretion to states to adopt it, as in the case of Chit funds. Other suggestions that the RBI has made on the Bill provisions include the definition of micro credit should only cover unsecured credit and that the power to supersede MFI boards should be one without the need for prior notice.

Apart from the above legislation on Micro Finance Bill, there is also a Financial Inclusion Advisory Committee (FIAC) under the Chairmanship of Dr. K. C. Chakrabarty, (appointed on October 11, 2012) to explore issues such as developing viable and sustainable banking services delivery models focusing on accessible and affordable financial services, developing products and processes for rural as well as urban unbanked consumers. Another Committee under the Chairmanship of Dr. Nachiket Mor has been appointed by RBI, in September 2013, with almost the same terms of reference. We have thus presently two independent committees working simultaneously on Financial Inclusion.

Key Lessons and the Way forward

The Subprime crisis of 2008, underlined the need for proper governance of institutions based on two basic tenets of transparency and accountability. The turmoil in the MFI sector happened due to the serious deficiencies in the governance framework of some of the MFIs which led to their fall and ultimately affected the sector as a whole. The Boards of the MFIs failed to balance the objectives of various stakeholders. *viz.* the equity holders, donors, borrowers and the society overall. The MFIs should align their business objectives with the requirements of the social segments (borrowers, etc.) they cater to. Although, regulations are in place to promote a vibrant and transparent MFI sector, the MFI Industry captains too have a role to play in promoting self regulation by the players in the industry. MFIs need to spread to hitherto untapped regions towards geographical diversification, reduce operational costs and leverage on technology to build a more cost effective and efficient delivery model to serve their customers.

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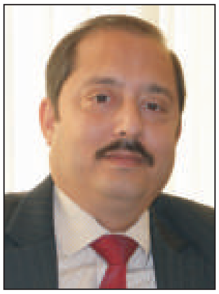
The Crisis and beyond : journey of MFIs in India



Dr. Alok Misra *

The advent of microfinance

In most developing countries, directed and subsidised rural credit programmes initiated in 1950s started to exhibit by 1990s similar institutional weakness, cornering of subsidies by the better off and the exclusion of the needy from the reach of financial services. As a response to these shortcomings of the formal sector, internationally in somewhat disparate settings of Bangladesh, Bolivia and Indonesia, microfinance experiments took root. In the late 70s, pioneering work by Professor Muhammad Yunus in Bangladesh was followed in the 1980s by PRODEM[1] in Bolivia and Bank Rakyat Indonesia (BRI) to provide financial services to poor people ignored by banks, primarily on account of their meagre requirements and lack of collateral in both the scope of their outreach and ability to recover costs, these interventions demonstrated techniques for lending to the poor that were more effective than previous approaches. While all this laid the foundation for the evolution of the concept 'Microfinance' in the late 1980s / early 1990s, during the early period of experimentation and pilots, it was termed primarily as 'Microcredit', but also as rural finance, agricultural credit, nonfarm credit and microenterprise finance. The term 'Microfinance' gradually replaced 'Microcredit' to acknowledge the integration of other services such as savings with credit.

The impetus for the kick-start of microfinance intervention in India in the early 1990s can be attributed to multiple factors : the realisation of the inability of the formal banking system to reach the poor sustainably, beginning of financial sector reforms in the early 1990s and successful microfinance interventions across the world especially in Asia and in India by NGOs. In this backdrop, many donor funded NGOs started group based savings and credit activities. As the microfinance work was taken up by the existing NGOs working in a range of developmental areas, the microfinance component was an add-on to the existing work. The next phase under this approach had two features namely separation of microfinance as a separate vertical and reducing dependence on donor funds.

As financial intermediation required a different set of competencies, systems and attitudes, most NGOs found it difficult to cope with the additional requirement, which resulted in separating microfinance activities. The limited nature of donor funds and the desirability of moving the sector towards sustainable operations was realised early. Just as NABARD had taken the leadership role for the SHG programme, SIDBI took a similar role for the MFI model which relied on making funds available to MFIs for on lending to clients. Enabling funds flow to the MFIs also entailed more transparent financial operations, which expedited the process of separating microfinance operations with separate financial statements. In order to accelerate the process of financial inclusion through the MFI model, SIDBI launched the Micro Credit Scheme in 1994 for extending financial support to the disadvantaged sections of the society through well managed Non-Government Organisations (NGOs). The NGOs were encouraged to on-lend to disadvantaged sections of society with emphasis on women for setting up the micro enterprises. It was followed by setting up of a dedicated department in 1999 called “SIDBI Foundation for Microcredit”.

Initially, SIDBI relied on lending directly as well as institutional strengthening through training and

* CEO, M-CRIL.

1. Promotion and Development of Microenterprises (PRODEM) was created in 1986 in Bolivia as a non-profit financial institution.

capacity development. In order to ensure linkage with the banking system for flow of debt funds, SIDBI supported M-CRIL[2] in developing a rating tool for MFIs. The development of a rating tool by M-CRIL ushered in a new phase by providing a credible third party assessment of performance and gaining the confidence of bankers. Though reliable figures for bank lending to MFIs till 2005 are not available, SIDBI's cumulative lending to the sector reached ₹137 crore by 2005.

Though by 2005, the MFI model had undergone transformation with emergence of "microfinance only" organisations as against earlier clubbing of microcredit with other development activities, moved to a system of external ratings for performance assessment, established linkages with the banking sector and received the support of apex institution in the form of SIDBI, it retained its ideology of client focus and had a modest outreach of 1.76 million (M-CRIL 2009). The sector was dominated by MFIs organised as societies and trusts and employed a variety of models (Grameen, Individual and SHG) in delivering credit services.

It can be said that by 2005, microfinance had well and truly arrived as the new mantra in tackling the vexed issue of providing financial services to the poor in a win-win paradigm.

The chase for numbers and valuation followed by the hard landing – What went wrong?

The pangs experienced as part of the bank led inclusion efforts till 1991 had demonstrated clearly that for deeper levels of inclusion, a target driven approach and a set model of products and services would not work. The microfinance initiatives started with this vital learning and initially the focus was on building social capital with the underlying belief that would be an intensive activity, both in terms of human resource and time. The MFIs (from their initial phase to mainstreaming phase) remained true to these fundamentals. Things changed post-2005.

The MFI model started with NGOs broadening their service delivery and later establishing separate microfinance focussed subsidiaries. Development was a key concern and growth was moderate. The total outreach of the model in 2002 was a mere 1.76 million in 2004 (M-CRIL 2009). The linkage of MFIs with banks based on independent ratings pioneered by M-CRIL in 2000 led to infusion of substantial sums of money into the system. In order to ensure financial discipline, banks relied on prudential norms like debt to equity ratio to have reasonable levels of leverage. MFIs registered as societies and trusts found it difficult to raise capital from external sources due to their legal form and retained earnings from operations were not enough to mobilise sufficient debt for scale up. This triggered the transformation phase with MFIs scrambling to transform into Non Banking Finance Companies (NBFCs), the only legal route permissible and acceptable to equity investors. Banks also found NBFCs as the preferred form as these are regulated by the Reserve Bank of India (RBI).

At this stage, it is necessary to document the regulatory stance of the Reserve Bank of India (RBI), which closed the other vital option for funding i.e. deposits. Call it conservatism or prudence, the policy stance of RBI has always been that deposit mobilisation is the sole ambit of banks and it is too risky to allow MFIs to collect deposits from low income families. Thus while in India, deposit taking by MFIs (even those registered as NBFCs) is not allowed at all, in other countries (Pakistan, Nepal, Cambodia) relatively few institutions are licensed for deposit taking. This leaves the possibility of generating loans and equity funds from commercial markets as the only serious, medium term option for financing the credit needs of low income families. This one legged paradigm of microfinance faced by MFIs in India left them with no choice but to transform to NBFCs.

The transformation phase starting around 2004 had been so comprehensive that it changed the entire landscape. By 2008, all major MFIs had transformed into NBFCs and dominated the sector accounting for 90% of market share by 2010. Issues involved with the transformation process in the form of Mutual Benefit Trusts by some of the leading MFIs were the earliest pointers of the sector drifting from client focus and has been well captured in the paper by Prof Sriram (Sriram 2010). Of the MFIs continuing as Societies or Trusts, only for a few, it was a matter of conscious strategy while for majority the capital

2. Micro-Credit Ratings International Ltd. (M-CRIL) is a microfinance rating agency working globally with focus on Asia. www.m-cril.com.

requirement for becoming an NBFC (minimum capital requirement of ₹2 crore) proved too steep.

Having the appropriate legal form under its belt, MFIs were set to attract private capital for equity and leverage that for accessing bank loans. Success factors of the model were paraded in the form of high recovery rates and massive jump in outreach, peppered with an occasional anecdotal story of smiling clients and the demand for ever higher funds was predicated on the huge exclusion gaps to be filled in India. In short, the MFIs promised year on year phenomenal growth with their clearly demonstrated, replicable and low cost model. Equity investors were mesmerised by this promise – the prospect of attractive returns with negligible risk and started chasing MFIs for equity investments. The equity investors came in all sizes and shapes ranging from multilaterals like IFC to venture capital funds like Sequoia capital to private equity. MFIs in order to continue to be attractive to investors went single-mindedly after growth. The equity deals reached a peak in 2009-2010 with equity valuation touching a high Price / Book Value of 7 to 10 (CGAP 2010a). With equity in place, bank funding to MFIs also touched a high of ₹17,000 crore by March 2010 excluding portfolio sales and securitisations.

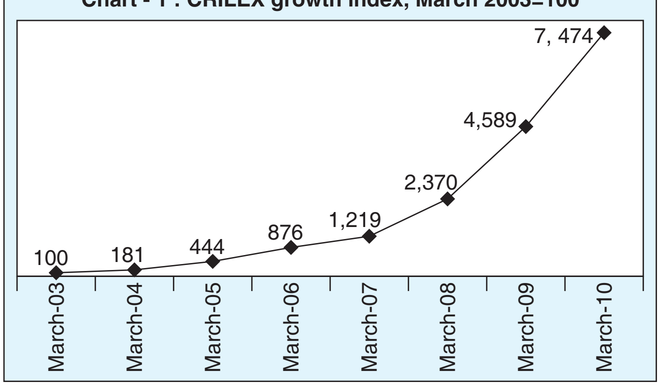
Table-1 : Year wise equity deals in India

Financial year	Amount (US$ Mn.)	No. of Deals
2007-08	52	3
2008-09	178	11
2009-10	209	29

Source : Srinivasan 2010 : 53

The growth spurt was obvious with MFI outreach touching 26.7 million clients by March 2010. M-CRIL developed CRILEX for March 2010 went up to 7,474 (CRILEX is a composite index of the growth of MFIs in India and uses information on the number of borrowers as well as size of loan portfolio) (Chart-1). By 2009, 9 Indian MFIs figured in the top 20 list of MIX Market.

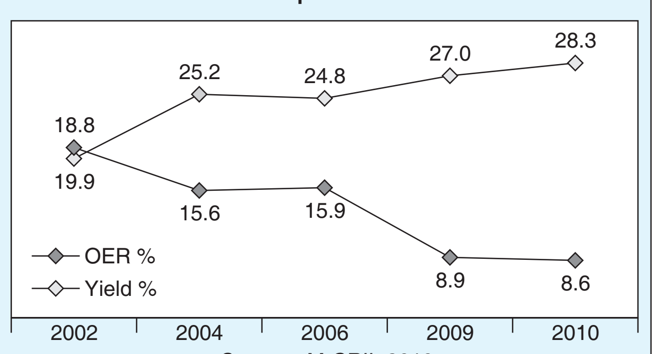
Chart - 1 : CRILEX growth index, March 2003=100



While the marriage of equity investors with MFIs was being consummated, clients fell by the wayside. Srinivasan (2009, 128) succinctly captures this drift "Many MFIs started financing the poor but somewhere they lost the customer focus and along with that mission too…. It is no more about improving income generation in the hands of the customers. Book value multiples, price to earning ratios and enterprise valuations dominate the discussion." Growth was achieved by cutting corners on client acquisition process, improving efficiency and thereby profitability, rolling out a plain vanilla product (50 / 52 week loan) which obviated the necessity of investing in staff training and changes in operational systems, ignoring investments in control systems and MIS and competing in similar areas.

Lower levels of client relationship building efforts coupled with gains in productivity (measured by clients per field staff) led to impressive gains in efficiency (Chart-2). With yield on portfolio remaining constant and not falling in tandem with efficiency gains, profitability went up making MFIs the darling of investors. Return on Assets (RoA) for top 10 Indian MFIs in 2009-10 were 6.5% as against global average of 1.5% (M-CRIL 2010). To the credit of the Indian MFIs, this resulted in Indian MFIs being the most efficient globally with global average for Operating Expense Ratio (OER) as per MIX being 20% in 2010.

Chart-2 : Trend in portfolio Yield and OER



Source - M-CRIL 2010

The growth engine was however not sufficiently matched by investments in human resources and control mechanisms. Massive recruitment at lower levels led to a situation, wherein trainee staff were heading the branches. Pressure to achieve higher productivity led field staff to look to centre leaders and agents to bring in clients in a shorter period, thereby further eroding the link between borrowers and loan officers (Srinivasan 2010).

By end 2010, almost every state was witnessing high competition, credit saturation, multiple borrowings and rising default rates. It was evident that something was going to break and while institutions with deep understanding of the sector had predicted the rupture a good one year in advance, others were still gung-ho with success of the SKS IPO. M-CRIL in its 2009 annual review of microfinance observed ominously, "The concern is that some of this high growth may have been stimulated by the advent of investment in Indian microfinance by private equity groups keen to maximize numbers under any conditions in order to boost firm size and improve share valuations. This stimulus is apparently leading to the cutting off corners in matters of consumer protection - multiple lending, over-indebtedness and consequently coercive collection practices - that are likely to trigger interference by political, religious or other community groups in the practice of microfinance (and may already have done so). Such practices result partly from the geographical concentration and rapid consumer enrolment that has occurred due to high growth" (M-CRIL 2009 : 1).

As voices of sanity and caution were ignored and these happenings were rationalised as one off incidents in pursuit of massive inclusion required in India, it was clear that a bigger crisis was round the corner. Unfortunately, the heavy handed ordinance of Andhra Pradesh government in October 2010 proved to be the straw that broke the back of microfinance. Linking it to the issue of SKS IPO or government's genuine concern for microfinance borrowers is not fair as there were a host of factors leading to the government ordinance. Industry observers and borrowers have pointed to variety of reasons like overlap with SHG programme, multiple borrowings, rising default rate under SHG programme as also intense media scrutiny of SKS IPO and possible envy / concern with profitability of MFIs (WMGF 2011, Srinivasan 2011), of which not all could be attributed to MFIs. However, the reasons offered by the Andhra Pradesh government focussed on coercive recovery practices, indiscriminate lending and usurious interest rate have not cut much ice with industry observers (Legatum 2012).

Within a span of months of the ordinance which resulted in massive defaults in Andhra Pradesh, the darling of investors and bankers became a pariah. The implications have been so huge that the sector has shrunk by 60% with the outreach dipping by nearly 10 million clients by March 2012.

Rebuilding phase : Post 2010

The crisis brought home the point that microfinance will have a sustainable future only if it a) brings back the focus on clients through reaffirming its social agenda b) redefines operational metrics balancing both sides – institution and clients and c) remains dynamic to client needs by going beyond the single product basket. If it sticks to these cardinal principles, it will by default avoid issues like multiple lending and public policy censure.

However, in midst of growing criticism, it has to be remembered that MFIs have played a vital role in inclusion in India. In 2010, MFIs accounted for nearly 40% of credit accounts for small borrowers with an outreach of 26 million customers, rest being accounted by small borrower accounts of RRBs and Commercial banks. The point is MFIs need to bring back the focus on clients and that is what they have done post 2010 through the following inititaives.

Initiatives to bring back customer focus

The initiatives can be broadly grouped as industry initiatives and government regulation.

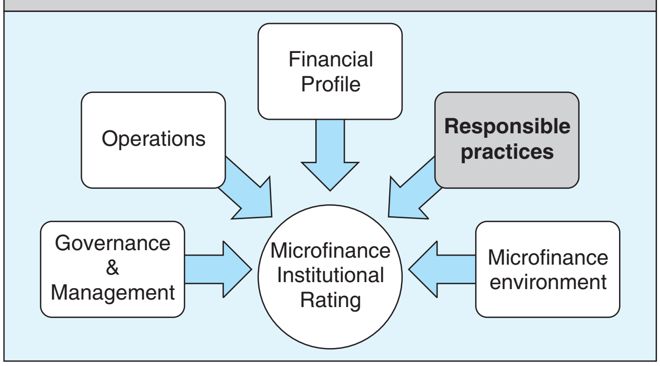
Industry initiatives

a) Social rating & Microfinance Institutional rating

Social rating was developed by specialised microfinance rating agencies such as M-CRIL. While social rating remains as an in depth tool for assessment of social performance, the recent events have clearly shown that certain aspects of social performance such as client protection also have a bearing on institutional and financial sustainability. Realising this microfinance rating agencies such as M-CRIL worked on a global initiative during 2011 supported by the Ford Foundation and Rating Initiative based in Luxembourg to refine the existing financial / credit rating product by integrating key areas of social performance. Initially termed as "Responsible finance rating" during the pilot phase, based on industry feedback and experience gained during the pilot, it was decided to term it as "Microfinance Institutional Rating (MIR)".

MIR expands the holistic assessment framework used by specialised rating agencies as opposed to pure financial evaluations used by mainstream rating agencies. Client protection principles, responsible profits and alignment of mission with governance and organisational practices have been integrated into the rating framework of MIR. The MIR framework is shown in Chart-3 below.

Chart-3



b) Social Performance Task Force

Social Performance Task Force (SPTF) an international initiative through its painstaking work over the years involving practitioners, funders, networks, technical service providers, microfinance rating agencies and researchers has recently in June 2012 been able to develop and adopt universal standards in social performance for MFIs that establish clear guidelines on social performance management and reporting. The process involved pro-actively pursuing feedback and suggestions for revisions from more than 1,300 members of the Task Force, as well as experts outside of the Task Force.

Meeting the standards signifies that an institution has "strong" Social Performance Management (SPM) practices. The standards are based on the following metrics[3]:

- Define and Monitor Social Goals;
- Ensure Board, Management, and Employee Commitment to Social Performance;
- Treat Clients Responsibly;
- Design Products, Services, Delivery Models and Channels That Meet Clients' Needs and Preferences;
- Treat Employees Responsibly; and
- Balance Financial and Social Performance.

The SPTF standards have been incorporated by microfinance rating agencies such as M-CRIL in their rating framework and the MIX market reporting template for MFIs on social performance.

c) SMART Campaign and Client Protection Principles

The Smart Campaign is a global effort housed at Accion International's Centre for Financial Inclusion aiming to unite microfinance leaders around a common goal : to keep clients as the driving force of the industry. To help the microfinance industry achieve this goal and its double bottom line objective, it is working with microfinance leaders from around the world to provide microfinance institutions with the tools and resources they need to deliver transparent, respectful, and prudent financial services to all clients.

Table-2 : Principles of Client Protection
• Appropriate product design and delivery
• Prevention of over-indebtedness
• Transparency
• Responsible pricing
• Fair and respectful treatment of clients
• Privacy of client data
• Mechanisms for complaint resolution

The campaign has worked on developing the seven principles of Client Protection (Table-2) with the help of industry experts. Microfinance rating agencies have played a key role as part of the technical committee in evolving 'adequate' as well as 'high' standards associated with each of the seven principles. While the adequate standards ensure that institutions do

3. http://sptf.info/sp-standards accessed on 1st July 2012

not cause harm to clients, high standards entail doing good to the clients.

SMART campaign has rolled out CPP certifications, wherein M-CRIL is the certifier for India. 4 MFIs in India have been CPP certified till date demonstrating their adherence to Client Protection Principles.

d) Code of Conduct

Before the crisis, the Indian MFI industry had a code of conduct developed by Sa-Dhan[4]. However, the Code was voluntary and there was no mechanism of checking compliance and taking corrective actions. MFIN[5] formed in 2009 also had its own voluntary Code of Conduct. The two codes were more or less focused on similar issues like transparency, governance and client protection, but there was no formal mechanism to check actual practice and take corrective action.

While these two associations represent two different streams of the MFI model, smaller community based MFIs organized as Societies and Trusts being represented by Sa-Dhan and bigger NBFC-MFIs being represented by MFIN with some overlap, before the crisis, there was hardly any common strategy and action. The 2010 Andhra Pradesh events changed the scenario, with IFC and Dell Foundation taking the initiative in harmonizing the two codes of conduct into the Unified Code of Conduct[6] which was adopted in December 2011. The Unified Code of Conduct (Table-3) goes beyond the fair practices code for NBFCs stipulated by RBI and prescribes standards for governance, integrity, transparency and client protection. In the changed scenario, both associations have indicated that member's adherence to the unified code of conduct will be checked as adoption of the code is mandatory. The ability of associations to perform actual checks on compliance remains to be seen, but SIDBI and banks have started asking for CoC adherence assessments by external agencies like M-CRIL for accessing bank funding.

Table-3 : Code of Conduct - Aspects covered
● Defines core values of microfinance
● Norms for
- Integrity
- Transparency
- Client protection
- Governance
- Recruitment
- Client education
- Data sharing-credit bureau
- Grievance redressal

Regulation & Responsible Microfinance

After AP crisis, RBI set up a Committee of the board under the Chairmanship of Mr. Y. H. Malegam, which gave its report in January 2011 and justified the existence of MFIs as well as their coverage under priority sector definition. However, the committee also followed the report with various recommendations on interest rate, income ceiling for microfinance borrowers, loan ceiling and norms for consumer protection significantly. The recommendations were considered by RBI and followed by issuing of guidelines in May 2011 and December 2011. While the major recommendations of the Malegam committee were accepted in spirit, RBI made critical relaxations in interest rate cap, loan ceiling and income level of borrowers.

