Growth Pangs of a Microfinance Institution:
Trying to speed ahead without going off-course

(Photograph from BWDA website, http://www.bwda.org.in/)

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Dr. Joslin Thambi, the Founder and Managing Director of the Bullock-Cart Workers Development Association (BWDA), had just seen off his young visitors from a well known finance company based in Mumbai. His meeting with them had been similar to many other meetings that he had had with potential financiers in the recent past. After a thorough review of BWDA, the visitors had conveyed that they were greatly impressed with its operations, its dedicated staff and loyal clientele. In the same breath, they, however, also suggested to Dr. Thambi that he should increase his lending rate and bring it closer to the rates charged by other micro-finance institutions in India.

Dr. Thambi explained to them that BWDA was very different from the organisations they were comparing it to. In the case of BWDA, the social mission of improving the welfare of the poor was not mere lip service but was its raison d'etre.

Financial sustainability was certainly an important goal, which had forced BWDA to increase its lending rate over the last few years to the present level of 18% p.a. A consequence of this action was BWDA's exclusion from the list of partner Non-Government Organisations (NGOs) of the Government of Tamil Nadu (GOTN) in 2008, for the first time in sixteen years. The GOTN viewed increases in lending rates as a sign of excessive commercialization. The exclusion from the GOTN list did not affect BWDA substantively, as it had developed its own microfinance activities by then. It however, brought home starkly, the dilemma faced by social enterprises, as they tried to balance their partnerships with the government and the corporate sector.

While Dr. Thambi could understand the requirement to increase lending rates to adjust for increasing borrowing costs, he did not believe in doing so just because there were others in the sector charging even higher rates. In fact there were microfinance institutions (MFIs) in India charging effective rates of 24% p.a. BWDA did not see itself competing with these entities who according to Dr. Thambi, were indulging in "financial prostitution" and appeared to be benchmarking themselves with rates charged by moneylenders. "In the name of microfinance, we should not exploit the poor", Dr. Thambi had said at the conclusion of his meeting with the representatives of the finance company. He was not sure if he would hear from them again.

Early beginnings as an NGO

The decision to setup BWDA had its roots in Dr. Thambi's personal background as the son of a bullock-cart driver. He had experienced the problems encountered by these workers first hand, when he had driven a bullock-cart on a part-time basis to support his college education. Even though there were nearly 30 million bullock-cart workers in India, there were no guidelines regarding where they should park their vehicles, making them vulnerable to harassment by the police as well as the public. In case of accidents, there was no recourse for them. They were also often not paid fair charges for their services. As bullock-cart workers were a heterogeneous group in terms of caste and religion, no particular interest group or political party had adopted their cause and they had remained marginalized.

After completing his masters in "Rural Services" and an M.Phil degree in "Micro Level Planning" from Gandhigram Rural University, in 1980, Dr. Thambi had joined an NGO called the "People's Association for Social Action" in Kanyakumari, Tamil Nadu, as the Secretary and Program Officer. While there, he developed his vision for an organisation for bullock-cart workers. In 1985, he was able to raise some grant funding from an NGO based in the state of Kerala, "Program for Social Action", for starting BWDA. At that time, his vision for BWDA was to provide a platform for the organisation of bullock-cart workers, so that their cause could be put forward to the government through various channels. In addition, he also wanted to take active steps to contribute to the overall welfare of these workers and their families. The organisation was registered as a "society"[1], a common form adopted by NGOs in India.

In 1986, BWDA conducted a study on the socio-economic conditions of bullock-cart workers in Tamil Nadu, where it was based. It was observed that most of the workers' families were dependent on local moneylenders for emergency funds and consequently, were often at their mercy. To counter this, in 1988, BWDA commenced the formation of Self-Help Groups (SHGs) among family members of bullock-cart workers. These groups were formed to encourage members to save regularly and thereby create a pool of savings. This pool was then rotated within the group, through internal loans, so that to an extent, the dependence on money lenders was reduced.

Triggers for growth in the scope of microfinance services

In 1992, the International Fund for Agricultural Development (IFAD)[2], the Government of India and the Government of the state of Tamil Nadu (GOTN) announced a joint scheme known as the Tamil Nadu Women's Development Project (known in the local language as "*Mahalir Thittam*" meaning "Women's Programme") in certain districts of the state. This scheme was intended to improve the economic and social status of women by providing credit to them through SHGs.

The SHG Model

The SHG model was developed by the National Bank for Agriculture and Rural Development[3] (NABARD)[4] in 1991-92 so as to reach low-income groups that were not able to access banks directly. The objective was to make better use of the infrastructure of rural branches of state-owned banks in India in order to reach the rural poor. Local NGOs were roped in by the program to link the poor with the banks.