Two aspects of the framework put in place by RBI are significant. First, it has accepted the creation of a separate category of NBFCs called NBFC-MFI conditional on meeting asset class norms and secondly, these regulations only cover NBFC-MFIs leaving out MFIs operating as Societies or Trusts. This gap is sought to be plugged through the Micro Finance Institutions (Development and Regulation) Bill, 2012, introduced in the Parliament in May 2012 as it is omnibus in its coverage. However, as the basic framework put in place by RBI for NBFCs will apply to other institutions also, that is what will influence responsible finance by MFIs.

Summing up

Inclusive finance or Microfinance is built on the premise that a strong motivation for a positive social change can be put at the heart of financial institutions which otherwise operate mostly according to mainstream best

4. Sa-Dhan was formed in 1999 as association of community organisations and currently has a membership base of 251.
5. MFIN was formed in 2009 as representative organization of NBFC-MFIs and has a membership base of 46 leading MFIs.
6. http://sa-dhan.net/Resources/Code%20of%20Conduct%20for%20MFIs%20in%20India.pdf

practices defined for enterprises that aim at creating value for their shareholders. This can only be ensured if institutions focus on maintaining the fine balance between institutional sustainability and needs of clients. Jolted by the AP crisis and realizing its mission drift during the phase leading to the crisis, the sector through various initiatives - internal as well as external- has bounced back by correcting its course demonstrating its resilience. It is estimated that the client outreach has reached 26.5 million by 30th September, 2013 and funding both equity and debt has started flowing back to the sector. It is hoped that passing of the regulatory bill pending before the Parliament will provide greater stability to the sector.

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Guidelines on Basic Savings Bank Deposit Accounts for Financial Inclusion

Banks have been advised to offer a Basic Savings Bank Deposit Account (BSBDA) that will offer the following minimum common facilities to all their customers:

i) The account should be considered a normal banking service available to all.

ii) This account shall not require any minimum balance.

iii) The account will provide an ATM card or ATM-cum-debit card.

iv) Services will include deposit and withdrawal of cash at bank branches as well as ATMs; receipt / credit of money through electronic payment channels or by means of deposit / collection of cheques drawn by central / state government agencies and departments; and

v) While there will be no limit on the number of deposits that can be made in a month, account holders will be allowed a maximum of four withdrawals in a month, including ATM withdrawals.

These facilities will be provided without any charges. Also, no charge will be levied for non-operation / activation of an inoperative BSBDA.

Banks would be free to evolve other requirements, including the pricing structure for additional value-added services beyond the stipulated basic minimum services on a reasonable and transparent basis that is applied in a non-discriminatory manner.

The BSBDA would be subject to Reserve Bank instructions on Know Your Customer (KYC) / Anti-Money Laundering (AML) for opening bank accounts, issued from time to time. If the account is opened on the basis of simplified KYC norms, it would be treated as a 'Small Account' and would be subject to the conditions for such accounts.

If a customer has other savings bank deposit accounts in the bank, he / she will be required to close it within 30 days of opening a BSBDA.

Existing 'no-frills' accounts should be converted to BSBDA.

Source : Reserve Bank of India (RBI), Annual Report, 2012-13.

Sustainable Self Help Group Bank Linkage Programme ...In Quest of Good Practices

Dr. Kolandavel Natarajan *

Introduction

Financial Inclusion agenda of the Government and the Reserve Bank of India, SHG- Bank Linkage agenda of NABARD and Priority Sector Lending agenda of banks overlap in many ways. These agencies target common segment of Indian population i.e., Small and marginal farmers, economically active poor, women and small and micro entrepreneurs. Self Help Group Bank Linkage Programme (SBLP) of the Indian banks was designed to meet the agenda of these agencies. SBLP is considered to be the largest microfinance programme in the world.

The SHG Bank Linkage Programme was started as an Action Research Project in 1989. The project was the offshoot of NABARD initiative during 1987 through sanctioning ₹10 lakh to Mysore Re-settlement and Development Agency (MYRADA) as seed money assistance for experimenting Credit Management Groups. In the same year the Ministry of Rural Development provided Professional Assistance for Development Action (PRADAN) with support to establish SHGs in Rajasthan.

The experience of these early efforts led to the approval of a pilot by the RBI in 1992. The pilot was designed as a partnership model among SHGs, banks and NGOs. A working Group in 1995 reviewed this pilot and found the outcome satisfactory. RBI subsequently approved guidelines for banks to enable SHGs to open bank accounts, based on a simple inter se agreement. This was coupled with a commitment by NABARD to provide refinance and promotional support to banks for the SHG linkage programme.

This article endeavors to bring out perspectives of SBLP especially good practices that are adopted by different agencies. The specific objectives of the article are :

I. To highlight the progress of SBLP so far.

ii. To enumerate good practices of SBLP adopted for SHG quality management, savings mobilization, credit linkage and recovery management under three models of SBLP.

The article is divided into three parts:

Part-A : SBLP - The Progress So Far

Part-B : Good Practices under Different Models of SBLP

Part-C : Management of SBLP - The Way Forward

Part-A : SBLP - The Progress So far

SBLP progressed in India at a great pace, thanks to the massive network of institutions like commercial banks, RRBs, cooperative banks and NGOs. Besides, several State Governments focused on SHG promotion as part of their development process. Even GOI adopted the SHG model for implementing Swarnajayanti Gram Swarozgar Yojana (SGSY) and National Rural Livelihood Mission (NRLM).

SBLP offers three types of benefits to SHGs, *viz.,* outreach, thrift service and access to institutional credit. The estimated savings corpus accumulated by SHGs across the country is whopping ₹27,000 crore[1]. Next to savings, credit is the important service enjoyed by the SHGs. The credit linkage has been growing year after year culminating to 44.51 lakhs SHGs availing outstanding loan amount of over ₹39,000 crore from banks as of March 2013.

* Program Manager, Sa-Dhan

1. Extrapolated : 70 per cent goes for internal lending and actual outstanding balance is ₹8,200 crore with banks as of March 2013 (source : NABARD)

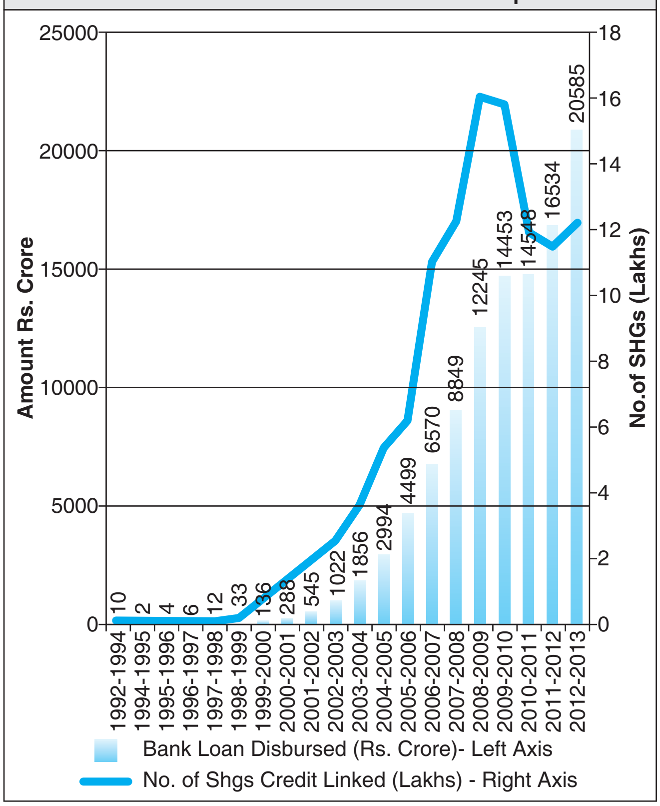
A.1 Key Statistics under SBLP as of March 2013[2]

- Total number of SHGs saving- linked with banks - ₹73 lakh.
- Total saving amount of SHGs linked with banks - ₹8,217 crore.
- Total number of SHGs having loan outstanding - ₹44.51 lakh.
- Total Bank loan amount outstanding - ₹39,375 crore
- Total No. of SHGs credit-linked during 2012-13 - ₹12 lakh.
- Total Amount disbursed during 2012-13 - ₹20,585 crore.

The average savings per SHG was ₹11,200 as of March 2013, while the average loan outstanding being ₹88,500.

Figure-1 shows the growth of SHG credit linkage since inception of SBLP.

Figure-1 : SBLP – Year on Year Bank Loan Disbursed and No.of SHGs Credit-Linked Since Inception



Source: NABARD –Various Reports

The figure shows that there had been steady increase in number of SHGs credit linked and bank loan disbursed till 2009-10. The progress has started showing slackness, perhaps due to microfinance crisis which affected SHG loan repayment too. This trend calls for an urgent attention by all the stakeholders.

The progress of SBLP has witnessed wide disparity among states and regions, with southern region having predominant share of transactions under savings, loan amount disbursed and outstanding. Region wise SBLP statistics are given in Annexure[3] as supplementary information.

Part - B

Good Practices under Different Models of SBLP

There has been a slowdown in the SHG Bank credit linkage during the past three years, despite widespread conviction among banks on the business viability of SBLP. Obviously, understanding the factors behind the successful and not-so-successful practices of SHG lending would help banks and other stakeholders to emulate good practices towards revitalizing SBLP. The SBLP is practised leveraging different institutional relationships (termed as Models here) for taking the financial services to the members of SHGs. Notable practices are narrated under different models of SBLP in order to make them clear to the practitioners adopting corresponding models.

The SBLP Models[4]

There are three principal models in which the SBLP operates in India. These models are based on banks' relationship with SHGs with or without intermediary agencies. Three models of bank linkage emerged are :

Model-I : SHGs formed by and linked directly to banks.

Model-II : SHGs formed and facilitated by Self Help Group Promoting Institutions (SHPIs) such as NGOs and government departments but linked directly to banks.

Model-III : Indirect bank linkage or 'bulk lending' where NGOs and other MFIs act as financial intermediaries by borrowing from banks and on-lending to SHGs directly.

2. Status of Microfinance in India - 2012 -13, NABARD.
3. Based on six years NABARD data.
4. Ajay Tankha (2012).

B-1 : Good Practices under Model-I SHGs Formed by and Linked Directly to Banks

B.1.1 Practices for SBLP Sustainability

The SHG lending has been a viable business proposition to banks. The viability, however, depends on good practices at different levels of SHG-bank transaction.

The question of sustainability is considered at three levels :

i. SHG Level Sustainability

ii. Bank level Viability

iii. SHPI Level sustainability

The sustainability at different levels is interdependent and leads to over all sustainability of bank lending to SHGs.

i. SHG Level Sustainability

At SHG level, the sustainability depends on the quality of groups formed. Investment made by leading SHPIs in intensive training and capacity building at various stages affects the group quality SHPIs incurring too much cost in the process would compromise their sustainability as well. They need to strike a balance. Table-1 shows the comparative SHG promotion cost incurred by different SHPIs. Obviously, SHGs promoted by banks directly involves the lowest cost.

Table-1 : Per-SHG Promotion Cost by Different Agencies

Type of SHPI (₹)	2004	2005	2006
Bank	2,440	2,957	3,575
NGO	4,045	8,512	8,701
Government	3,562	3,595	4,010

Source : NCAER, 2008

Note : Some NGO-SHPIs reporting to Sa-Dhan, the national level Community Finance Association, incurred up to ₹5,000 per SHG during 2013

The cost structure has to be looked at carefully reckoning the benefit accruing to per- unit cost incurred. As to be seen in the next section, the bank lending becomes more viable when SHGs formed and linked by NGO-SHPIs.

Group Quality Assessment is a precondition for lending. Banks have devised assessment criteria for that. The Assessment indicators include frequency and attendance of meetings, volume of savings, rotation of own savings, development of financial skills and quality of leadership.

NABARD in its circular[5] indicated broad criteria for selection of SHGs. The criteria envisage active existence of SHGs for at least six months, successful savings and credit operation from own resources, democratic working, maintenance of proper accounts and records, homogeneity and affinity among members and support from NGO-SHPIs in the grooming of SHGs. NABARD had developed a Critical Rating Index which the banks may use for rating the SHGs.

APMAS study[6], which used the NABARD criteria, has found that repeat loans to SHGs tend to enhance the group quality. Similarly, governance of groups improves when age of groups goes up.

Findings related to financial sustainability of SHGs per se stresses that SHGs may not measure up to the highest standards in terms of financial performance. Yet, the fact that overall empowerment and financial inclusion of SHG members would offset the deficiency in SHG sustainability in the long run.

ii. Bank Level Viability

Viability of SHG lending is critical consideration for banks in SBLP. Lending to SHGs has been profitable new market for many banks, particularly those with underutilized rural networks. Intermediation by NGOs and SHGs significantly reduced the transaction costs of both banks and borrowers[7]. Several other studies also corroborated this conclusion.

Total transaction cost at the branch level was 9.83 per cent in the case of lending to NGOs -SHPIs where as it was 13.07 per cent in the case of lending directly to SHGs.

Non-performing loans (NPA) to SHGs was found to be zero per cent[8]. In contrast, non-performing loan ratios of consolidated portfolio ranged from 2.6 per cent to 18 per cent. The default risk was negligible in the case of lending to SHGs through NGOs.

5. Circular No. NB.mCID/H-1626/SHG-1/1999-2000 dt. 28 February 2000.
6. Adopted from Ajay Tankha (2012).
7. Study by Puhazhendi (1995).
8. Seibal and Dave (2002).

The Return on average Assets (RoA) of SHG banking ranged from 1.4 per cent to 7.5 per cent as compared to -1.7 per cent to 2.3 per cent for the consolidated portfolio. Operational self-sufficiency of SHG banking ranged from 110 per cent to 165 per cent by average cost analysis.

The studies recommended that the cost incurred by NGOs in group formation should be reimbursed by the banks in the form of service charge conditional upon good repayment performance of the loans by the groups. The banks, in turn, could charge a higher interest on the bank loans to the SHGs.

Interestingly, many studies confirmed that the revenue depends on SHG loan volumes. Transaction costs were almost the same regardless of the size of the loan. This has to be factored in while pricing small loans.

To quote some viable - lenders[9], Oriental Bank of Commerce, Rudrapur Branch, UP; Pandian Grama Bank, T.N; Bidar Central Co-operative Bank and its PACS in Karnataka, among others, engaged themselves in viable SHG lending even during the early SBLP period. Similarly, Indian Bank Micro sate branches have been documented to be viable.

iii. SHPI Level Sustainability

There has been a debate among the SHPIs on the sustainability, SHG formation and linkage services. The SHPIs, who are members of Sa-Dhan Association, have expressed concerns about inadequate compensation from banks for the linkage services discouraging them from continuing their services. In addition, large numbers of unlinked groups formed by them, the Government agencies move to form groups without NGOs active involvement under NRLM, etc., have been the source of concern. On top of it, the dwindling grant support for their work has forced them to look for alternative options. This offers valid ground for banks to take care of SHPIs needs to profitably engage their services in SBLP. GoI has fixed a compensation pattern for SHPIs-₹10,000 grant assistance per group and 5 per cent per annum on net loan outstanding credit - engaged in women SHG programme in 150 Left-wing-Extremist affected districts of the country. This norm may be followed for all SHPI work across the country.

B.1.2 Star Rating -SHG monitoring by Indian Bank

The rural branches of Indian Bank have significant portfolio of SHG loans from early years. For example[10], in 2003, Indian Bank at Usilam patti (Tamil Nadu) started offering microfinance under its special unit of microfinance project. It provided a range of flexible microcredit products to over 1000 SHGs. It had an outstanding portfolio of ₹7.5 crore out of the total branch outstanding of ₹19 crore (39 per cent of total credit business of the branch).

The branch had very unique monitoring system. The bank tracks loan repayment at group and individual level to ensure stability of the group prior to advancing subsequent loans. The branch loan passbooks, issued to SHGs, were uniquely printed with stars and in different colors to designate group credit worthiness. A SHG taking its first loan gets red pass book. For their second loan they get a pass book with single star and the third loan with two stars and so on. Star marks are printed prominently on the front cover page of the passbook. Each star indicates the number of loans successfully repaid by the SHGs. This system has allowed banks to improve loan monitoring and recognition of good versus bad groups / clients.

B.1.3 Doorstep SHG Service by OBC, BoB and Andhra Bank

Under Grameen Project, the Oriental Bank of Commerce opened bank branches in Uttarakhand, Rajasthan and Punjab serving SHG clients. It provided loans at door steps of SHGs and individuals at 9 per cent annual interest rate and has covered 287 villages through 67 branches so far. Appointing its own staff at branch level, it has disbursed ₹21 crore among 3668 SHGs. The group also contributed almost ₹4 crore as savings deposit.

Similarly, Bank of Baroda's Micro Loan Factories at Raebareli and Sultanpur in UP have a mobile van with facilities, all stationeries / documents related to SHG financing. It is managed by officers, who are duly authorized to sanction and disburse loans up to ₹25,000 to SHGs on- the- spot and at their doorsteps. Andhra bank has been piloting doorstep banking for SHG members in four branches in Andhra Pradesh.

9. Ajay Tankha.
10. Knowledge Products of Microfinance , Synthesis of Consolidated Replies.

B.1.4 *Community insurance by Co-operative Bank*[11]

Nadia District (West Bengal) Central Cooperative Bank operates a Welfare Fund for the members of all SHGs organized through their PACS (Primary Agricultural Credit Society). Each member of SHG is required to contribute ₹24 per year towards the membership of the fund. The fund compensates up to ₹30,000 in the unfortunate event of death or disability of the member / her spouse and also provides for meeting the expenses of the members' girl children. The bank has been able to enroll more than 35,000 members for the fund and over 250 claims have so far been settled during the last six months. The bank aims to cover all the members of over 18,000 SHGs organized by PACS in the district.

B.1.5 *VKG Bank appoints SHGs as Business Correspondents*[12]

Vidarbha Konkan Gramin Bank (VKGB), with help of NABARD, has been successful in leveraging local community members of SHGs to act as Business Facilitators and Business Correspondents to enhance its business. This model has been recognized as highly successful and scalable by other financial institutions. NABARD has arranged exposure visit to "VKGB model" for over 100 officials of various commercial banks and Regional Rural Banks.

B.1.6 *Pragathi Bank Goes Beyond Lending to Joint Liability Groups*[13]

Pragathi Krishna Gramin Bank, Karnataka, had nurtured several Joint Liability Groups, the members of which include farmers and farm women. The case in point here is the peculiarity of Sri Devi Farmers Joint Liability Groups Welfare Society, Devi Camp. Karatagi branch of the bank initiated the process of organizing tenant / leased land cultivators at Devi Camp into Joint Liability Groups during June 2009. By November 2009, 300 JLGs comprising of 1,500 members (5 members in each groups) were formed. The benefit accrued to members :

- During 2010, the JLGs formed a Federation of the JLGs. The Federation was registered with the Registrar of Societies on 13.05.2010.
- The society secured the dealership license from Karnataka State Co-operative Marketing Federation Limited (KSCMF) and supplied fertilizer, pesticide, valued ₹4 crore, to its members at below-market price.
- Because of lower input cost, as well as popularization of Paddy Translator, the cost of cultivation of paddy came down by ₹3,500 per acre.

B.1.7 *Banks Become Tech. Savvy for SHG Lending*

The financial inclusion target to banks has prompted banks to embrace innovations in SBLP. To quote certain examples, State Bank of India had covered approximately 28,000 SHG groups and 1,54,000 SHG members with 'tiny cards' for individuals as of March 2011. Using authorized signatories and finger-print validation technology, the clients can operate the cards with BCs / Customer Service Points / Point of Sale near their place of residence. The bank's kiosk banking initiative uses internet-enabled Personal Computers (PCs) with biometric validation.

Similarly, Indian Bank, Indian Overseas Bank, Bank of Baroda and United Bank of India also have introduced Smart Card Banking through BCs as per the guidelines of RBI.

B.1.8 *Gramin Bank's Financial Inclusion as Business Proposition*

South Malabar Gramin Bank (SMGB), headquartered in the northern part of Kerala is a public sector institution that has made financial inclusion as business proposition. SMGB's activities in financial inclusion involve awareness creation on financial literacy, mobilizing the rural poor through SHGs for offering microcredit, micro saving and capacity building. During the last one year, the bank had financed more than 4,000 SHGs and 600 JLGs. It has opened over 2,60,000 No Frills Accounts (NFA) many of which have overdraft facility for meeting emergency needs.

B.1.9 *SHG-Focused Indian Bank Micro Sate Branches*

Indian Bank has several MicroSate branches exclusively for SHG lending in more than 41 locations across the country. The idea behind the Microsate

11. NABARD -2012-13.
12. NABARD -2012-13.
13. Contribution from Vithal Rao, Pragathi Krishna Gramin Bank, Karnataka (Nov., 2013).

branches is to give focus on women groups and provide them extra attention. They act as exclusive branches for SHGs. The SHGs could avail all services and operate their accounts through these branches.

To take an example, Hyderabad branch[14] had many operating features of a typical SHG branch. The branch involves SHPIs including government agencies to form groups and link them to the branch. Municipality (Greater Hyderabad Municipal Cooperation) is involved in the group formation and linking to the branch. The municipality trains groups and then helps the branch to grade them before offering loans. There is a concept of community resource person also to follow up the group activities.

Loan amount is up to five times of SHG saving with minimum of ₹50,000 per SHG. The first cycle loan is for maximum of 36 months. The maximum loan amount depends upon the group performance, age of the group, savings amount, internal rotations, etc.

B.1.10 NABARD's Move to Bolster SBLP[15]

NABARD has introduced SHG-II scheme, keeping the need for intensifying the SHG savings service to SHGs. As per that, SHGs may go in for voluntary savings apart from the compulsory savings. Besides, SHG-II provides for formation of JLGs from among SHGs to cater to the needs of enterprising members needing higher loan limit. The scheme has introduced Cash Credit form of loan to SHGs to enable them to avail credit at will and at lower cost.

NABARD has been continuously supporting training and capacity building of different stakeholders of SBLP such as bankers, NGOs, government officials, SHG members and trainers. During 2012-13, NABARD organized and supported close to 6,000 training covering 1.85 lakh participants of various stakeholders. Cumulatively over 30.34 lakh stakeholders have been trained.

NABARD's grant support to SHPIs to form SHGs is an ongoing attempt to form quality SHGs. Altogether, NABARD had offered to SHPIs a grant of ₹73 crore for nurturing ₹4.81 lakh SHGs as of March 2013.

NABARD SBLP Training Module has been revised to broad base the content. NABARD undertook a Comprehensive Training Need Assessment of all stakeholders with the assistance of GIZ (German Technical Cooperation). The findings of this detailed assessment were deliberated upon at a National Level Training Consultation Meet on SHG-Bank Linkage training. Based on the deliberations in the meet, a revised Hand Book on Training Module for SBLP stakeholders was prepared, distributed to all stakeholders. The soft copy of the hand book is available on the NABARD's website.

NABARD has been main agency refinancing SHG loans extended by banks in India. Table-2 carries the quantum of refinance.

Table-2 : Quantum of NABARD Refinance to Banks for SHG Lending

₹ Crore	2010-11	2011-12	2012-13
Bank Loan to SHGs	14,547	16,534	20,585
NABARD Refinance to Banks	2,545	3,073	3,917

Source : NABARD-2013

NABARD has piloted a “Tablet PC accounting for SHGs” pilot in Nandurbar district of Maharashtra. It is used by NGO field staff and by SHGs themselves to feed SHG data and store meeting resolutions, etc. from which different financial reports can be generated. The PC can also generate several analytical graphs on the performance of SHGs. The pilot is being expanded to cover 50,000 SHGs. The project will be implemented in various states with help of technology partners.

B. 2 Good Practices under Model-II SHGs formed by and Linked by SHPIs

B.2.1 Practices of NGOs as SHPIs :

The SBLP movement took root from the pilots that pioneering NGOs like MYRADA and PRADAN had done in the 1980s. Study results have shown that involving SHPIs has reduced the cost of credit delivery to SHGs by banks. The NGOs had been mobilizing rural women into SHGs with help of grant support either from NABARD or from other agencies and then link the groups to banks. In the process, the lending cost of banks comes down

14. Where the author paid a personal visit.
15. NABARD Report 2012-13.

significantly. Thus, SHG formation and lending with help of NGOs help banks to externalize cost of operation. NGOs bridge the knowledge gap between banks and the rural poor. They act as facilitating agencies, helping banks to reach out to the poorest families of SHGs.

B.2.1.1 SBLP Plus by PRADAN

PRADAN is a renowned NGO working with poor community in northern India. SHG Formation, linking SHGs with banks, training, developing Community Based Organizations like Producer companies, Co-operatives, Mutual Benefit Trust, Federation, etc. are primary services rendered by PRADAN. PRADAN identifies Community Resource Persons (CRPs) from among the SHG members who are literate and can help build capacities of SHG members through awareness creation about banking services, etc. The mechanism helps banks to lend to SHGs and build quality assets among the SHGs.

Innovation in SHG Book Keeping[16]

SHGs face huge challenge in maintaining the books of accounts manually. PRADAN works in most backward and remote areas where illiteracy is rampant. SHGs depend on PRADAN for data processing and analysis. To make the SHGs autonomous, MIS needed to be developed. PRADAN innovated to bring in Computer Munshis. A Computer Munshi is a person who provides accounting services to SHGs by using a computer and also helps them conduct business. The transaction sheets pertaining to the SHG meeting etc. from different SHGs in a village are sent weekly to Computer Munshi who would enter the data into computer and makes the processed data available for the subsequent weekly meeting of the SHGs. The processed data helps to track repayment performance of SHGs, savings mobilized, etc. Similarly, he would prepare other accounting statements like Trial Balance that help to monitor the financial performance of SHGs. The Computer Munshi System facilitates banks to appraise / rate the SHGs linked to the banks before advancing loans to the groups.

B.2.1.2 MYRADA and DHAN - Veterans in SBLP

Similarly, MYRADA, the mother of Self Help Affinity Groups, continues to form SHGs and Community Managed Resource Centers (CMRCs). CMRCs help SHGs to borrow from banks and other financial institutions, link the groups to government programmes, apart from rendering host of other capacity building services.

Similarly, Kalanjiam Development Financial Service (KDFS), a section 25 company promoted by Dhan Foundation, Tamil Nadu, supports SBLP in a big way. The primary objective of KDFS was to establish sustainable financial linkages between SHGs and banks. KDFS would establish the credit worthiness of a new group before it is linked to bank. The second objective of KDFS was to improve the quality of life and asset base of the SHG members through designing and up-scaling innovative products. As far as SBLP is concerned, KDFS has enabled 34 banks and 320 bank branches to have transaction with SHGs.

Repco Foundation for Microcredit[17], a section - 25 company formed by Repco Bank, the Govt. of India enterprise based in Chennai, forms SHGs across southern states and links them to Repco Bank for depositing savings and getting bank loans. The foundation has also launched mobile banking service across hill districts of Tamil Nadu to offer doorstep service to geographically isolated SHGs.

B.2.1.3 Mentoring and Financial Literacy for SHGs

NABARD[18] has engaged Rang De, a non-profit organization engaged in supporting rural entrepreneurs / individuals by providing them access to the low cost loans. A pilot project, covering 300 poor households across Maharashtra, Madhya Pradesh and Bihar is implemented to gain useful insights into the credit *vis-à-vis* credit plus mentoring service to SHGs. The outcome of the pilot would be used to realign SBLP to fund livelihoods.

Indian School of Microfinance for Women (ISMW) has formed, National Alliance for Financial Literacy (NAFIL) with the help of partner NGOs. ISMW has designed financial literacy module for rural women and SHG members that the partner NGOs use to raise financial literacy of SHG members.

16. Case Study by Indian School of Microfinance for Women, Ahmadabad.
17. Author's own experience in the Bank.
18. NABARD -2012-13.

B.2.1.4 NGOs Nurture Voluntary Savings under SHG-II[19]

- MYRADA promotes mandatory savings among their SHGs / SAGs (Self Help Affinity groups). It also educates members of SHGs to save additionally in multiples of minimum savings.
- APMAS promotes purpose – based savings for health, education, marriage, festivals, asset creation and other purposes among their SHGs. Focus is to meet the specific needs of the poor women. There is no ceiling on monthly savings amount.
- Centre for Microfinance, Jaipur, introduced recurring deposit of six months and one year durations. Savings are collected in SHG meetings along with mandatory savings. Entire amount of savings is rotated to provide credit to the members.
- Dhan Foundation encourages savings for specific asset or purpose, such as electricity connection, gas connection etc.
- About 20 per cent members of SHGs promoted by IBTADA, Rajasthan have started voluntary savings called Special Savings, meant for purposes like marriage, festivals, etc.

B.2.1.5 SKDRDP - BC[20] *Serving 1.25 Lakh SHGs*

Shri Kshetra Dharmasthala Rural Development Project (SKDRDP), a charitable trust, acts as a SHG Promoting Institution (SHPI), works in the backward districts of Karnataka. It has collaborated with various banks to provide access to formal financial products and services for the poor and unbanked in its area of operation. SKDRDP found value in becoming a Banking Correspondent Network Manager (BCNM) as it offered a variety of benefits including additional revenue stream, efficient cash management system, a broader range of financial products and funding assistance from banks for the benefit of SHGs, etc.

There are three partners in the whole arrangement of Banking Correspondent Network. One is SKDRDP. The second is the bank and the third is the Technology Service Providers (TSP). The important role of each partner is indicated in Table-3.

Table - 3 : SKDRDP - BC Partners Symbiotic Role

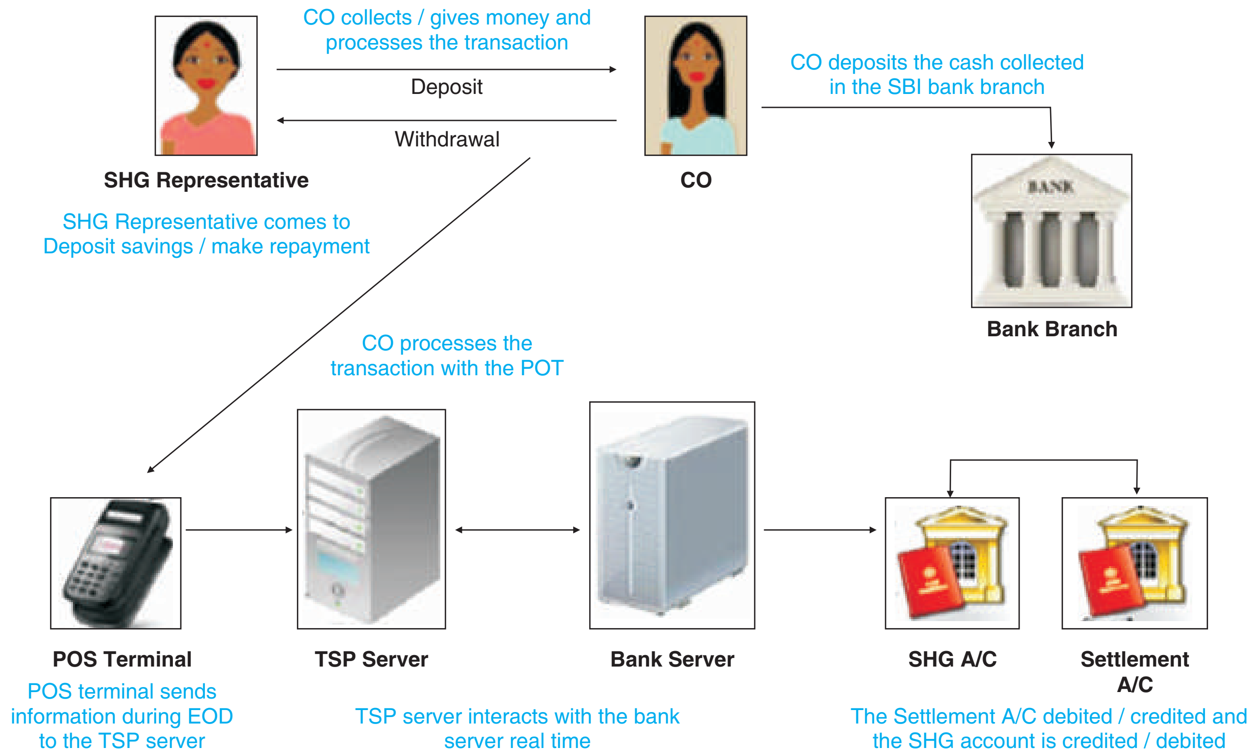
SKDRDP	Bank	Technology service Provider (TSP)
Forms SHGs	Opens savings bank accounts for SHGs	Provides enrolment data to the bank
Opens SHG accounts on behalf of the bank	Sanctions loans to SHGs	Technology hardware support (Point of Sale devices and smartcards)
Processes and recommends loan application forms of SHG members	Provides deposit and withdrawal facility to customers	Provides field level transaction data to the bank
Cash Management – deposit and withdrawal funds. Loan disbursal and repayment on behalf of the bank	Provides liquidity rebalancing facility to the BC	Backend support : hosting of savings account activity for both SHGs and individual members and transaction processing
Monitors loan repayments	Pays service fee and commissions to both BC and to TSP	MIS support : sharing of MIS data with bank and SKDRDP in pre-defined formats and timelines
Training field staff on bank products, processes and cash handling		Trains the BC / BC agents on POS handling
Reconciliation of cash collection reports with bank statement		
Adopted from Microsave Case Study		

The partnership relationship is very much symbiotic. The grass-root experience of SKDRDP, the financial strength of the bank and the technology driven transaction support of TSP are the three cornerstones of the BC operation.

The financial transaction under SKDRDP - BC is depicted in Figure-2. The Credit Officer (CO) of SKDRDP plays the central role in villages while the bank and TSP process the transaction initiated by the CO and give effect to the same by debiting or crediting the SHG / Settlement Account.

19. UNDP Microfinance Solution Exchange – E-Discussion Summary Issue dated 23 April 2012.
20. The section draws heavily from the Case Study of SKDRDP Suvidha BC Model done by Micro Save.

Figure-2 : Schematic Illustration of SKDRDP-BC Financial Transaction



Adopted from Microsave Case Study

BC-Lessons for other banks / SHPIs :

- The BC has to help SHGs to open savings account with bank and enable it to obtain loans so as to ensure early financial breakeven of the whole transaction. The BC need to work with bank to offer value- added services to SHGs like recurring deposit, remittance, insurance, etc.
- SHPI- leadership is very critical to engage multiple stakeholders to take forward the BC operation.
- The BC needs to prepare the bank in terms of understanding the grass root level challenges and transactions. The bank will have to devote committed branch team for taking care of the BC business.
- The BC need to obtain the due commission from the bank for various transactions and monitoring service rendered by it on time to make the BC operation sustainable.
- The field-focus is very vital for the successful BC operation. The feedback from clients and their satisfaction should drive continuous improvement of the product / process.
- Staff choice, training and motivation are equally important areas deserving the attention of BC. The BC staff quality and their relationship with bank staff may make or break BC system.

B.2.2 Practices of Government Agencies as SHPIs :

Launching of Swarnajayanti Gram Swarozgar Yojana (SGSY) programme in 1999 by Government of India paved way for the government agencies getting into the business of forming SHGs directly. The state Government through DRDA (District Rural Development Agency) and Development of Women and Children in Rural Areas (DWCRA) programme initiated the SHG formation for channeling various government subsidy-backed bank loans to SHG members.

Different State Governments launched massive SHG programmes, pioneering one being Society for Elimination of Rural Poverty (SERP) in Andhra Pradesh which implements Indira Kranthi Patham (IKP), a brief note on it follows in next paragraph. Similarly, Tamil Nadu Government forms SHGs through Mahalir Thittam, Kerala Governmnet implements Kudumbashre', Odisha has Mission Sakthi, Maharastra manages MAVIM and Bihar government operates Jeevika - Bihar Rural Livelihood Project.

B.2.2.1 SERP has Built SHG Architecture in AP

SERP actively promotes bank linkages and tracks repayment of SHG members. As of March 2013, SERP served 10.54 lakh SHGs garnering ₹4,314 crore savings and ₹5,721 crore corpus from them[21]. During 2012-13 alone, it made available loan to the tune of ₹4,000 crore to 1.5 lakh SHGs.

SERP Loan recovery mechanism is noteworthy. They ensured repayment rate ranging from 85 to 95 per cent. As per the arrangement, partner banks send the repayment due / overdue lists to SERP every month. Using the list, SERP maps the default-SHGs detailing their geographical locations on Geographical Information System (GIS) Map, using software developed by TCS.

Leveraging communication technology, SERP sends the due / default-list to sub-committee of SHG Federations. SHG members help federation to collect the dues from the members concerned. This mechanism helped banks gain confidence to fund SHGs in a big way.

B.2.2.2 SBLP Gets Boost from World Bank under NRLM

The Ministry of Rural Development, Government of India has launched National Rural Livelihood Mission (NRLM) by restructuring Swarnajayanti Gram Swarozgar Yojana (SGSY), effective from April 2013. The world bank- sponsored mission will provide a continuous hand-holding support to the institutions of the poor for a period of 5-7 years till they come out of abject poverty. NRLM enables the state rural livelihoods missions to professionalize their human resources at state, district and block level. So far, the ministry has approved Annual Action Plan of 14 States who met the NRLM criteria and funds have been sanctioned to them. These states are Andhra Pradesh, Assam, Bihar, Chhattisgarh, Gujarat, Jharkhand, Kerala, Madhya Pradesh, Maharashtra, Mizoram, Odisha, Punjab, Rajasthan and Tamil Nadu.

The Mission will spearhead the financial inclusion through SHGs, replicating the combined desirable features of IKP, Mahalir Thittam, Kudumbashree, etc., across the country. The bank linkage is the main component under NRLM.

B.3 Good Practices under Model III Banks' Indirect Linkage through MFIs

Bank–MFI partnership evolved because of certain compulsions among three partners in the SHG lending : Banks, NGOs and the SHGs. On the bank side, the banks, especially private sector banks not having sufficient branch network in rural areas had to meet priority sector lending target set by the Reserve Bank. The banks started lending bulk loans to MFIs for on-lending to SHGs. On the NGO side, those who had been acting as SHPIs had to seek alternative business model because of tardy flow grant support from donor agencies with which they had been forming SHGs and linking them to banks. The Government / The Reserve Bank's tacit permission for NGOs to bulk- borrowing from banks to on-lend to SHGs encouraged them to embrace the new business model. On the SHG side, non availability of sufficient loan amount on time from the banks prompted SHGs to seek loan support from SHPI – turned MFIs.

Some prominent examples of NGOs turning into or floating MFIs to lend to SHGs included Sanghamithra (formed by MYRADA), SKDRDP (Direct Channel other than the BC channel), Kalanjiam Development Finance Services (DHAN Foundation, Tamil Nadu), Swayamshree Microcredit services (CYSD, Orissa), SNFS (ASSEFA, Tamil Nadu) and others. NABFINS (NABARD Financial Services Ltd) launched by NABARD had been a fast emerging NBFC in SHG lending in the recent past.

B.3.1 Sanghamithra – A Healthy Competitor to Banks

MYRADA launched Sanghamithra a 'not-for-profit' company in 1995 under Section 25 of the Indian Companies Act of 1956, which became operational in

21. Source : Indira Kranthi Patham Website.

2000. The purpose of the MFI was to meet the increasing demand from SHG promoted by MYRADA and that could not adequately be met by the banks. The objective of Sanghamithra was not 'to grow fast' but to ensure that the SHGs received a line of credit easily and quickly, whatever the source may be. Sanghamithra does not compete with banks but creates competitive conditions. The SHGs are free and encouraged by MYRADA to choose between the banks and Sanghamithra. This helps to ensure that both the banks and Sanghamithra provide quality service at competitive rates. Sanghamithra has a well thought-out business plan in a way to meet the unfolding demand from SHGs and ensure quality assets.

B.3.2 NABFINs[22] – A Responsible Lender to SHGs

NABFINS was constituted by restructuring Karnataka Agriculture Finance Company Ltd (KADF) with equity support of NABARD, Karnataka Government, Canara Bank, Federal Bank and Dhanalakshmi Bank. NABFINS balances between profiteering and development finance. NABFIN finances SHGs, rural institutions and farmers for on-farm and off-farm livelihoods. It levies interest at reasonable rates but also ensures that the overall cost to the client remains low by providing door step services. Up to March, 2012 the rate of interest to SHGs / JLGs was 13.5 per cent. To second level institutions, like producer collectives, it was 11.5 per cent. The margin cap was 4.66 per cent. These rates are below the RBI ceiling of 26 per cent (interest) and 12 per cent (margin cap). The average cost of funds was reasonably low. The institution is etching out a niche in rural and SHG lending.

Part-C : Management of SBLP – the Way Forward

Multiple govt. agencies' patronage to SBLP is the key strength of the programme. The good practices attempted by very different agencies highlighted in the article will have to be replicated across stakeholders to strengthen the programme. Simultaneously, pitfalls in the practices recorded through experience and studies will have to be addressed early. A glimpse on the areas needing improvement and some suggestions are given as the way forward here.

C.1 Banks to Improve Service Quality

The banks' service quality to SHGs determines the success of SLBP. In Model-I, for instance, the banks themselves form SHGs, train them and provide financial services to SHGs. Knowledge on the perception of SHGs on the support received from banks would help banks adopt good practices by addressing the areas of weakness. Table-4 provides results of a study held across six states by National Council of Applied Economic Research.

The table reveals that the banks service to SHGs in terms of hand holding and advising needs to undergo a sea change, at least on the parameters indicated, to make the SHGs strong enough to become viable borrowing entities for banks. SHGs satisfaction level on the financial services has been comparatively better, though there is a scope for improvement.