An SHG was usually a group of people that voluntarily came together with the objective of providing mutual aid. In India, the SHG referred to a group of 12 to 20 low-income women who came together for the purpose of creating a pool of savings that could be used for lending to members, as and when the need arose. The women were between the ages of 18 and 60 years and residents of the same neighbourhood. The number of members of an SHG was capped at 20, to avoid the need for registration with the authorities as a formal group. Often a voluntary agency

[1] Registered with the "Registrar of Societies" in each state, societies have minimal regulatory requirements.
[2] A specialized agency of the United Nations.
[3] NABARD was set up in 1981 as an apex development bank for agriculture and rural development.
[4] The apex governmental institution in India for financing agriculture and rural development.

(NGO) or a Government agency acted as a catalyst for group formation and also provided some basic training.

A group leader (called "animator") and deputy leader were elected by the group. The animator had to undergo a compulsory awareness program within the first three months of the group's formation. The group met regularly (weekly or monthly) in the same neighbourhood and started saving. The monthly saving ranged between Rs. 20 and Rs. 100 depending on the capacity of the members. The pooled amount was initially kept in a box or in a post-office account. Thereafter, a savings account was opened in a nearby bank branch. As the accumulated funds grew, the group started giving small amounts (between Rs. 2000-3000) as interest-bearing loans to individual members. The process continued and a record was maintained by the animator, giving the members experience in assessing individual credit worthiness, monitoring and record-keeping. The members also built up credit histories and acquired experience in keeping accounts and adhering to terms and conditions. After a few cycles of mutual savings and credit had been successfully completed, the group approached an external financial agency, usually a commercial bank, for funding.

Usually the group got two or three times the pooled amount as a loan from the financial agency. A grading system was followed according to which the banks assigned grades to SHGs based on various performance parameters such as the volume and regularity of savings by members, the frequency of group meetings and member attendance as well as the quality of record keeping. SHGs which achieved more than the minimum score were advanced credit. The borrowing entity was the SHG and not the individual members. The loan taken by the SHG was distributed among the members in a proportion decided by the group, taking into account each member's need and repayment capacity.

Financial incentives were usually provided by the government to NGOs for group formation and training. Over a period of time, the NGO reduced its involvement with the group. Some NGOs continued to meet the SHGs formed by them, at least once a month. This meeting was used to monitor their performance and also to provide inputs on matters they considered important for the socio-economic progress of the women, such as information on measures for prevention of diseases.

Joint Liability Group (JLG) model

While the SHG model was introduced in India, almost simultaneously, another model, the JLG model, also developed, mainly through initiatives by social entrepreneurs. The organisations using this model were called MFIs and were initially funded by donors but subsequently by other sources, including commercial ones. The model drew many of its features from the practices of Grameen Bank, Bangladesh.

In the JLG model, groups were usually composed of 5 members, with 6 to 8 groups forming a centre. The members were again low-income women living in the same neighbourhood. The MFI had a team of field officers who formed the groups and trained them. While there was a group leader, she was not required to maintain records for the group as these are maintained by the field officers themselves. Hence no special training for the leader was necessary. After training the members, there was an assessment of the group by the MFI branch manager which involved visits to the residences of the members. This process was called "Group Recognition Test (GRT)". Thereafter, the groups met regularly on a weekly basis in the neighbourhood where the members lived. Loans were disbursed soon after the GRT. Savings were not usually insisted upon. In fact, most MFIs (other than those registered as banks or cooperatives) in India were not permitted to collect savings from members.

Loans were given to individual members, though the group as a whole was responsible for repayment. All disbursements and repayments were made in the weekly centre meetings over fifty weeks, which typically took place in the early hours of the morning. The meetings were conducted by the MFI field officers. Strict discipline was enforced at the meetings so that they took place on time and were concluded within a fixed time frame. This was because the field officer usually had a tight schedule of centre meetings in the morning. All records of transactions of the group were maintained by the field officer. Progressively higher loan amounts were considered by the MFI on successful repayment of loans. All group members were usually given equal amounts of loan.

While the SHG and JLG models dominated the microfinance sector in India, there were some MFIs who used individual lending models. Some other MFIs used more than one model and were said to be using a "hybrid" model.

BWDA's involvement in the SHG programme

Due to its impressive track record in working with rural and backward women, BWDA was selected by the GOTN as one of its partner NGOs for the "*Mahalir Thittam*" program in 1992. Two blocks in Villupuram district in Tamil Nadu were allocated to BWDA for its operations. While implementing this programme, BWDA extended its coverage to other low-income families, in addition to those of bullock-cart workers.

After the IFAD scheme came to an end in 1996, the GOTN launched a similar programme on a state-wide basis using its own funds and BWDA became a partner NGO in five districts of the state, namely, Villupuram, Cuddalore, Kancheepuram, Tirunelveli and Kanyakumari. This partnership continued till 2008.