Table-4 : SHGs Perception of Banks' Service

Service Parameter	Figure
Average No. of Times of staff member of Bank / FI visit SHGs in a year	*2.2*
SHGs reporting support / activities provided by bank / FI (%)	
i. Training on book keeping	24.3%
ii. Checking & advising on book keeping accuracy	23.2%
iii. Reviewing & advising on SHG financial activities	20.6%
iv. Reviewing & advising on SHG financial health aspect	11.6%
v. Appraising SHG loan request	15.3%
SHGs satisfied with the adequacy / appropriateness of services received from banks / FI (%)	
i. Frequency of visits to the SHGs	26.8%
ii. Provisions of loans according to the needs of SHG	58.9%
iii. Conditions for loans savings of the SHG	60.0%
iv. Savings Services according to the needs of SHG	64.7%
v. FI conditions for savings of the SHG	63.5%
vi. Accessibility of SHG representative to bank managerial staff	64.6%
Source : Impact and sustainability of SHG Bank Linkage Programme – NCAER 2008	

C.2 Diagnose NPA and Put Remedy into Practice

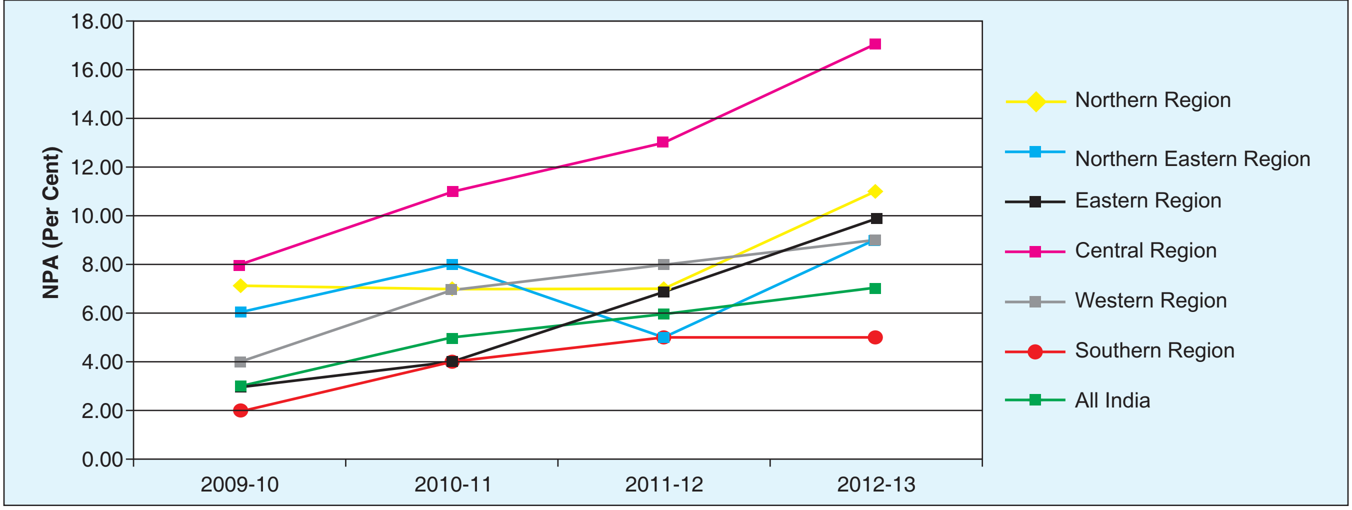
Different studies provide a mixed picture of the SBLP. While benefit accrues to SHGs in terms of income, assets and increased savings, problems of default seem to bog down the programme. Incidentally, the

22. NABFIN Reports.

NABARD data over the years analyzed for this article reveals progressive increase in Non Performing Asset in SBLP portfolio (Figure-3).

under Models-I, II and III and the weaknesses disclosed by studies point to certain key recommendations for robust SBLP :

Figure-3 : SBLP - All India and Regional Trend in NPA of Banks SHG Portfolio[23]



Field studies diagnose the NPA problem further. In a study of the default of SHGs in Rajasthan, the Centre for Microfinance, Jaipur found that improper process of group formation was the foremost reason for default. Appropriate norms such as selection of area and members, concept seeding had not been followed in any of the defaulting-groups. The groups with 100 per cent repayment were found to have gone through some localized formation process.

A study carried out on behalf of CMF-IFMR among 1000 SHGs over 100 weeks revealed that higher frequency of meeting increases social interaction and eventually results in much lower defaults. The economic return on social interaction has been assessed to be the reason behind lower default risk.

Spectrum of studies conducted at different levels and geographies found that all the stakeholders, i.e., SHGs, SHPIs and Banks, had a contributory role in not-so-proper implementation of the schemes that eventually resulted in groups turning into defaulters.

C.3 Key Recommendations

The good practices highlighted in the article covering strategic, financial and operational management of SBLP

1. Quality of SHGs is the foundation for robust SBLP. Banks' partnership with NGO-SHPIs which invests sufficiently on the group formation, capacity building and follow- up on behalf of banks should be the fundamental strategy. This will address the emerging issues like NPA, group indiscipline, etc.
2. Subsidy-driven NRLM, in all likelihood, will shape up SBLP in the years to come. It needs to engage NGO-SHPIs for building capacities of SHGs, livelihood promotion and bank lending to realize quality outcome.
3. Banks' adequate compensation for the NGO-SHPIs will pave way for best practices on the ground. GoI has fixed a compensation pattern for NGOs–₹10,000 grant assistance per group formed and 5 per cent per annum on net outstanding credit – engaged in women SHG programme in 150 Left - wing - Extremist affected districts of the country. This norm may be followed for all NGO-SHPI work across the country.
4. SBLP is an excellent financial inclusion tool as well as viable business proposition for banks. Dedicated bank team working on business plan for SBLP and constant drive from the bank board will go a long way

23. NABARD Data for four years.

in building sustainable low cost savings and risk free rural portfolio through SHGs.

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Annexure

SBLP Statistics : Analytical Graphs[24] (Based on Six years NABARD Data)

Figure-4 : All India and Regional Trend in No. of SHGs Savings Linked with Banks

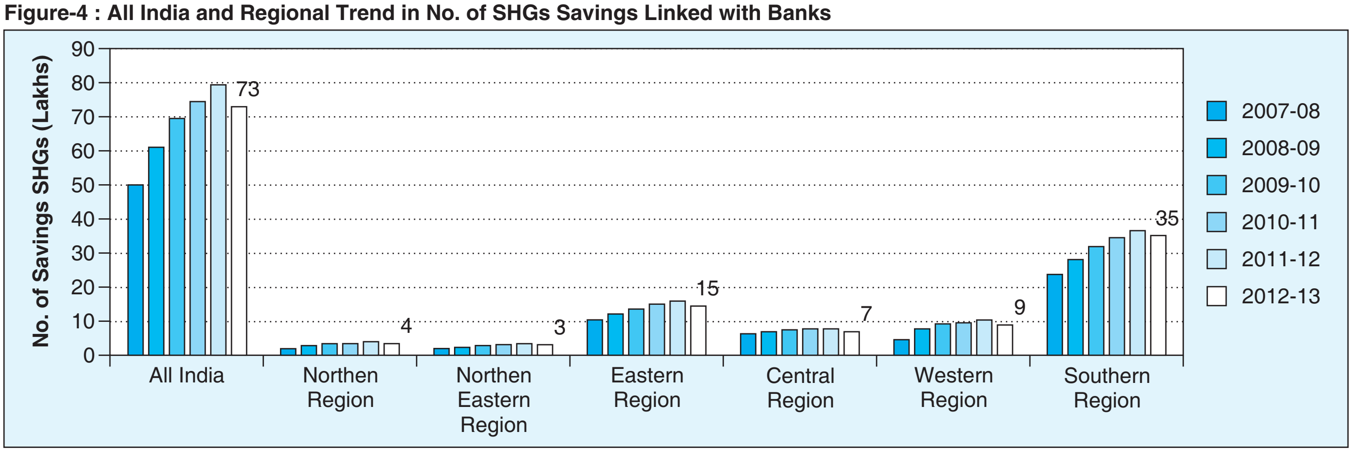
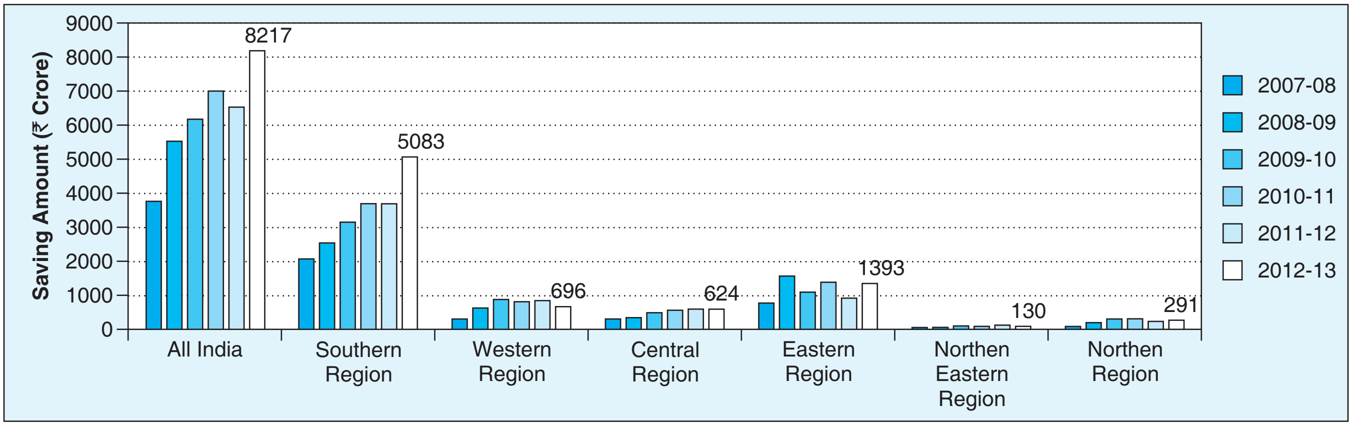


Figure-5 : SBLP - All India and Regional Trend in SHG Savings Amount Held at the Indian Banking System



24. In each graph, the figure for all years have been deliberately not displayed to avoid cluttering of the graph.

Figure-6 : SBLP - All India and Regional Trend in No. of SHGs Availing Bank Loan

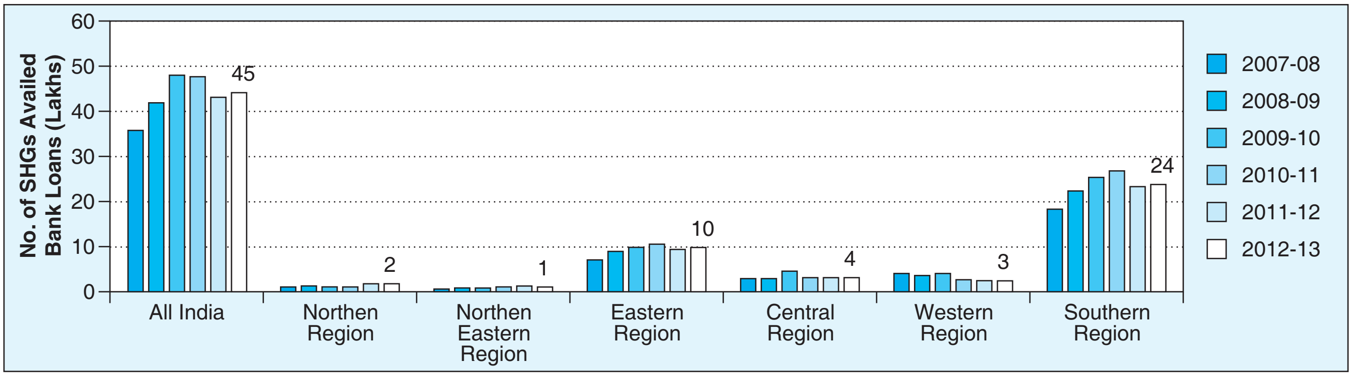


Figure-7 : SBLP - All India and Regional Trend in Bank Loan Amount Disbursed to SHGs

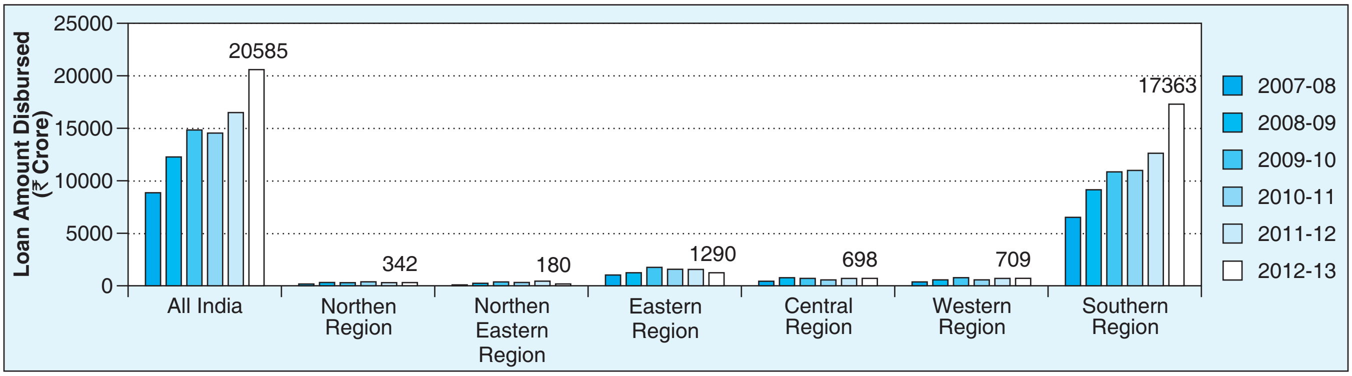


Figure-8 : SBLP - Amount of Bank Loan Disbursed to SHGs in Top 10 States in Terms of Amount Disbursed

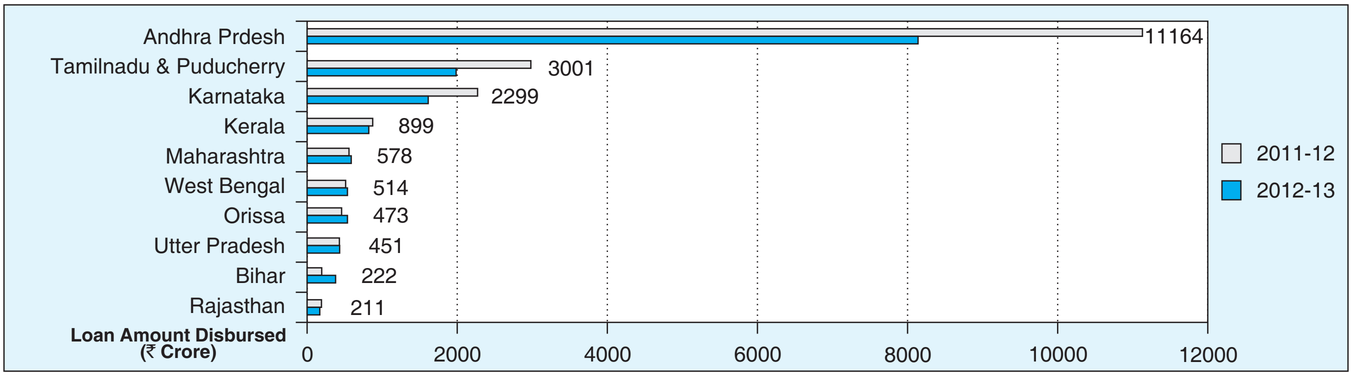
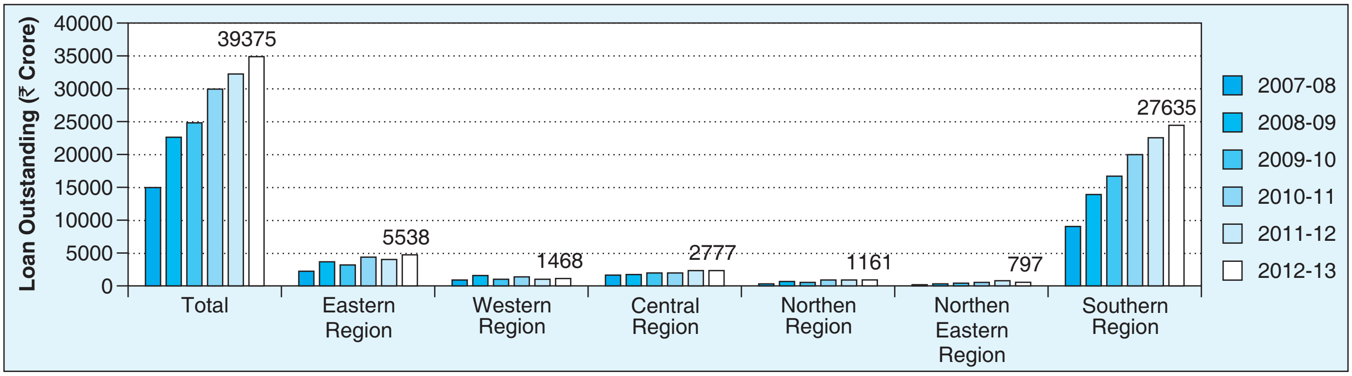
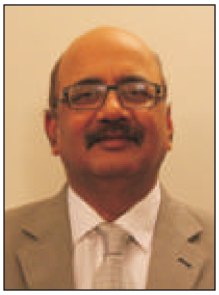


Figure-9 : SBLP - All India and Regional Trend in SHG Loan Outstanding in the Books of Banking System





The use of technology for client outreach for small ticket loans – The Janalakshmi Story

N. S. MuthuKumaran *

Background:

Janalakshmi Financial Services (JFS) Private Ltd is an NBFC-MFI providing financial services to the urban underserved customers in India. JFS was registered as a Private Limited Company in July 2006.

To align its social spirit with the for-profit focus, promoter's stakes of Janalakshmi are held in a not-for-profit Section 25 Holding Company called Jana Urban Foundation (earlier known as Janalakshmi Social Services). The Foundation is focused on social dimensions of the various issues concerning Financial Inclusion such as financial literacy and advisory services, skills and livelihoods etc., besides undertaking Client-centric research and analytics, to have better understanding of the financial inclusion needs of the target customer base.

While Janalakshmi is focused on the financial inclusion space, the Foundation has another operating entity, Janaadhar, India's first affordable housing company that is focused on building affordable, high-quality homes - to create an inclusive society, and a better quality of life.

Janalakshmi is a unique Financial Inclusion player. It is committed to delivering more customer centric product and the best service delivery model. This is reflected in the investments JFS has made to understand the various issues of poverty and coming up with different solutions to resolve them. It undertakes an independent study to track the poverty levels of the urban poor and its customers which are paramount in designing of a product, delivery mechanism. The study acts as a scale to measure, customer's ability to get out of poverty is enabled along with finding out, if the factors that make them more vulnerable are addressed.

Janalakshmi is uniquely placed in the inclusion landscape, wherein it is geared to deliver upon the opportunity by systematically, evolving in the nature and design of a bank and by establishing the brand franchise value by being present at door-step, in customer communities.

"Janalakshmi envisions being a new age full range financial institution that seeks to service the financial needs of the un-banked in India, in a market-oriented fashion".

This vision is translated into a market-based approach to financial inclusion which is defined by three distinct characteristics :

- A pioneer in inclusion services for the urban poor;
- A strong customer-centric driven approach in designing a range of financial products and services and delivery models;
- The centrality of technology driven processes as the foundation of a scalable enterprise.

Target customer group is inclusive of what is defined as urban poor as well as the large segment that is technically not "below-the poverty line" but still has difficulty in accessing adequate financial services. Any individual, who is unable to obtain financial assistance from the existing formal banking-financial services sector, is Janalakshmi's customer.

Over the last 7 years, Janalakshmi has grown to be a large MFI in the industry. The table below illustrates its growth and size of business across 100 branches in the country, today.

Indicators	FY 2010-11	FY 2011-12	FY 2012-13
Number of active borrowers	1,93,515	3,00,847	6,95,974
Number of loan Officers	595	852	2007
Loan Outstanding (In. Crore)	181.7	350.7	956.2
Loans Disbursed (In. Crore)	249.4	422.2	1125.9

* Vice President & Head - Customer Insights and Analytics, Jana Urban Foundation, Bangalore.

Janalakshmi expects to achieve ₹2,500 crore in loan disbursed by April 2014. Such a scorching pace of growth has been possible only due to the robust technology backbone. Let us briefly look at the technology that has been put in place at JFS, how such decision was taken, any issues in implementation, the benefits of the investment in technology to the firm and the customers in the following paragraphs.

Why invest in technology?

In the case of Janalakshmi's investment in technology was not an option but the entire business model was built with technology as the back bone. Let us trace back to the incubation years before Janalakshmi was born. During the discovery phase between 2000 and 2005 when its Founder and Chairman Ramesh Ramanathan did extensive work understanding the needs of the urban poor, he found that it was not just a group loan that they were looking for but an entire suite of financial services. In effect what they needed was a full-fledged bank. The traditional banking system will not be able to cater to their needs given the specific characteristics of this clientele and their needs. It would require a custom built institutional architecture that apart from being able to cater to their needs, would also ensure the core control and risk aspects of running a full-fledged bank. Such a system should also generate adequate return on capital from such small - ticket transactions.

Thus Janalakshmi was born in 2006 with the vision of one day becoming a bank for the urban poor. Apart from taking care of the regulatory requirements, Janalakshmi's architecture to enable it to deliver multiple products to the target group cost effectively and with complete controls was based on three fundamental principles

1. State of the art scalable technology platform with three key components
   a. A biometric based front end transaction device to ensure that all customer – facing transactions are digitised at source during any financial transaction – disbursement or collection.
   b. A back end Core Banking System (CBS) that would be the repository of all customer financial information. This level of sophistication is very rare in the Microfinance institutions which usually use a low cost patchwork back end system which will not permit scalability, product diversity or adequate controls.
   c. A CRM (SFDC) to act as a bridge between the front end biometric device and the back end CBS that would hold all KYC information on the customer and their family
2. Field level organisation that would encourage multiple touch points with the customers and provide the capability to handle multiple products. Unlike the traditional microfinance model that had just one person doing all the jobs – customer acquisition, information collection, disbursement and collections, Janalakshmi had three different persons doing these three jobs – customer relationship, sourcing and collection. This structure would enable the organisation to handle multiple products and will be more amenable for scaling up.
3. Brick and mortar branch system.

   With this clientele it was imperative to have brick and mortar branch system to build trust and to encourage them to slowly and steadily engage in financial transactions through the branch network. Thus unlike the traditional MFI model which operated with minimal physical branch network, Janalakshmi invested in creating a vast brick and mortar branch network which although was expensive to create initially, paid off as it helped fast scaling up.

Thus, to quote Mr Ramanathan, “investing in state of the art technology was not an option but the only way to go. We had to make it work”.

Challenges to implementing technology :

As with any organisation, the implementation phase was challenging both in terms of initial cost – say for e.g. the cost of acquiring Core Banking System and customising it to the needs of a Micro Finance Industry was too high and also in terms of the teething troubles to be overcome during the implementation phase.

Indeed there were many 'Nay' sayers and sceptics who felt that Janalakshmi was biting a bit too much than it can chew. But the commitment to make it happen and the will to overcome any challenges was there among the leadership team backed to the hilt by the board. Luckily for Janalakshmi at the time when it was building its technology components - there were some interesting innovations in the IT Sector. This is the development of the concept of SaaS (Software as a Service). We had the core banking system & Smart card solution - as a service (the only capital investment was the Smart card terminals). The Customer Relationship Management (CRM) and workflow automation was done on salesforce.com - the premier SaaS provider in the world.

Hence capital investment was not much and was affordable. But the bets were laid on the best in class technology to catapult the organisation into the growth path. In this context, Janalakshmi also consciously rejected the choice of small operators - who would not have been able to sustain the huge growth, which could inevitably follow, if model was accepted by the customers.

The logic was simple. When the traditional banking system had to take recourse to the best technological solutions for its operation, the complexity and the magnitude of the MFI operation would warrant similar solutions if not anything better.

Distributed architecture with best of class solutions in each of the application / problem areas to support scale (functional, volumes and complexity) were the key parameters. Hence the best technology, in terms of proven capability and the best vendors, with established processes were brought in.

The challenges to implementation were many. To begin with the absence of ready, available and proven solutions for the Micro Finance industry was the primary challenge. Solutions had to developed ground up or existing products had to be customised to suit the unique needs of Janalakshmi.

Janalakshmi has been instrumental in gathering financial institutions and technology solution vendors to develop a core-banking platform and related solutions for the microfinance sector. Its efforts have been manifested in the conceptualization of the “Common MFI platform”.

While the capital costs were low because of SaaS model investment in design and solutioning were high.

Each of the Products had to go through a lifecycle of POC (Proof Of Concept), Pilot and field implementation and the learnings fitted into the Products before rollout.

What was planned to have been completed in one year took three years to fully implement and break even. There were many teething troubles but the team was determined to make it work. This determination, belief in the technology lead model and hard work coupled with the support of the board were key to the successful implementation.

Technology as Backbone of business :

Because of its vision to build a robust business model that is scalable and sustainable, Janalakshmi has put in place a best-in-class loan management system and a transactions engine that would support efficient service delivery mechanisms, as well as create a seamless management information system.

Today millions of customers and their transactions (be it instalments, disbursals, savings, insurance premium, etc.) are biometric enabled. The entire customer and her family information is compiled on a customer relationship platform called SFDC. The backbone of its technology platform is a robust world-class Core Banking System (CBS) from Oracle that is geared to maintain transactions at a customer level. Janalakshmi is the only microfinance institution in the world that has implemented these enterprise class platforms for purposes of urban inclusion.

Benefits of investing in technology

As we had quoted Mr Ramanathan earlier, this business model would have been possible without the technology. Having said that let us see what kind of benefits that accrued to Janalakshmi because of the technology it had implemented.

i) The use of proven banking solution iFlex from Oracle for managing the financial accounting has ensured transparency and credibility for investors, employees and customers.

ii) The automation of work-flows has brought in several benefits like : control over turn-around times; accountability for credit decisions, performance management of employees, handling increased volumes of work at various levels. This has enabled Janalakshmi to put in place a Balanced Score Card (BSC), a strategic planning system to align execution with strategy. All the parameters in the BSC are monitored and reviewed every week (The data from ground up is available any time almost real time with just a day's lag).

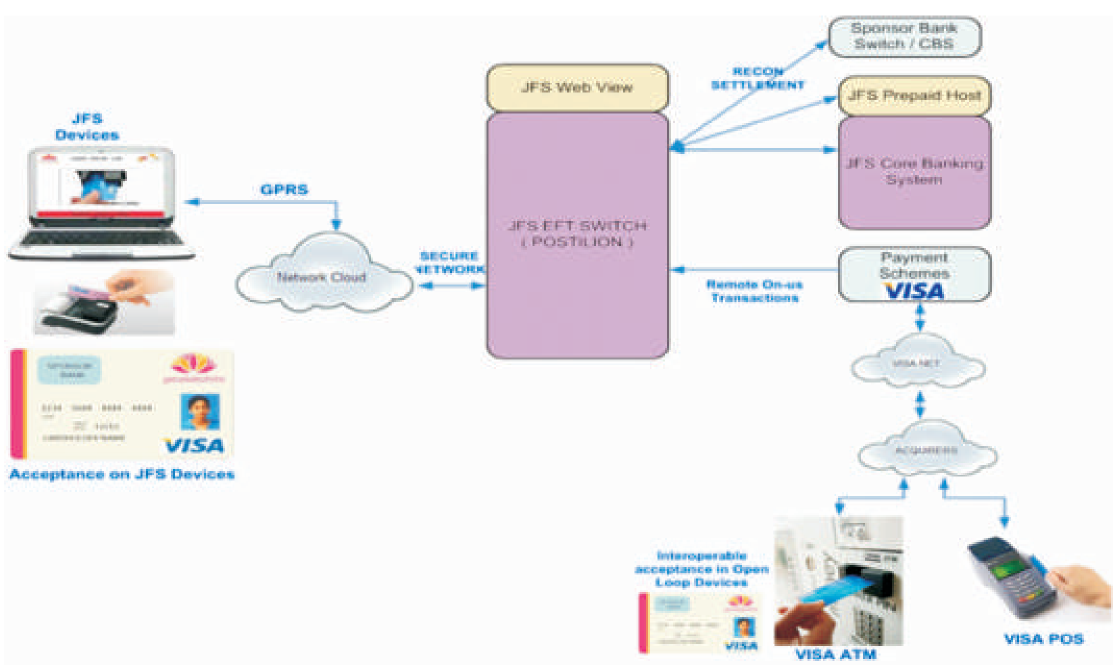
iii) All customer interactions are managed by micro-ATM terminals with biometric authentication that establishes the customer identity. The customer's biometric is used to uniquely identify her. The value of a secure, fast and accurate transmission of field transaction to the backend systems cannot be overemphasized. Besides this the de-duplication of the customer, helps to prevent multiple lending within the organization.

iv) The power of the solution architecture is also its versatility, in terms of supporting multiple products by supporting add-ons in a plug-and-play mode, thereby fulfilling the vision of the founder and the senior management. The necessary operations and controls when automated reduce the overheads in terms of cost, delay and efforts.

v) Scaling up with such rapidity would have been impossible in the absence of this technology. Janalakshmi expects to have 155 branches by end of the financial year 2013-14 from around 95 branches same time last year!

The future :

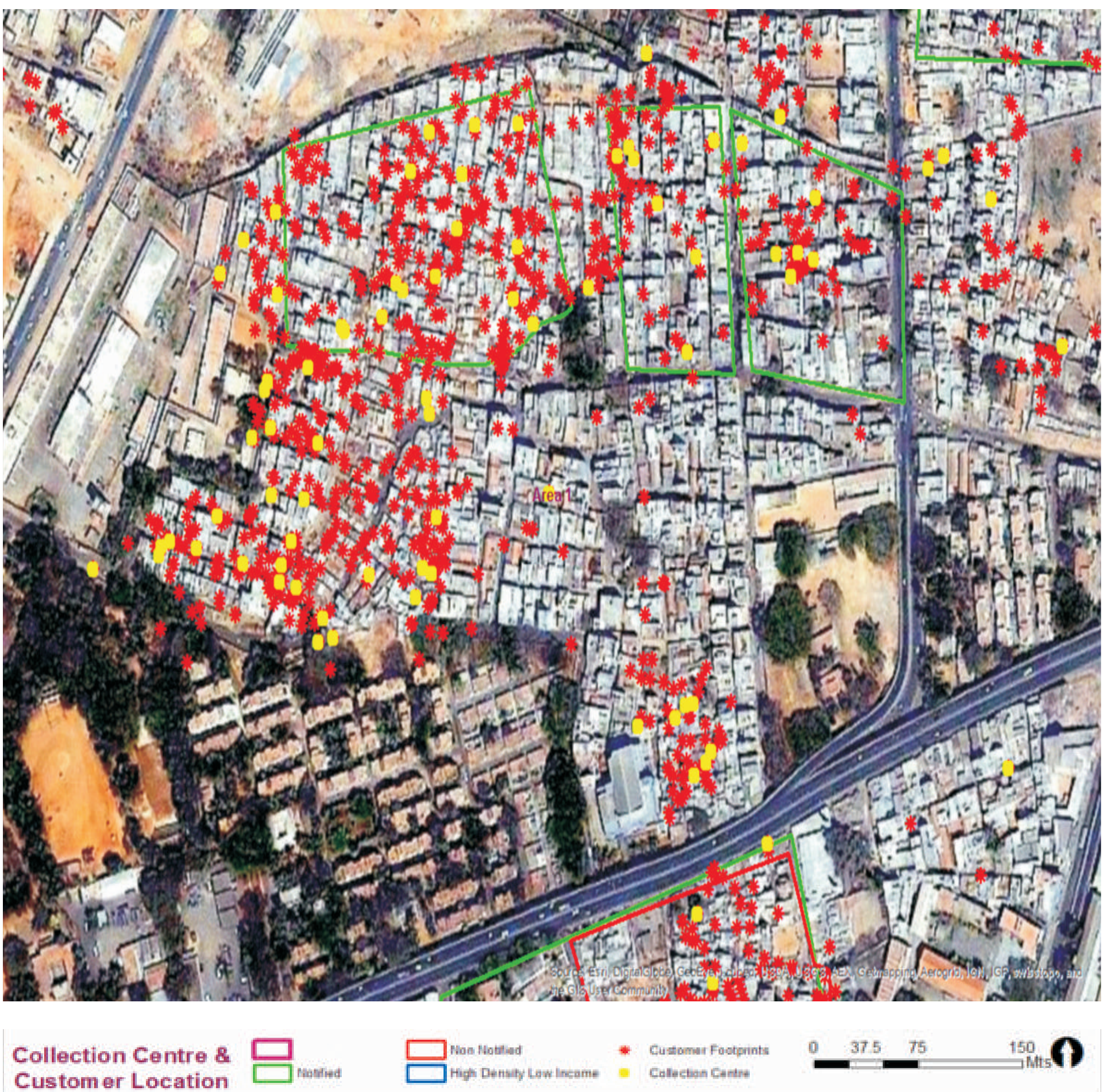
Janalakshmi does not believe in resting on its laurels but would like to keep working to constantly improving the systems and processes so as to serve the clientele better. The front end devices act as a single transaction device for doing enrolments, loan payments and repayments today. In future the same device can be used to provide a full functionality of remittances and transfers in future. The front end devices are supported by a switch at back-end which is a Visa certified switch. The switch can be exposed to external world and connected to participating bank ATMs in future over Visa Net. The future technology architecture is represented in the following diagram.



Spatial analytics:

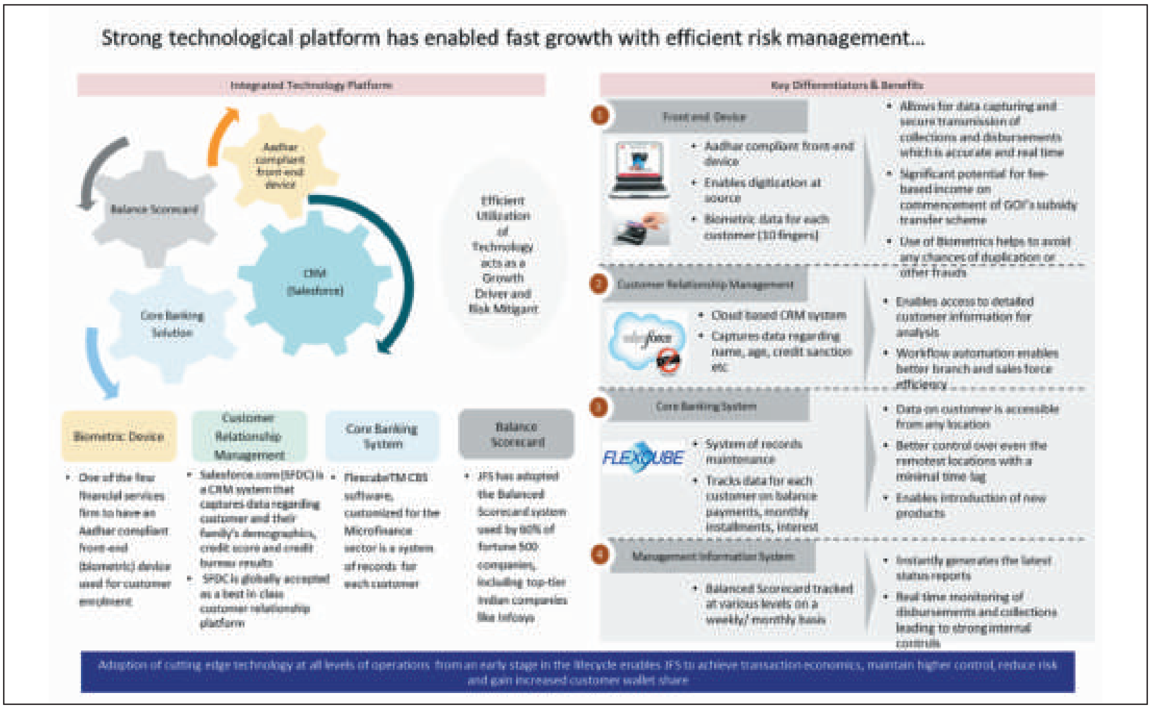
Janalakshmi has also invested in spatial analytics technology and expertise to realise its power in serving the urban poor better. Spatial analytics helps us map the slum areas and high density low income areas and align our branch boundaries and the branch location so as to service these areas more efficiently. All the Balanced Score Card parameters are now being rendered spatially for better impact and additional insights. This technology is also being used extensively for new branch location. Going forward, all the customers of Janalakshmi will be geo tagged and this information will be used to serve them more efficiently.

Shown below is a sample Spatial Analytics output of one of our branch – its boundary, location of slums and high density low income areas and our customer foot print.



To conclude, the technology story of Janalakshmi conveys the power of a clear vision coupled with self belief and commitment to make the vision come true. This is not the end of the story but an evolving one and we will continue to hear more of Janalakshmi's pioneering efforts and successes as the years unfold!

Annexure



Technology Focus – Set to drive growth and profitability

System Used	Customer Acquisition	Sanction	Disbursement	Collection	Key Advantages
Front end System	• Field enrollment of Customer – Capture of Photograph, Fingerprints • Customer ID capture and Dedup • Secure transmission to the backend systems	• Smart Card Enrollment	• Automatic download of Disbursement list • Customer authentication using Biometrics	• Automated download of Demand list • Identification of Customer • Providing receipt generated real-time from the device	• **Each client of JFS is given a biometric, UID compliant smart card which facilitates transaction tracking** • Secure, fast and accurate transmission of collections and disbursements • De-duplication in the database with use of biometrics • Integration of the field with the backend/ management • Usage for other products e.g. Micro-pension
Salesforce.com	**Customer Info** • Data Entry • Data Approval • Pipeline Generation • Credit Scoring and Credit Bureau verification • Report from Loan Generation Software	• Uploading CBS Account on SFDC • Loan Sanction Details - Amount, Tenure, Collateral, Interest Rate, Repayment Schedule	• Disbursement Preparation • Uploading CBS Accounts on SFDC • Upload Smart Card details for each customer on SFDC	• Demand List Preparation	• Customer Centricity: full view of the CIS, quality & process (TAT) of service to customer • Support Field Staff: Planning Collections & Pipeline, up to date Operational MIS, highlight exceptions • Integration of the Organisation: Single version of information, Daily Reviews, Reporting, Insight into Business • Complete Customer Information – supports customer analytics, simplification of CIS • Workflow automation – monitor TAT's, Credit Scoring, Credit Bureau Integration, Balanced Scorecard for Branches
Core Banking System FLEXCUBE		• Customer Account Opening	• Loan Account Opening • Upload of Disbursements	• Posting Collections received from Smart Card to CBS	• **Only Indian MFI that operates on FLEXCUBE** • Robust and automatic handling of all business scenarios • Supports scale • Allows introduction of new products

JFS is best placed technologically amongst its peers and can track performance by branch, executives, collections etc on a real time basis

Creating Jobs at the Bottom of the Pyramid through Credit Plus Microfinance program of Hand in Hand India.

Dr. N. Jeyaseelan *

i. **Background :** In the era of globalisation, India is growing as one of the "Emerging Market" economies and this has resulted in lot of developments in the country. The Government of India has been taking a lot of initiatives to promote inclusive growth. Even though the poverty levels in India have come down from 37.2% in 2004-05 to 21.9% in 2011-12[1] as per the 'consumption expenditure' criteria, India is ranked 136 out of 186 countries in the Human Development Index[2]. As per the multi-dimensional poverty criteria, 53.7% of the population (612 million) lives below the poverty line. Hence, poverty alleviation emerges as national priority.

In India, the poor continue to be marginalised — socially, politically, and economically — due to their lack of access to education, health, employment, training, technology, market and credit. Poverty is a multi-dimensional problem and hence, an integrated approach, rather than a sectoral approach, is the need of the hour in addressing poverty. The Government has recognized the need to adopt pro-poor policies by allocating bank credit resources to sectors where the poor are employed *viz* agriculture, allied activities, rural non-farm sector and microenterprises and also by allocating bank credit resources to areas where the poor are concentrated or development is slow (e.g. northeastern states). The Government has directed its substantial resources to social sector investments like poverty reduction programmes, education and health services for poor, which in turn has improved the productivity of the poor. In spite of intensive efforts on financial inclusion, the poor are still left out of formal banks. They continue to depend on the informal sources of credit. The absence of collateral prevents the poor from accessing credit from banks. Provision of customised microfinancial services like savings, credit and insurance services to the poor through an alternate delivery system involving banks, Non-Governmental Organisations (NGOs) and Self-Help Groups (SHGs) enables them to invest the capital in their microenterprises, to smoothen their consumption expenses, to increase their income and build assets and also ensure the safety of their livelihood by reducing their vulnerability. The resulting economic development of the poor will lead to their social empowerment at the household and community level, which will ultimately lead to the holistic human capital development. In recent times, building a more inclusive financial system is emerging as the Government's priority. This will lead to reduction of poverty and will empower women. Both SHGs and microfinance have the potential for building and making the inclusive financial system a reality.

ii. **Self-help groups and microfinance :** The group concept was implemented in 1987 by MYRADA as an action research pilot funded by NABARD; Credit Management Groups were formed subsequently. Later in Tamil Nadu, the Tamil Nadu Corporation for Development of Women Ltd launched the SHG-based Tamil Nadu Women Development Project in 1989 in Dharmapuri district with funding from IFAD (International Fund for Agriculture Development), Rome. In 1992, NABARD started the first pilot of the SHG bank-linkage programme with a target of 500 SHGs. The SHG bank-linkage programme has since grown into one of the largest microfinance initiatives

* **Chief Executive Officer, Hand in Hand India.**

1. Poverty Estimate 2011-12, July 2013, Planning Commission, Government of India.
2. Human Development Report 2013, United Nations Development Program.

in the world with the formation of 73.18 lakh SHGs[3] as of March 2013 covering 95 million families. The bank loan outstanding under the SHGs bank-linkage programme is ₹39,375 crore as of March 2013. In India, MFIs (Microfinance Institutions) also lend to people at the Bottom of the Pyramid (BoP) and the loan outstanding with MFIs[4] as of March 2013 is ₹21,245 crore covering 24.43 million clients. The phenomenal growth in the microfinance sector has thrown open lot of opportunities and challenges to all the stakeholders and these challenges need to be tackled by taking concerted actions at various levels by different players. Under this context, Hand in Hand's SHG-based microfinance programme is unique and a brief note on the Hand in Hand's microfinance initiative is presented herein below.

iii. **Hand in Hand India's Credit plus model :** Hand in Hand India is a public charitable trust with its headquarters in Kancheepuram, Tamil Nadu. Its vision is to alleviate poverty through job creation and integrated community development. Hand in Hand's mission is to work for the social and economic empowerment of women, by creating enterprises and jobs through an integrated development approach that creates sustainable communities. Its goal is to support creation of 5 million jobs by 2020. Hand in Hand India initially focused on eliminating child labour in Kancheepuram district, where silk weaving has been the predominant livelihood activity for many families. It was against this background in 2004 that Hand in Hand India started working in Kancheepuram and undertook the challenging task of weaning away the children from the looms by redeeming the debts of the parents. Even though banks are used to lend to the poor, still many poor are left out of the formal financial system and many more are underserved. This paved the way for Hand in Hand India to enter into the SHG - Microfinance arena in 2004. Hand in Hand aims to target women at the Bottom of the Pyramid and engage them in help to self-help and income-generating activities. Hand in Hand sees economic empowerment as imperative to increasing living standards, making women "agents of change" and becoming active citizens who are able to recognise and safeguard their entitlements.

In order to alleviate poverty and economically empower women, Hand in Hand mobilises economically poor and socially marginalised women into democratically governed SHGs, provide training and capacity building, facilitate access to affordable and flexible microfinance products through a savings-driven approach, and support the group members in building sustainable livelihoods. Hand in Hand's application of the principles and the pillars primarily starts with formation of SHGs and linking them for credit as described below :

- Target women from below poverty line households and, among them, give preference to women headed households, widows, and deserted women. Poor, rural women account for 70-80 percent of all group members.
- Form active and cohesive SHGs of women from similar socio-economic background.
- Train SHG members in thrift, savings, internal rotation, leadership skills, group dynamics, capacity building, basic arithmetic and literacy skills, etc.
- Manage a savings bank account for the SHG and ensure the proper upkeep of SHG books of accounts.
- Give the SHG members access to credit through the groups from rural banking services as well as through Hand in Hand's direct microfinance programme.
- Provide skill training and entrepreneurial development training in the specific area of skill and interest.
- Promote the establishment of family - and group - based enterprises and facilitate backward and forward linkages.
- Arrange insurance cover for the members.
- Create solid and lasting community structures by empowering rural poor women in forming federations.

3. Status of Micro finance 2012-13, NABARD, Mumbai.
4. Micro meter, MFIN (Micro Finance Institution Network), March 2013.

We believe that when microfinance products are offered to women for asset creation and income generation it improves their economic status, it also strengthens their position within the family as well as their immediate socio-economic context, allowing them to migrate from poorly-paid work or unpaid household work, to self-employment, entrepreneurship, and self-reliance. Since the woman contributes economically to the family and her empowerment leads to equitable decision making in households, the entire household is directly impacted when a woman joins an SHG and is linked for microenterprise creation. Since the programme targets communities in situ, it also limits migration of families from rural to urban areas since their economic needs and aspirations are addressed within their own village.

iv.Hand in Hand's Capacity Building programmes : Hand in Hand's capacity building programmes for SHGs are more structured. Hand in Hand also offers business support and coaching in production, quality control, pricing, marketing, distribution, logistics, etc. The first module for SHG members covers group management, covering the need for SHGs, roles and responsibilities of SHG members, how to conduct a group meeting, savings, internal loans out of savings, book keeping and introduction to enterprises. In the second module, Hand in Hand trains SHG members on financial literacy, MF loan's terms and conditions for offer, third module covers on enterprise up-gradation. The SHG leaders are trained on SHG bookkeeping.

Hand in Hand has been providing skill training to select members of SHG. It is a demand-driven programme. The SHG women are guided on the emerging opportunities in various sectors in their area. Based on this, when a group of women (15 to 20 per batch), comes forward, the skill training is organised. Hand in Hand offers skill training in 44 income-generation activities and the most popular trainings are tailoring, beauty parlour and artificial jewellery making. Hand in Hand uses the most effective training methodologies like the use of games, visuals, mock exercises to enhance members' participation and learning.

In addition to providing credit for microenterprises, Hand in Hand also provides handholding support for enterprise promotion. Hand in Hand believes not only in strengthening the economy of rural households but also in addressing the critical needs at the next level. To address the complex process of socio-economic empowerment at individual and community level, Hand in Hand has adopted a holistic approach that includes the following intermediate objectives in addition to the microfinance programme :

- Universal education for all children and eradication of child labour;
- Strengthening of grass-root democracy;
- Improved health levels for the community especially women and children: and
- Environmental protection

Once a strong base of SHG members and clusters are established, the programme branches out into other pillars by creating linkages among the pillars :

- Volunteers and grass-root level functionaries in child labour elimination and health pillars
- Citizen Centres are started as enterprises with a loan to a SHG member in the implementation area.
- The community-level RO water plant has been set-up to ensure safe and clean drinking water supply. The marketing of water is done by SHGs.
- The solid waste management programmes ensure clean environment and the watershed development programme helps dry land farmers to conserve water and use the water for additional crop area.

These interventions delivered through the pillars of Hand in Hand lend themselves to an integrated community development approach that addresses the community needs at all levels. Though the key development outcome is always the number of jobs created, Hand in Hand directs its efforts to improve the overall situation of vulnerable communities.

v. Livelihood promotion strategies : Hand in Hand India is adopting various strategies to promote livelihoods in a sustainable manner.

a. *Sub-sector approach :* Hand in Hand has chosen two sub-sectors *viz* dairying and vegetable cultivation as most of the SHG members are engaged in these two sub-sectors. Hand in Hand has developed user-friendly training manuals for this 15-day programme spread over 5 months (3 days per month). This kind of phasing enables the SHG members to learn and apply the best practices and come back with field insights for the next module of training. Hand in Hand has trained 8,108 women under sub-sector approach from 1,349 SHGs in 16 blocks across 507 villages in 4 districts.

UNIQUE ACHIEVEMENTS OF THE PROGRAMME

- Developed user-friendly training manuals for dairying and vegetable cultivation,
- Trainings using participatory methods and A-V aids
- Exposure visits to commercial units
- On-site method demonstrations
- Model farms in the project areas
- Post training follow-up and support for market & bank linkages
- Facilitation for insurance services
- Continued technical support and ensuring backward integration
- Dissemination of low cost technologies like pro tray nursery, bio-pesticides production and vermicomposting
- Establishing collection centres for marketing milk and vegetables
- Promoting dairy farmers and vegetable growers federation as an apex organisation.

Each federation has promoted various activities in the value chain among its members

Pro tray nursery – ensures the supply of quality seedlings and timely availability. This low cost technology also reduces the cost of cultivation as the seedlings establishment rate is good.

Impact study by ICRISAT (International Crops Research Institute for Semi Arid Tropics) : Impact study was carried out by ICRISAT, a reputed International institute, Hyderabad in Sep 2010.

HIGHLIGHTS

Dairy enterprise

- 82% of the beneficiaries reached the level of awareness to comprehend basic management of a Dairy enterprise.
- 71% of the beneficiaries gained enhanced understanding on cultural practices in dairy enterprise.
- 42% of the beneficiaries gained enhanced understanding on productivity in dairy enterprise.

Vegetable farming

- 85% of the beneficiaries gained enhanced understanding of the cultural practices in vegetable cultivation.
- 38% of beneficiaries reached the level of awareness to comprehend the plant protection capacity indicator.
- 60% of the beneficiaries gained enhanced learning on market linkages

Overall impact

- 81% of the beneficiaries gained access to formal source of credit, i.e. through banks and MFIs.
- 90% of the beneficiaries utilised the loan for business expansions and hence high rating on credit utilisation.

The sub-sector based value chain project has created tangible impact among the women as their productivity at the farm level has gone up and their access to technology and market has improved.

b. Credit deepening approach : The SHG movement has witnessed many changes over the past two decades The Government of India's National Rural Livelihood Mission (NRLM) Programme and NABARD have come out with SHG-Version-2, wherein Enterprise / Livelihood / Joint Liability groups (Activity-Based Groups) are focused as a credit deepening strategy. Hence, Hand in Hand has adopted the promotion of ABGs, which will enable us to take our target groups to the next level of enterprise promotion.

NABARD aims at promoting the formation and nurturing of groups involved in small scale activity, engaged in similar economic activities to improve the efficiency of their enterprises and for getting better terms from the market through economies of aggregation and scale. ABGs may be formed and supported around any legally permissible economic activity.

Activity Based Groups in Hand in Hand India :

In November 2009, NABARD sanctioned a three-year project to Hand in Hand to form 200 ABGs in Marakkanam block of Villupuram district and facilitate credit linkage with banks. Hand in Hand has formed 200 ABGs so far, enrolling 5 members per group. The members have been taken from existing SHGs. Initial training has been given by Hand in Hand.

OBJECTIVES

- Encourage SHG members, engaged in dairying, to form an ABG and thereby improve the efficiency of their enterprises.
- To facilitate higher quantum of credit from banks to ABG members for doing the activity in a scaled up size.

Hand in Hand - ABGs norms :

- In existing SHGs – as a Credit deepening strategy, selected entrepreneurs with a good track record and those who aspire to scale-up their enterprises form an ABG.
- Size of the group : 5 members
- Meetings : weekly or fortnightly or monthly meetings on specific days.
- Savings : Separate savings is not compulsory. But voluntary savings in banks directly through no frill accounts will be encouraged.
- Internal loans : For ABG members, who are in existing SHGs, they will access the internal loans of SHGs.
- Bookkeeping : For ABGs in existing SHGs, only one additional minutes book for ABG will be maintained wherein all the details related to the dairying economic activity (promoted by the ABG) will be recorded.
- ADFT loans : ABGs access ADFT (Agricultural Development Finance Tamilnadu) loans, when their credit needs are much higher and for long term. So far, ₹1.60 crore has been lent by ADFT to Hand in Hand for on-lending to 120 ABGs at INR 25,000 per ABG woman to purchase dairy animals.

Other services : Under the project, feed supply and green fodder supply has been ensured. A veterinary officer has been posted to provide round-the-clock veterinary care to milch animals. Tie up with an insurance company has been initiated to cover the milch animals. Marketing collection centres have been opened to procure the milk and sell it at a better price.

Impact : The project has created a tangible increase in income among ABG members as the per day yield of milch animal has gone up from around 3 to 4 litres per day to around 8 to 10 litres per day per animal. The price realised by the ABG women has also gone up prior to the project, milk was sold at INR 14 per litre and today (post project) it is sold at around INR 18 to 20 per litre.

c. *Promotion of Enterprise hubs :* Many entrepreneurs in the unorganised sector, who are economically active face exploitation by middle men, local distributors and larger operators. These individual entrepreneurs find it difficult to invest in market information and channels unless they are organised into a federation and empowered or supported by development organisations like Hand in Hand India. Due to the lack of market information and marketing channels many women tend to limit themselves to basic enterprises, which yield only sporadic income; others, unable to foresee the potential and stand up to challenges, opt to discontinue their entrepreneurial venture, and the rest do not feel confident even to start. Hence, in Phase III it is planned to provide continued enterprise support by way of handholding through dedicated hubs for specific activities. These hubs will be like training-cum-production centres, but managed by the entrepreneurs themselves. The hubs will ensure that the following tasks are undertaken by them *viz.* enrolling new entrepreneurs in the hub (a registered entity), market research, getting orders, entering into contract with bulk consumers, providing or procuring inputs, training in new skills, ensuring quality control, packing, branding, financial management, design development and participation in fairs and exhibitions, collaboration with government agencies, fair & ethical trade practices and so on. Individual entrepreneurs will reap the benefit on the basis of their contribution to the production. Each hub will be expected to serve around 250 women.

Progress under the Enterprise hubs : Hand in Hand India has started three hubs (Garments, Handicrafts and Dairying) out of the four planned. For the embroidery hub, the base work has started for enrolling women involved in embroidery in the Sriperumbudur area. More than 600 women have benefitted out of the hub.

vi. Microfinance Outreach and Job creation at the Bottom of the Pyramid : Hand in Hand India's microfinance programme complies with all recommendations of the Malegam committee and RBI guidelines on microfinance. Hand in Hand offers a wide range of microfinance products *viz.* enterprise loans, water and sanitation loans, education loans and dairy loans to address the various needs of the SHG community. The loan size ranges from INR 5,000 to INR 30,000. Under "Missing Middles[5]" pilot, the loan size is INR 50,000 per member without any collateral. Hand in Hand charges an affordable rate of interest of 18 to 23% on reducing balance. Hand in Hand has adopted the Fair Practice Code prescribed by the RBI and all staff have been trained on the code of conduct and social performance. Hand in Hand India has scaled up its microfinance initiative in 8 States in India and replicated its model in very diverse territories (Afghanistan, South Africa, Brazil, Kenya, Cambodia & Myanmar) across the globe. Hand in Hand has promoted 63,135 SHGs enrolling 894,119 women (as of October 2013). So far, through microfinance programme, women have started 961,432 Family-based Enterprises (wherein the investment level isupto INR 50,000) and 101,87 microenterprises (wherein the investment level is above INR 50,000). To validate the number of jobs created out of the enterprises created / supported by Hand in Hand's microfinance programme, Hand in Hand had engaged M-cril to undertake a study in 2012. Excerpts from the study :

- Hand in Hand has created / supported 1.16 million jobs out of its microfinance programme as of March 2012.
- 94.9% of members used the Hand in Hand loan for productive purposes.
- Out of total loan amount, 90.1% of Hand in Hand loan amount is used for productive purposes and 76.4% of bank loan amount is used for productive purposes.
- Through microfinance either family-based enterprises / microenterprises are created afresh or existing family-based enterprise / microenterprises are expanded.
- One family-based enterprise supported by Hand in Hand creates 1.67 jobs.
- One microenterprise supported by Hand in Hand creates 2.61 jobs.

Hand in Hand's focus on capacity building of clients and handholding support for enterprise promotion leads to this high level of loan usage for productive purposes and creation of jobs at the bottom of the pyramid, which adds to the vibrancy of the local economy and prosperity at the house-hold level. As of February 2013, Hand in Hand India has achieved its initial goal of creating 1.3 million jobs. Now Hand in Hand India has set a higher goal of creating 5 million jobs by 2020 and looks forward to taking up its interventions in the new geographies which are unserved and under served. The jobs created by the microfinance programme have resulted in incremental income to SHG members, which have impacted the households in a more positive way and added to the prosperity of the clients and empowerment of women. Most of the households are investing their incremental income to educate their children and providing better nutrition, which will go a long way in building the human capital among the underprivileged.

5. Missing Middles are those SHG entrepreneurs who have well established enterprises and need higher quantum of loans, but do not have any collaterals to give as security to avail the individual loans from banks.

Best Practices in Microfinance : Equitas Story

John Alex *

Introduction :

Having been employed for over 20 years in the retail finance sector, Mr. P. N. Vasudevan was an unlikely candidate for starting a company of his own. Yet, in 2007, he found himself exploring that possibility as he relocated to Chennai due to personal reasons. He had been aware of the microfinance sector for a brief while; and the more he learnt about it, the greater his determination became to establish a company for providing micro-credit to low-income group women. As a business model that was vastly different from the typical asset financing departments he had lead in the past, Vasu began by visiting a wide range of microfinance institutions across the country. And seeing the model up-close, he realized the efficacy and simplicity of the Grameen model. But he also noticed that while Mohammad Yunus' brain-child had made the front-end of microfinance effective, the back-end of a typical MFI was not the most efficient model he had seen in his asset financing years. Convinced about the vast unmet demand for microfinance and the supply-side gap in terms of an efficient service provider, Vasu set out to launch his microfinance company.

Preparing for the sprint

Vasu valued the need for a top notch management team; and believed in investing in the right team up-front. He tapped into his professional network and found past associates willing to join his microfinance venture. Then christened UPDB Ltd, the company began with a formidable management team – COO, CTO, Head – Ops, Head - HR and Regional Manager bringing between themselves over 100 years of professional experience. (Please visit http://www.equitas.in/Abt_ManagementTeam.html for details of the current management team). Vasu also worked on constituting a respected board of directors – including Mr Rangachari (who was the first Chairman of India's insurance regulator & Former Chairman of Central Board of Direct Taxes) and industry experts to ensure responsible corporate Governance. The initial round of equity funding was put together by Vasu's friends & well wishers, along with his ex-employer of 20 years.

The management team visited MFIs and potential customers to understand their requirements and made suitable adaptations to the Grameen model. Since members were flustered by the time spent on centre meetings every week, the company built a model around fortnightly repayment frequency. Also, during the initial surveys, it was observed that members availing a first loan of ₹5,000 or so typically use the entire amount to pre-close high-cost loans and have little left to deploy on their business activities. Therefore, the company decided to launch a base loan product of not less than ₹10,000.

1..2..3…Go!

With this strong preparation phase spanning across a few months, the company created a record-of-sorts by setting up a fully integrated IT system before the first loan was disbursed on 15th December 2007. Over 1,000 members were acquired in the first seven days of operation. This exponential growth continued through the next eighteen months with the company clocking 400,000 members by April 2009 (crossed 1.5 million members in 2011). The company, which was renamed Equitas in early 2008, achieved this growth by leveraging a rapidly scalable business model. Such a rapid growth might have seemed a tad too ambitious

* Vice President and Head-CSR, Equitas Group.

when the company scouted out for capital infusion. However, then only in its first few months of operations, investors valued the quality of Equitas' management team and their promise of building a successful business out of a huge untapped opportunity. In two rounds of capital infusion completed within its first eight months of operations, Equitas has built a substantial equity base of around USD 16 Million. This equity base has fueled Equitas' phenomenal growth making it the world's fastest growing start-up MFI with the largest number of members in the first year of operations.

In tandem with its rapid growth, Equitas has deployed a wide range of customer-friendly measures as well as portfolio risk management processes. Incidentally, 'Equitas' is a Latin word that translates to being equitable, fair and transparent. True to its name, Equitas aims to be the leader in the microfinance industry by setting benchmarks in the industry in terms of being fair and transparent to customers. In line with this objective, Equitas has taken a clear stand of communicating our all-inclusive IRR interest rate to all our members. Equitas is probably the only MFI in the world to have done this. As part of its risk management processes, Equitas has constituted an independent risk & audit team for validating a random sample of all transactions performed in the previous month. This audit score is directly tagged to the field personnel's incentive structure.

The Equitas DNA

In its first full year of operations, Equitas has derived strength and direction from clearly defined mission & vision statements. The mission statement's clarity helps define the company's purpose in our employees' mind. In a period of rapid employee growth, this helps ensure that all employees are aligned to the company's requirements. The mission statement also effectively captures our identity in the microfinance sector. We expect our mission & vision statements to steer us through our subsequent years of operations as well.

Mission : (1) To improve quality of life (2) by increasing total household asset value (3) of those who are not effectively serviced by the formal financial sector (4) by providing transparent and trustworthy access (5) to financial and other relevant products and services (6) by deploying cutting edge technology (7) and forming partnerships and alliances.

There are seven parts to the mission statement.

1) The main purpose : to improve the quality of life of our customers

2) Indicator : While there are many indicators of quality of life, we have chosen the yardstick of measuring the total household asset value as the indicator of quality of life. While giving the loan, we take a list of all household assets of the customer which is entered into the system and using a pre assigned value for each asset, the total asset value is determined and stored. At the end of every two years, we would do a similar exercise and get the value of assets at that point in time. A comparison between these would show whether the assets have increased or decreased giving an indicator of movement in quality of life

3) Who are our customers : Those not served by the formal financial sector

4) How do we serve : Transparent and trustworthy access. Equitas, in Latin means 'Equitable' meaning fair and transparent. Everything done here would be tested against this measure and only those which pass would be allowed to be rolled out. Every action that the company does should be transparent and should create trust in the minds of customers and other stakeholders. Our pricing is very fair and not opportunistic. We have priced our products such that at an optimum efficiency of operation we would be able to get reasonable return on equity, even though there exists a temporary opportunity to price higher. We are also totally transparent in our communication of interest rate to clients. As per Mr. Chuck Waterfield of mftransparency.org, Equitas may be the first MFI in the world to print the true IRR in the customer pass books.

5) What do we offer : Both financial and non financial products and services. On the non financial / social side, Equitas has developed an Ecosystem aimed at holistic improvement in the quality of life of its member

base in the field of Education, Health care facilities, Skill Development, Food Security and placement services for unemployed youth among our member base

6) How do we do this : By leveraging technology to ensure lower cost and hence lower price to customer. Equitas has put in place significant innovations both in processes and IT to improve efficiency and reduce cost. Our 'Sticker' process for collections is protected now through a Copyright. Our SMS meeting tracker system, Form Tracker system and Optical Mark recognition are recognised as unique initiatives with the OMR being the first in the BFSI sector in India. We are already better than all leading competitors in terms of various productivity parameters and expect to be the lowest cost organisation during the coming year

7) Do we go alone in this : Not necessarily. Wherever we can form alliance or partnership with others we would be happy to look at the same. We have successfully outsourced many non-core activities to various vendors, thus improving productivity and controls.

Vision : "To be the leader in Microfinance and to be known, as the most fair & transparent MFI in the World"

The mission & vision statements are communicated directly to every employee by Vasu as part of the regular induction process. The deep impact of these statements is borne out by a recent employee satisfaction survey in which around 90% of the employees strongly agreed that the mission statement of the company made them feel their work is important.

Operational Highlights – FY 2008-09

FY 2009 was our first full year of operation. Some of the highlights during this year are :

- New customer acquisition crossed 3,50,000
- Loan outstanding crossed ₹288 Cr
- Quality of portfolio good – PAR 30 less than 0.05%
- 85 branches in operation, largely in Tamilnadu with 2 branches in Hyderabad and 2 in Pune
- Staff strength of over 700 with a very strong and well knit management team
- IT system very stable and settled for current volumes
- Processes are well established and the company is working towards ISO certification
- Company has broken even during the year and by March 09, expect to wipe out brought forward losses also (after providing for 1% standard asset provisioning)

Equitas has been recognized and appreciated by a wide range of external stakeholders :

- CRISIL accorded Equitas an mfR3 grading, which is the highest grading any MFI has obtained in its first full year of operations
- Equitas is the first MFI in India to be involved in a rated portfolio securitization transaction. The portfolio was rated by CRISIL.
- Equitas won the Unitus Accelerator Award in 2008
- Equitas was awarded the TiE Canaan Entrepreneurial Award 2008

The Equitas model of microfinance

- *Fairness & transparency*

It's a matter of pride for us at Equitas that, ever since our inception, we have taken a clear stand of communicating our APR interest rate to members. In fact, some members have compared our APR interest rate with other MFIs' stated flat interest rates and they have questioned us on why our interest rate is 'excessive'. Equitas has trained its field staff to welcome such questions from members and use that as an opportunity to help members understand the true cost of their loans. We believe Equitas is the only MFI in the world to have done this. It's heartening to note that this demonstration of transparency has not been at the cost of our growth. As part of our consumer protection program, we have also launched a campaign to educate our members about the perils of over-borrowing. The idea is to provide a visual reminder nudging them against over-leveraging. In addition, another message on the benefits of investing in education is also included in the communication. Overall, it is hoped that client education initiative will protect members' households from over-borrowing; while also motivating them to invest in their children's education. It also loosely translates to "Education / knowledge secures client's future. Multiple borrowing imperils client's future." Equitas is pleased to note that we've received good positive feedback from our members on this programme.

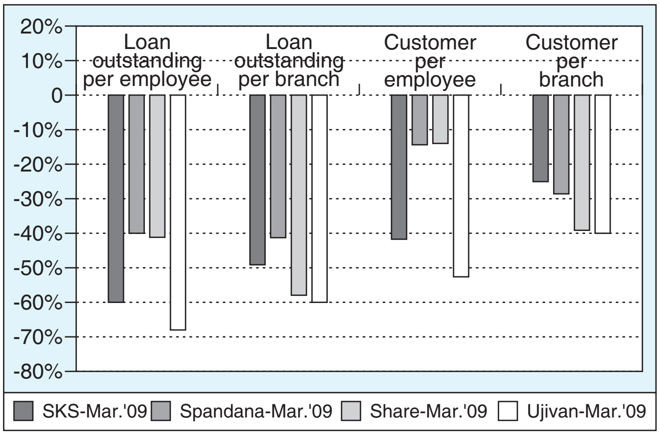
- *Efficiency*

The bedrock of Equitas' scalability is its approach of delivering efficient back-office support to its branch teams. Equitas is the first and only, MFI to establish a dedicated and centralized back-office team. By setting up this back-office team, Equitas has enabled its field personnel to focus purely on customer-facing activities; and thereby multiplied the productivity of its branches. Currently, a lean team of only 70 personnel is deployed to service the back-end requirements for the entire customer base of 400,000! Such high levels of efficiency have been enabled by a series of innovations adopted by Equitas :

- Pre-printed stickers : Though Equitas has leveraged cutting edge technology for many of its solutions, ingenuity and reason have prevailed in its choice of many solutions. Instead of implementing expensive technology at the field, stylized stickers © have been deployed at Equitas. These stickers deliver the benefits of hand-held devices at a much lower cost. In addition, the transaction time at the Centre meetings take just 20 minutes compared to 30 minutes in other MFIs.
- Real-time collections monitoring : With its rapid growth, Equitas has established a simple and highly effective system to track its collections on a real-time basis. Equitas is the first in the BFSI sector to have implemented such a system. A central server obtains SMS-based information on the proceeds of every collection meeting within fifteen minutes of its completion. An internet-based application helps Branch & Area Managers detect any anomaly in their collections immediately; and facilitates quick resolution of the anomaly.
- Forms tracking system : With close to hundred branches expected to go live in the next couple of months, tracking the progress of every new centre's paperwork is crucial in assessing and improving the turn-around time involved in disbursing loans. Towards this purpose, an FTS (Forms Tracking System) has been established for monitoring stage-wise progress of the membership forms. MIS reports based on this system provide aging analysis information; that helps the management team to identify bottlenecks in the operations for prompt resolution.
- Automated forms processing : In order to multiply the productivity of its back-office team, Equitas has introduced an Optical Mark Recognition (OMR)-based membership form. Most fields in these forms are parameterized; and are updated directly into the system on scanning the OMR form. The introduction of this OMR system has reduced, by a factor of three, the time required for the back-office team to update new members' details in the system. This has resulted in a direct impact on the scalability of Equitas' business. This is yet another first for Equitas in the BFSI sector.

The impact of the efficiencies built into the Equitas model can be observed in the following chart benchmarking Equitas against SKS, Spandana, SHARE and Ujjivan on four key parameters.

The baseline (0%) corresponds to Equitas and the chart depicts the relative performance of other MFIs against Equitas' baseline values. As may be observed, the efficiencies of Equitas' model are borne out by the large gap in these productivity parameters.



- Risk management

Any model of rapid growth has the potential for compromise on quality. Given its rapid growth projections, Equitas recognized the need for checks and measures to ensure portfolio quality as well as to eliminate the risk of fraud. These processes are aligned to verify the efficacy of group bonding in every centre; which is the core strength of the Grameen model.

Equitas has instituted a check of every member prior to disbursement. This inspection by the Sales officer is corroborated by a random check (of at least 5 members per centre) conducted by the Branch Manager (BM). These inspections include verification of the member-candidate's household and business details. In parallel, the Operations team conducts de-dupe of every member based on her ration card ID for eliminating the duplication of members at a household level. Also, the BM conducts a comprehensive Group Recognition Test to ascertain the bonding of members within the centre. In addition, after the disbursement, Equitas Relationship Officer conducts a loan utilization inspection. Also, Equitas has addressed the risk of fraud during collections by deploying pre-printed stickers.

In addition to these checks and measures, Equitas has pioneered the establishment of a final line of defense – an independent field risk audit team. Field Risk Officers (FRO) are deputed to independently confirm the adherence to standard processes in a random sample of all transactions performed in the previous month. The entire risk audit process is parameterized in order to deliver an audit score; which is directly linked to the field personnel's monthly incentive scheme. The design of Equitas' risk audit structure lends itself to successful risk-management due to the following reasons :

Independence from branch offices : The risk audit team is delinked from the branch manager; and has a parallel hierarchy of Territory and Regional Risk Managers.

Randomized sample selection : The sample to be inspected by the FRO is selected by an automated system. By ensuring a truly random sample covering every branch, the pressure on branch personnel to adhere to processes will be consistently maintained.

Blind validation : Instead of validating the entries made by a branch personnel, an FRO is instead required to fill in member details afresh. The FRO is not aware of the corresponding details filled in by the branch personnel. This blindness to the information submitted by the branch personnel further strengthens the risk audit process.

Automated audit score generation : By using OMR-based audit forms, the information provided by FRO is automatically updated into the system without any manual data entry. Also, the system matches these details with those already provided by the branch personnel and computes the staff and branch audit score.

Clear motivation for branch personnel : A staff's audit score is directly linked to his performance appraisal; the branch manager's performance appraisal is linked to the branch audit score. As a result, the teams recognize the need for process-adherence in their operations.

- Employee engagement

The rapid growth of Equitas has been facilitated by the employee-friendly policies of the company that have helped to maintain employee morale at high levels. Equitas' business model of involving a centralized back-office has helped the branch personnel focus on customer-facing activities alone.

Recruitment : To match its aggressive growth projections, Equitas has ramped up its team size to 700 in its first year. Such rapid recruitment of personnel – both from within and without the microfinance industry – has required innovative practices. Apart from according importance to employee referrals, Equitas also provides an opportunity for its potential employees to visit the field and obtain a 'live' experience of their respective role before accepting an offer from Equitas. This has lead to low levels of attrition. Also, Equitas has taken special care to recruit Area Managers and above only through employee referrals.

Performance recognition : Fostering healthy competition amongst the branches, Equitas has instituted a monthly Best Branch Award. The branch that wins this award is rewarded with a team outing at the company's expense.

ESOP scheme : Equitas is probably the only MFI in the world to provide employee stock options to all its employees. The universality of the ESOP scheme coupled with the early stage of the company is bound to enable employees to participate in the value creation.

Structured induction & training processes : Through a structured induction process, every employee of Equitas is provided a holistic overview of all departments of the company. During this induction, an employee is provided every department's perspective of the business operations by its top management personnel. This helps employees understand the management team's vision for the company. Coupled with this induction process, Equitas mandates a process training module for every field personnel. This helps reinforce the emphasis on process adherence to all its employees.

The Equitas Ecosystem

As a mark of its commitment to ensure comprehensive development of its customer communities, Equitas has launched Equitas Development Initiatives Trust with eminent citizens such as Dr. C. K. Gariyali (IAS Retd), Dr. S. P. Mathur (IPS Retd) and M. B. Nirmal (Founder, Exnora International) serving as founder trustees. The company is committed to contribute 5% of its annual profits to the Equitas Development Initiatives Trust. The trust is a not for profit organization formed to promote education amongst poor children and community development where their customers reside.

- Equitas Gyan Kendra

Towards increasing the members' income, Equitas has partnered with a variety of third-party training agencies to provide vocational training to its members. In the months of Nov.-Dec. 2008 alone, over 2,000 members have been trained and over 2,80,000 as on date in a variety of skills including tailoring & embroidery, agarbathi / candle making, detergent / phenyl manufacturing and preparing processed food such as pickles & jams. To further demonstrate its commitment for vocational training for its members, Equitas has launched an exclusive training centre for its members. This centre will provide week-long skill-based training to around 6000 members annually. On completion of this pilot, Equitas expects to rollout this training initiative across all branches. Equitas will also seek to establish business linkages for these newly trained members.

- Equitas Dhanya Kosha

Equitas Dhanya Kosha has been incorporated as a Section 25 (i.e, not-for-profit) company. Through this initiative, Equitas seeks to provide food security to its member households. Members would be encouraged to save money onto a smart-card so that she has saved for 1-2 months of grocery expenses on the card. In case of an income shock, a member may use this card to obtain instant access to staple items such as rice and dal. In other words, Equitas seeks to build a grain bank for its members. This grain bank will also enjoy the benefits of aggregation. Equitas has observed that every member household spends around ₹1,000 on staples such as rice and dal every month. Equitas seeks to aggregate the demand of its 400,000 members for such staples in order to provide them a monthly saving of around ₹100-150. This monthly saving would be a significant benefit to members in reducing their monthly grocery expenses.

- Equitas Gurukul

Under the aegis of Equitas Development Initiatives Trust, Equitas seeks to establish schools to provide high quality education to its members' children at an affordable price. Equitas would provide the best quality of education in these schools comparable with the best of schools in Chennai city. The education would be English-medium education to members' children from LKG to XII standard. It will conform to the Matriculation syllabus. During every school's launch, it will cover LKG to V standard only. Inducting students at a higher level might make it difficult for them to manage their shift into this school. With every passing year, the school will start providing education for the next grade / standard. There would not be any upfront donation and the fees will be structured to ensure financial sustainability of the schools. Equitas runs 5 such regular schools and 50 tuition centres as an after school coaching centre

- Health & hygiene

Equitas also recognizes the limited access its members have to quality healthcare services. As a first step, Equitas conducts health & hygiene camps in every branch on a regular basis. In the past couple of years, Equitas has partnered with a wide range of healthcare providers in conducting these camps for around 1.4 million members. In addition, Equitas has also partnered with a leading eye-care provider in order to provide life-time free eye care, telemedicine and health helpline for all Equitas members.

Every arm of the Equitas ecosystem is designed to provide a safety net to our members; while also generating goodwill for Equitas in their minds. As a result, Equitas has consciously decided that every arm of the Ecosystem shall be operated on a not-for-profit basis; and that the MFI arm would be the only profit-seeking venture of the company. In fact, since its inception, Equitas has been clear that it would not profiteer out of the poor – and it has clearly informed investors at every stage that Return on Assets will not exceed 25% at any point of time.

OUTCOME / IMPACT / RECOGNITION FOR THE ABOVE MODEL :

In a matter of 4½ years, the company has set benchmarks in the Micro Finance industry :

1. A combination of process and technology innovation has helped us maintain an operational efficiency which is about 100% better than any other MFI in the country
2. CGAP (an arm of World Bank) have a blog in their website, that the technology we deploy at Equitas is the best amongst MFIs in the world
3. mfTransparency.org which is a global NGO floated to improve transparency amongst MFIs has confirmed to us that we are the only MFI in the world to transparently publish the true cost of funds for the clients in the passbook which are given to clients and by way of reducing balance method
4. Harvard Business School has written a case study on Equitas (Harvard Business School Case 510-104.)
5. CRISIL has consistently rated us well and has given us the highest rating they have ever given to any other micro finance company in the country, though we are among the youngest.
6. We crossed 1.5 million client base and operate out of 7 States and 290 branches with around 2500 staff
7. Conservative accounting policy : we provide 1.25% standard asset provisioning though RBI norms do not require us to do any such provisioning
8. We have recently been rated by CRISIL under their Corporate Governance rating and we have received a Level 2 rating (on a scale of 1 to 8, 1 being best). We are the only 8th corporate in the country to have got this rating, besides being of course, the first MFI.
9. Has been listed as one among top MFI's in the Great places to work awards every year

The reach under the social initiatives, called the Equitas Ecosystem for the holistic improvement in the quality of life of our member base which is being either free of cost or on not-for-profit basis has been significant and spoken about in the MFI world as a model :

The Equitas Ecosystem

The mission statement of Equitas is to improve quality of life by increasing total household asset value of those who are not effectively serviced by the formal financial sector by providing transparent and trustworthy access to financial and other relevant products and services by deploying cutting edge technology and forming partnerships and alliances.

In line with this mission statement, Equitas has developed a wide range of ecosystem initiatives towards improving the quality of life of its members. A snapshot of the Equitas Ecosystem is provided herewith and all such initiatives are run either free or on not for profit basis :

CSR- Health, Skill Development, Placement Services :

1. *Primary Health Care :* Our primary health care medical camps done free has benefited cumulatively 15,82,326 members so far which is a record in the MFI sector globally – Done by CSR Division
2. *Secondary Health Care :* Our tie up with large number of hospitals helps our clients get treated for serious illness at a discount to normal cost, during the year the savings to 1084 members was around ₹41.27 lakh – Done by CSR Division
3. *Telemedicine :* Equitas strongly believes that Telemedicine is the future in health sector, capable

of taking quality health care facilities like diagnosis, treatment and prevention of diseases to underserved rural and urban slums beyond the walls of the hospital in a cost effective model- A Pilot has been launched in partnership with Apollo Telemedicine centre in 3 centres at Chennai 8,859 members benefitted from this facility-Done by CSR Division

4. *Health helpline :* Members call this line for serious illness and the operator guides them to network hospitals, nearly 15,784 members benefitted from this facility- done by CSR division
5. *Health Camps in Vehicle Finance Branches :* we conduct health camps in transport Nagar's to screen truck drivers & cleaners for general health, eye and also educate them on Aid's awareness, we were able to screen 8,162 beneficiaries- done by CSR Division
6. *Livelihood support :* We have given skill training (vocational training-Equitas Gyan kendra) and trained 291041 members on a cumulative basis so far which is also a global record – Done by CSR Division
7. *Placement Services :* In another proactive step, Equitas conducts job fairs for members' unemployed children to enable employment opportunities, through this initiative Equitas was able to facilitate job placement for 11,550 unemployed youth on a cumulative basis- Done by CSR Division

CSR- Equitas Facilitates Long term Investment in Education :

1. *Education :* Around 5,000 members children are studying in 46 tuition centres (Equitas Shiksha) run as an after school education support – run through Equitas Trust
2. *Schools :* We run five regular schools called Equitas Gurukul, 2,330 members children study in Trichy and Dindigul, Salem, Sivakasi & Coimbatore – run by Equitas Trust

CSR-Beyond microfinance – Socially Disadvantaged Segment :

1. *Ultra Poor Programme :* (Equitas Birds Nest) We commenced a programme in 2009-10 for Rehabilitation of Pavement Dwellers in Chennai and identified 100 families in the first phase. We have moved 102 families into houses and hand held them for initial 6 months to lead a dignified life and they have now started paying rent on their own. Most families have attained self sustenance status through a host of interventions from Equitas. Many have received Voters ID for the first time in their lives some have applied for ration cards – run by Equitas Trust
2. *Persons with Disability :* We have financially supported on a cumulative basis to 6,484 Persons with Disability of whom 621 are blind in setting up some livelihood activity so that they can stand on their own feet

Food Security- Demand Side Aggregation

Retail : We run a chain of grocery stores on a not for profit basis, where our clients can buy groceries. Benefit of aggregation is passed on to them. They also get a card / credit from us with a limit loaded in it which acts just like a credit card to them, more than 81,654 members used the facility and obtained a savings of 6-10% over MRP – run by Equitas Dhanya kosha, a Sec 25 Company

In 2011, Equitas expanded the scope of providing financial services for the financially excluded segments of the society. Equitas has setup separate businesses for providing finance for purchase of used commercial vehicles and housing loans for self-employed through wholly owned subsidiaries. In the next few years, Equitas expects to balance its portfolio equally across these 3 businesses

Efforts to start savings products in collaboration with Banks, gold products etc :

At Equitas at every customers meet, we could sense the felt need was for some savings product which could never be addressed alone as NBFC, unless it found some new way of collaborating with either Banks or Insurance companies, here is a summary of the efforts which were very disruptive but didn't scale up to the level due to various reasons

- SB / RD with IOB : Equitas & IOB signed an MOU to encourage and facilitate easy opening of SB a/cs with a RD piggy backing on it, 5,000 a/cs were opened in fast track mode, but failed to scale up as each a/c was tagged to one Branch, IOB is revisiting their process to ensure a revised model.

- BCs : Many of our members have been made BCs but most are unsustainable
- Incubation Cell : To help handhold budding entrepreneurs graduate to next level in enhancing their business and assess their credit needs and access through Banks Failed because of delay in processing these applications by Banks.
- Gold jewellery product : It was very popular had to be shelved when RBI raised the LTV
- B2B (supply side aggregation) : Though we succeeded on the demand side aggregation we could not face the same level of satisfaction in the supply side when we set up 6 distribution centres in Chennai to supply daily demands of Vegetable / fruit / Flower vendor clients due to internal & external factors, we are now studying the feasibility of doing B2B in textiles / garments.

Product Name	Product Brief	Product Launch Rationale	Current Status
Swarna Mudra	Loan for purchase of gold coins from MMTC	Low-income household women expressed the desire to have means of accumulating savings. And gold was construed as a proxy saving instrument.	Product withdrawn Members preferred to convert gold coins to gold jewellery, rather than retain gold in coin format. Product dropped after AP Crisis.
Swarna Varsha	Loan for purchase of gold jewellery from empanelled stores	Primarily based on feedback from Swarna Mudra product	Product withdrawn RBI regulations against NBFC lending for purchase of gold
B2B	Provision of fruits & vegetables at wholesale rate to microfinance members (in Fruits & Vegetables business)	Large number of Equitas members in F&V trade within a small radius, whose demand may be aggregated and goods will be delivered at a reduced cost	Product withdrawnLimited scope for product differentiation in a dense market such as Chennai

- MSE Loans : When the effort for sustaining the incubation cell failed, the concept of direct lending to small business was put to trial, today we have a 12 member strong team heading this division
- Education loan Product : It was very successful and was stopped due to RBI regulation post AP crisis
- Gold coin product : It was very successful but had to be shelved as it is a secured loan contravention to RBI's new norms

Conclusion

When Vasu set out to start his company, he had internalized three key drivers for a successful company – clarity of purpose, honesty of intention and integrity of execution. Looking back, one would imagine that Vasu would feel proud to have delivered on each of the three drivers and thereby proving the statement true.

Client Engagement Process in KGFS

S. G. Anil Kumar *

Introduction

Kshetriya Gramin Financial Services or KGFS is a financial services delivery model that leverages innovations in technology and financial markets to roll out a network of local financial services access points offering a complete range of financial services in remote rural India. The mission of each KGFS unit is "*to maximise the financial wellbeing of every individual and every enterprise by providing complete access to financial services in remote rural India*". Given the vast diversity and spread of rural areas, a localised entity with a tight geographical focus is better placed to identify customer needs, adopt local culture, provide better front-end services and offer a complete range of financial services. The KGFS model stands out in creating a structure that brings together the distinct advantages of a local entity that is supported by a robust backend infrastructure and can serve as a cost-effective delivery point for large financial institutions. The model allows for seamless partnership with larger financial institutions keen to reach out to rural customers in a viable, efficient manner. The model addresses the need for an effective channel partner in the Indian Banking and Financial Service sector that can overcome the challenges of "last mile" reach.

The **6** KGFS in **3** states currently reach **3,72,011** customers through a network of **206** branches. The KGFS have disbursed a total of villages through **5,387.61** million in loan products while in non-credit services- provided pension accounts for **44,226**, insured **99,617** individual lives and **190,865** against disability.

There are few, if any models, financially viable or otherwise, for this business that currently exist and fulfil all the criteria that are considered necessary for high quality origination. The above approach has found realisation through the *Kshetriya Gramin Financial Services* (KGFS) model pioneered by IFMR Rural Channels and Services Pvt Ltd (IRCS). The KGFS has been designed as a model that can withstand scrutiny on the four basic essential parameters and thus pave the way towards complete financial inclusion in remote rural India.

A typical 'brick and mortar structure'

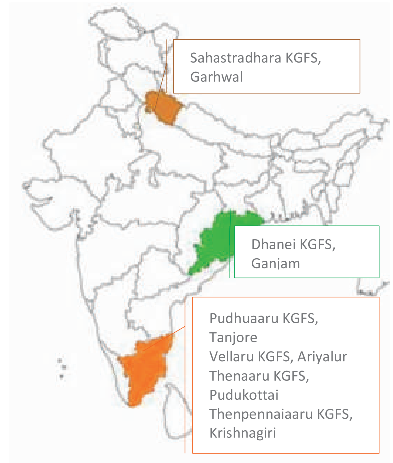
Characteristics of KGFS

1. Tight Geographical Focus : Each KGFS institution and branch is responsible for a specific catchment area and is expected to serve the entire population in that area. The objective is to offer products and services that are relevant to the local population in the service area.

Three fundamental operating principles distinguish the KGFS approach:

* Director, IFMR Rural Channel & Services Pvt. Ltd.

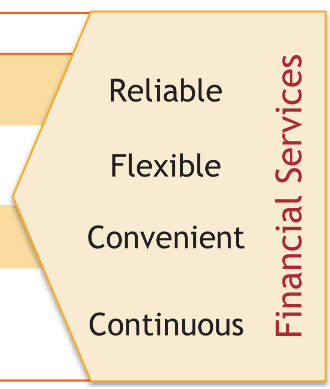
2. Wealth Management Approach : KGFS branch staff recommends a customised set of financial solutions for each client based on in-depth household assessments.



3. Access to a broad range of products : The branches of KGFS are built and equipped -to offer a suite of financial products across assets, liabilities, insurance, remittances and other services, either directly or on behalf of regulated entities.

4. Transactional Transparency: The front-line staff members at a KGFS branch, called Wealth Managers, are expected not to sell any financial products to the customers. Instead, they go through intensive training and are supported by technology, to be able to actively work with their clients to explore opportunities to reduce their financial vulnerability and to maximise their wealth.

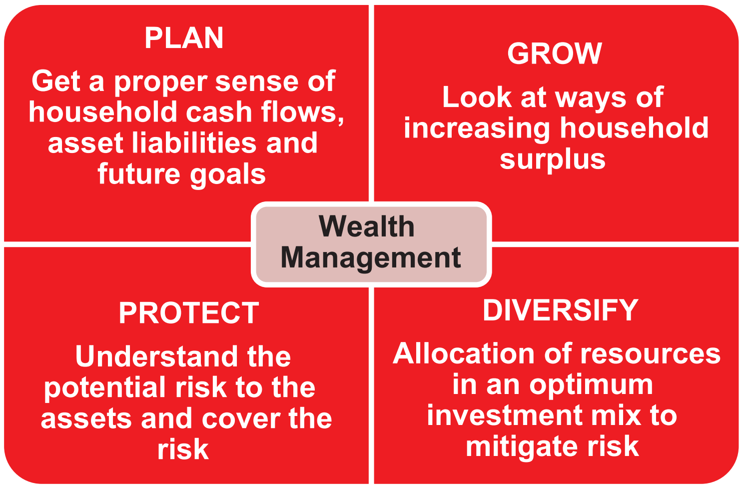
Characteristics	Features
Tight Geographical Focus	Serving all households & enterprises in a geography
Wealth Management Approach	Customised proposition to rural households
Multiple Products and Economies of Scope	Multiple and comprehensive financial services package
Technology as an enabler	Higher degree of automation, lower cost of transaction, centralised back-ends coupled with standard process



Wealth Management Process

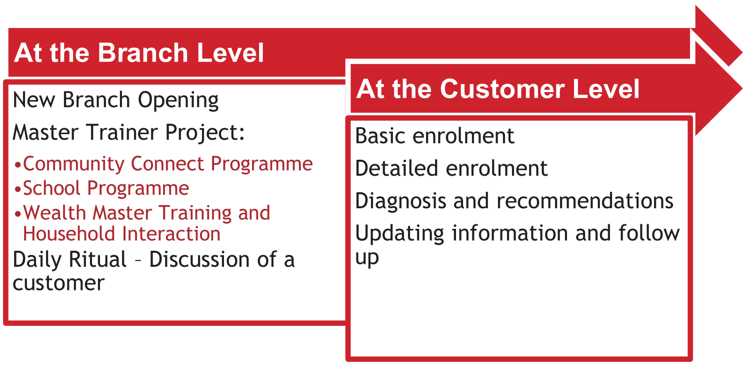
At the heart of the KGFS model is the "Wealth Management" approach. This is an approach to financial services delivery in which the provider designs a customised financial offering for the household and is expected to take ex-post liability and accountability for customer outcomes. This approach of Wealth Management makes a clear distinction from the traditional approach where the provider is merely making a menu of financial products available for the customer to choose from. The sole objective of Wealth Management is to maximise the financial wellbeing of the household to which the individual client of KGFS belongs.

The Wealth Management process is under-pinned by the following four strategic elements -*Plan-Grow-Protect-Diversify* (PGPD). These are presented as separate elements below:



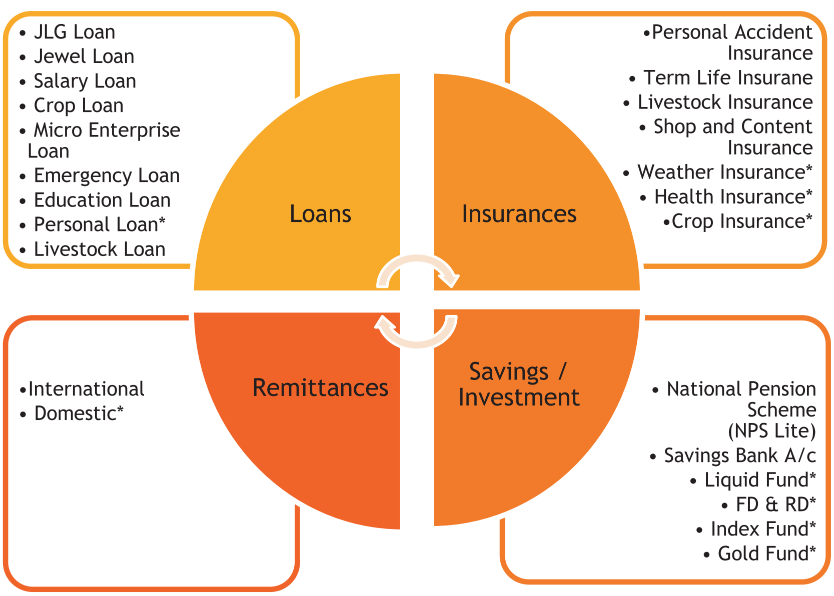
KGFS Operating Structure

At the heart of the KGFS model is the local, village level branch which serves as the customer touch point. It is at the branch that the mission of maximising the client household's financial wellbeing is fulfilled. The branches are supported by the Head Office (HO), through a series of hubs. The front-line staff managing the branch and interacting with the customers are called Wealth Managers. A typical KGFS branch is managed by three Wealth Managers. These Wealth Managers are recruited from the local geography where the KGFS is operating. They are imparted extensive training on financial products and services, effective customer interaction and wealth management methodologies. Through their knowledge of the local geography and by constant engagement with the customers the wealth managers are able to understand the client's financial needs and offer them the right mix of products to improve their financial wellbeing.



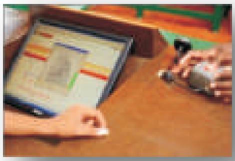
Product Suite

The KGFS model rests on a multi-product offering approach that caters to the complete array of financial needs of a household. It stems from the conviction that "access to finance" cannot be defined as mere provision of credit but needs to entail a comprehensive offering under the PGPD framework. This approach brings in *‘economies of scope’* thereby allowing the entity to take a portfolio view of the household vis-a-vis per-product view. Extensive in-house product development is carried out to ensure that the product bouquet keeps expanding and the client requirements are adequately met.



*Indicates proposed products or product under pilot

Process of Product Offering

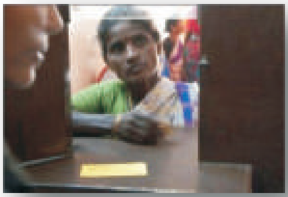


Enrolment

- Details on household income, expenses, assets and liabilities are collected in the Customer Management System
- Thorough KYC is done by collecting and scanning the Identity and Address proof documents. Photograph and fingerprints are also captured in the system.

Wealth Management Process

- A Financial Wellbeing Report (FWR) is generated from the system which contains customised product offerings for the household
- The Wealth Manager engages the household in a detailed wealth management conversation

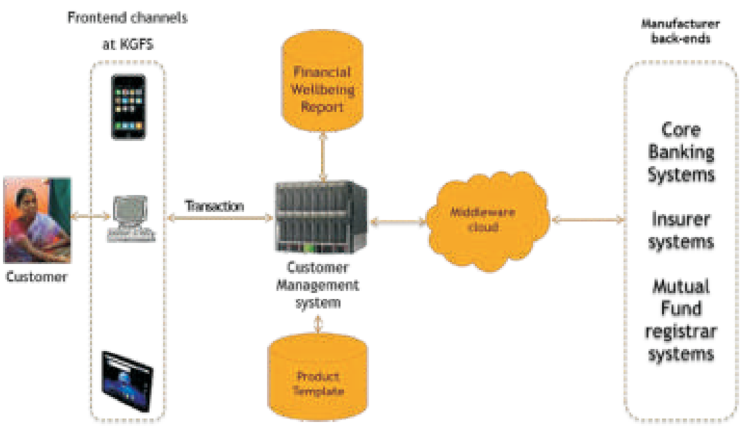


Offering the Product

- The Wealth Manager recommends the appropriate product based on the FWR
- The customer chooses to avail the product
- All product related features are communicated to the customer in a transparent manner

Technology

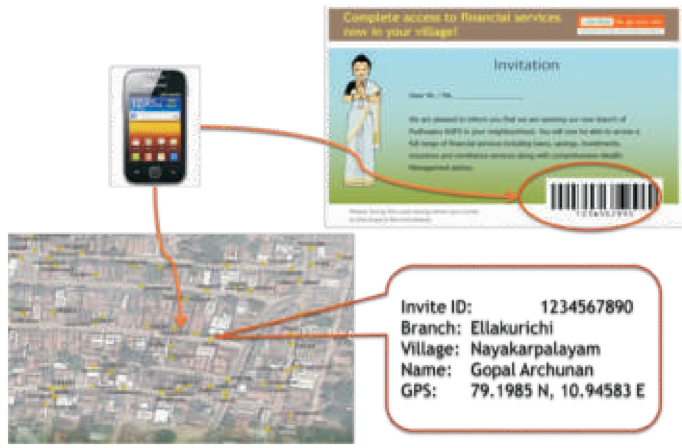
Low-ticket transactions in remote areas can only be made viable through technology supported operations. The KGFS model leverages technology by using hardware and connectivity solutions such as a Core Banking System (CBS) and a proprietary Customer Management System (CMS). The functioning of the entire set up therefore is online, and real-time. Co-ordination and monitoring becomes automated and effective. Each KGFS has high degree of automation via centralised technology back-ends coupled with standard processes creating outreach to otherwise un-banked areas. The architecture allows for seamless integration with the systems of the partner entities thereby enabling smooth transaction booking and process control.



Technology Innovation

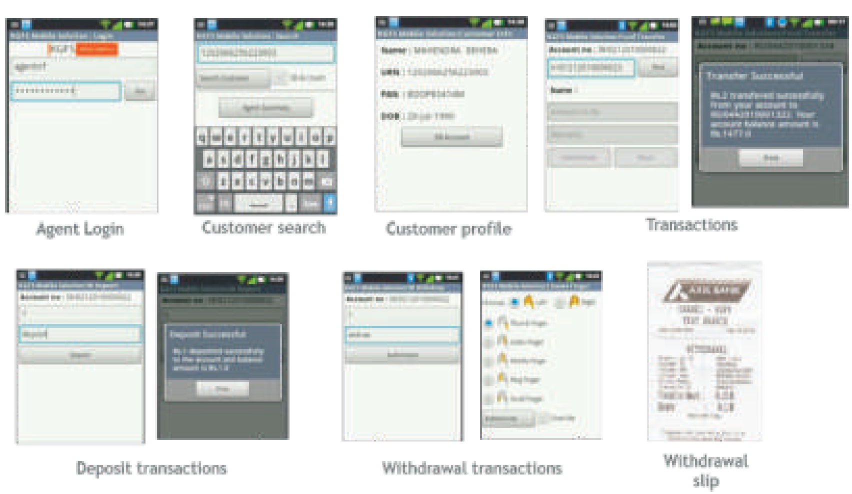
Branch Mapping:

Geographical Information System maps all customers, households, streets in the service area and provides a visual component to existing information systems, providing a rich geo-spatial dimension to existing customer analytics. This exercise is carried out at the time of branch opening to track coverage and product uptake.



Mobile Payments

Mobile transactions have been piloted in various locations to enable Customer Service Points and offload transactions away from branches. This channel has been designed to cater to both biometric and non-biometric transactions based on requirements.



Partnership Arrangement

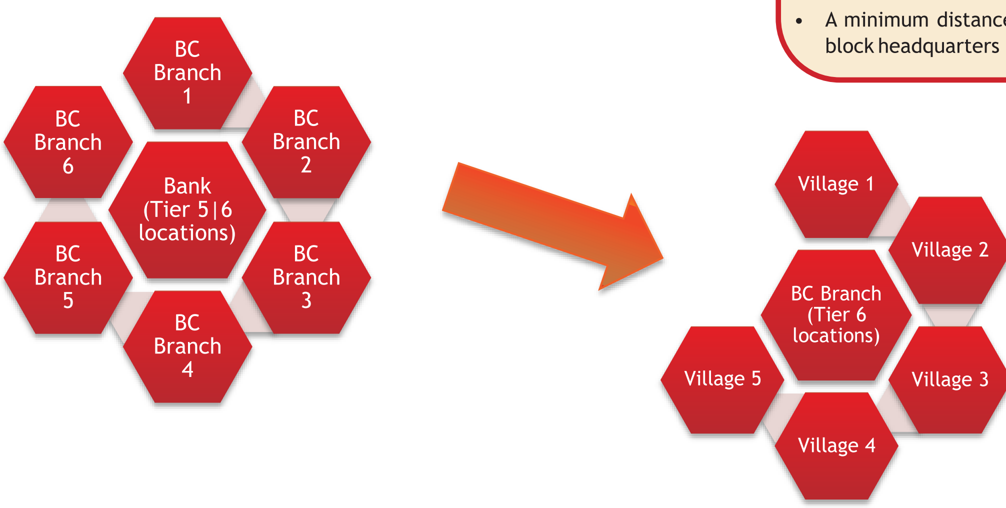
Under the Direct Origination Model, IRCS shall set up branches under the KGFS model that would serve as BC to the partner Bank. The BC branches can deliver all the products of the Bank, including savings, deposits, payment services and loans to the remote rural customer household. The choice or suite of products can be mutually arrived at.

Direct Origination Structure

- The Bank's Nodal Branch can serve the customers through BC branches in a 30 Km radius
- 6-10 BC branches to operate under one Nodal Branch
- Operational geography to be mutually agreed upon

Branch Location Criteria

- No private sector bank branch in a 5km radius
- No more than one state owned bank branch in the service area
- A population of 10,000 within a 3km radius of the location, with each village in the service area not exceeding a population of 4,000
- A minimum distance of 5km from the block headquarters



Roles and Responsibilities

IRCS clearly formulates the roles and responsibilities of the bank and the originator. It is as proposed below:

Role of Originator (IRCS)	Role of a Bank
• Identification and creating a network of branches and CSPs • Training of personnel and CSPs • Provision of technology platforms to operate the network • Implement internal control and audit mechanism • Product Offering: - Client Sourcing | KYC: documentation, collection and verification | Customer Authentication-biometric identification | Product recommendation based on the Wealth Management framework | Loan Appraisal and documentation | Disbursement | Collections and Loan Utilisation Checks | Follow-up of Overdues | Monitoring and Reporting	• Provide assured credit line • Final approval and sanction of all asset products and Saving Bank Accounts • Monitoring of the BC network

Risk Sharing

In line with our commitment towards creating high quality assets for our banking partners we are willing to share a part of the credit risk in the form of FLDG. The modalities and impact on final pricing will be based on mutual agreement. We believe that the additional stake built in by such incentive-alignment mechanisms is critical for strengthening the BC-Bank operating model.

Value Proposition to the Banking Partner

New Channel	• Model to deliver financial services to a new customer class • Expand outreach in rural areas • Opportunity to leverage the team experience with setting up the KGFS - proven model, demonstrating impact, in five diverse geographies • Create high quality priority sector assets • Comprehensive coverage of service area- optimum capacity utilisation • Incubation capacity and rapid scalability
Proven Model	• Branch Based, low-cost operating model • Robust technology infrastructure • Seamless system integration with the Bank • Multiple product offering based on "product suitability" approach • Well trained resources hired locally • Standardised processes across branches • Control and oversight mechanisms

Our client engagement processes have evolved significantly over the years. We have a long way ahead but are convinced that the Wealth Management approach holds tremendous potential for unlocking the power of financial services.

BOOK REVIEW

Name of the Book : Barons of Banking : Glimpses of Indian Banking History

Author : Bakhtiar K. Dadabhoy

Publishers : Random House Publishers India Private Ltd., Windsor IT Park, Tower-B, A-1, Sector 125, Noida,

Pages : xxiii +478.

Price: Rs.599

Reviewed by : Dr. N. K. Thingalaya, Former CMD, Syndicate Bank

Banking history, like economic history, is one of the neglected areas in social science research in our academic institutions. Though there are quite a few century-old banks in India, there are hardly any comprehensive study made by 'outsiders' about the evolution of the banking sector over the years. No doubt, there are a few 'commissioned studies', making authentic documentation of individual banks' history. The novelty of this book is an in-depth assessment of role played by a few barons of banking in India stretching over more than a century.

Written lucidly by Mr. B. K. Dadabhoy, a civil servant, not directly connected with banking, it provides insights of many less known facets of the evolution of banking in India from the British days to the present. Compiling relevant data from different sources, the author has highlighted the impact made by men in power on the financial sector's developmental process. The sources tapped for collecting relevant details make an amazing list.

"The book attempts" as stated by the author himself, "to showcase the achievements and contributions of six distinguished personalities from the world of banking who played a pioneering role in the founding of new institutions, or who guided the destiny of an institution in such a manner as to leave their impress on it for many years to come". He has done ample justice to show case the invaluable contributions of the eminent personalities to the national banking and financial sectors, some of which were not properly articulated so far.

The six personalities include; Sir Sorabji Pochkhanawala and Sri R. K. Talwar are the two bankers of great repute; Sir Purushotamdas Thakurdas and Sir Chinthaman D. Deshmukh are the visionaries; Sri. A. D. Shroff and Sri. H. T. Parekh are the institution builders. Many other persons, with whom these pioneers had to interact and their interesting interactions also find a place in different contexts. On the whole, the author has provided a comprehensive picture depicting the roles played by many who mattered then.

Sir Sorabji Pochkhanawala, the founder of Central Bank of India had steered the bank in its infancy, when bank failure were quite common. When Tata Industrial Bank failed, he courageously took over that bank during those turbulent days. Surviving to face the

BOOK REVIEW

competition from the British banks was a difficult task. A commemorative stamp in his honour was released by Indian Postal Department in 2010, when the bank celebrated its centenary. Commenting on this honour, the author records, "This is the first and only stamp in India honouring the founder of a bank'.

Sri Raj Kumar Talwar, Chairman of State Bank of India, the oldest and largest bank in India was a towering personality, known for his administrative capabilities and integrity. He became the chairman of State Bank in March 1969, a few months before bank nationalization. Since SBI was already in the public sector, it was growing like a monolithic organization, which Sri Talwar reorganized as a strong and vibrant bank.

Sir Purushotamdas Thakurdas was a business man, highly respected in business and government circles. His note of dissent against the official view on the stabilization of Indian Rupee was highly acclaimed, though it was not appreciated by those in power. Sri Chinthaman Deshmukh was the first Indian to become the Governor of Reserve Bank of India. Both of them had contributed to the evolution of the central bank of the country.

Sri A. D. Shroff was the promoter of Free Enterprise and had a role in the formation of Industrial Credit and Investment Corporation of India Ltd, of which, Sri. H. T. Parekh was the executive chairman. Housing Development Finance Corporation Ltd was the brain child of Sri Parekh, which has enabled thousands of people to own houses, when housing finance was not easily available.

There are many references available in the book, which relate to the stand taken by some of the other prominent persons in morphing the banking sector in India. Sri J. R. D. Tata "made a scathing attack on the failure to Indianize Imperial Bank of India" in 1946 but he was not in favour of its nationalisation, stating that "it may create nervousness and serious misgivings regarding the future of free enterprise in the country."

In sum, the book provides a good reference material for the discerning reader on the banking growth and developments during the last hundred years or so and it will be a very useful addition to any library.

Books Added to the IIBF Corporate Library			
No.	**Title**	**Author**	**Publisher & Year of Publication**
1.	Balancing the Banks : Global Lessons from the Financial Crisis	Mathias Dewatripont & others	Princeton University Press, 2010
2.	Basic Marketing : A Global Managerial Approach, 15th Edition with CD	William D. Perreault (Jr) & E. Jerome McCarthy	Tata McGraw Hill, 2006
3.	Business Law for Management, 6th Revised Edition	K. R. Bhulchandani	Himalaya Publishing House, 2010
4.	Elements of mercantile law, 33rd Edition	N. D. Kapoor	Sultan Chand & Sons, 2012
5.	Essentials of Management, 4th Edition	Joseph L. Massie	Prentice Hall, 2011
6.	Financial Engineering Principles : A Unified Theory for Financial Product Analysis & Valuation	Perry H. Beaumont	John Wiley & Sons, 2004
7.	Financial Modeling, 3rd Edition with CD	Simon Benninga	MIT Press, 2008
8.	Global Meltdown : Regional Impacts	Nandita Sethi & A. V. Balakrishna	New Century Publications, 2010
9.	Indian Commodity : Derivatives Market in Operation	J. N. Dhankar	Skylark, 2005
10.	Macroeconomic Theory, 14th Edition	M. C. Vaish	Vikas, 2010
11.	Macroeconomics, 10th Edition	Rudiger Dornbusch & others	Tata McGraw Hill, 2012
12.	Macroeconomics, 4th Edition	Olivier Blanchard	Dorling Kindersley (India), 2011
13.	Managing Bank Risk : An Introduction to broad – Base Credit Engineering	Morton Glantz	Academic Press, 2003
14.	Marketing Management, 2nd Edition	Arun Kumar & N. Meenakshi	Vikas, 2011
15.	Marketing Management, 4th Edition	Rajan Saxena	Tata McGraw Hill, 2009
16.	Marketing, 2nd Edition	Dhruv Grewal & Michael Levy	Tata McGraw Hill, 2011
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18.	New Marketing : Transforming the Corporate Future	Malcolm McDonald & Hugh Wilson	Reed Elsevier India, 2007
19.	Organizational Behavior, 10th Edition	John R. Schermerhorn	Wiley India, 2010
20.	Organizational Theory, Design & Change, 6th Edition	Gareth R. Jones & Mary Mathew	Dorling Kindersley (India), 2011
21.	Organsiation Theory : Modern, Symbolic and Post Modern Perspectives	Mary Jo Hatch & Ann L. Cunliffe	O U P (India), 2006
22.	Principles of Macroeconomics, 6th Edition	Gregory N. Mankiw	Cengage Learning India, 2012
23.	Quantitative Techniques for Decision Making, 4th Edition	M. P. Gupta & R. B. Khanna	Prentice Hall, 2011
24.	Security Analysis & Portfolio Management, 6th Edition	Donald E. Fischer & Ronald J. Jordan	Dorling Kindersley (India), 2011
25.	Strategic Management : Text & Cases	V. S. P. Rao & V Harikrishna	Excel Books, 2003

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