Introduction of BWDA's own microfinance program

By 1998-99, it had become clear that the demand for credit from BWDA's members far exceeded the amounts provided by commercial banks. At that time, there was hesitation on the part of many bankers in sanctioning loans to SHGs. It appeared that the nightmares of defaults in government-propagated lending programs in the past continued to haunt them. BWDA therefore, decided to start its own microfinance operation with funding of Rs. 1.5 million from a government agency, Rashtriya Mahila Kosh (RMK)[5].

[5] National Women's Fund set up by the Government of India.

The BWDA microfinance model

BWDA's microfinance programme made use of the underlying SHG structure that it had put in place over the years. In the government-supported SHG program, when the SHGs were ready to access external funding, they approached a commercial bank for funds. In the BWDA program, the SHGs could approach BWDA, an NGO, for funding as BWDA itself was in a position to provide funds to the SHGs.

This was beneficial to BWDA's customers as there were often delays in getting approvals and disbursements from the banks. Bank managers typically liked to conduct the grading of a large number of SHGs on the same day, so that the process was more efficient. This meant that groups had to wait till there were a sufficient number of SHGs that had to be graded and only after that, a date was fixed after taking into account the branch manager's schedule. These delays were avoided when the NGO itself was the financier. The members had to visit the NGO branch for disbursement and repayments instead of going to the bank branch, due to which the waiting time was greatly reduced. Moreover, due to the NGO's involvement with the group from inception, it was in a better position to judge repayment capabilities and affix an appropriate loan amount for the group. Records continued to be maintained by the group animator, with regular checks by the BWDA field officer, called the Cluster Coordinator (CC).

The other difference in the case of BWDA's own program, was that unlike in the case of the government-supported SHG programme, BWDA was free to start operations in any area it chose. It usually used field surveys to aid this decision. Once an area was chosen, the CC organized a general meeting of members in the target low-income segment and presented details of the organisation, its social development activities and the microfinance programme. Those interested were then encouraged to form SHGs.

Most of the SHGs formed by BWDA met on a weekly basis though repayment transactions took place on a monthly basis. Meetings were held either at the animator's house or at a public place in the neighbourhood. All matters relating to the SHG, both with regard to the internal loans as well as the external loans from banks and BWDA, were discussed. The distribution of each SHG loan among its members was decided by the members, keeping in view each member's overall repayment capacity and need at that particular point of time.

The CCs attended one meeting of every SHG in a month, in which they checked the books of accounts maintained by the SHG. The field staff also often used the opportunity to convey social messages and information regarding training programs organized by BWDA. Individual members' plans for investment and borrowing were also discussed.

Most SHGs had a bank account, but the SHG members preferred to take loans from BWDA in cash. Local money transfers through cheques from BFL's account to the SHG bank account took considerable time[6] and attracted bank charges, both of which the SHG members wanted to avoid. In addition, some local bank managers objected to frequent account operation by SHGs as they tended to crowd the local branch. Moreover, as SHGs often had negligible balances in their accounts, since they usually gave out their savings as internal loans among members, there was no incentive for the bank in servicing their accounts.

Managing BWDA's new role as an MFI

When BWDA started MFI operations, it was in a position to provide loans itself, however, it continued to encourage SHGs to mobilise savings from their members and use these internal funds, together with external loans from the banks. Only when the loan demand at the SHG exceeded available funds from members and banks, or if there was delay in obtaining loans from the bank, were the SHGs encouraged to approach BWDA for meeting the funding gap. In instances where BWDA was the first external lender to an SHG, it was often asked by banks to provide its assessment of the SHG, when it applied to banks for loans.

BWDA's microfinance program had very high repayment rates and was considered very successful. Encouraged by its success and that of other similar programs, banks later started becoming interested in financing NGOs such as BWDA. An important incentive for them was that lending to the microfinance sector was considered as part of priority sector lending, which mandatorily required to account for 40% and 32% of net bank credit in the case of domestic and foreign banks respectively. Even so, BWDA was constrained by the level of debt that it could take on its balance sheet.

A number of independent consultants suggested to Dr. Thambi that, with BWDA becoming a financial intermediary, the "society" form adopted by it was no longer appropriate. If the organisation wanted to grow further and expand its outreach, a migration to a more commercial non-banking financial company[7] (NBFC) form was advised. Such transformations by NGO MFIs were being increasingly observed, not just in India but worldwide, as it enabled greater access to funding from lenders and investors for at least two reasons. First, as companies were required to meet more stringent disclosure and audit requirements as compared to societies and trusts, investors and lenders had a greater sense of comfort. Second, NBFCs provided for ownership of capital and returns to investors, a necessary condition to attract funding in the form of equity.

Creation of BWDA's NBFC

In 2002, BWDA decided to set-up an NBFC and transfer its microfinance services to this entity. As incorporating a new NBFC involved a lot of paper work, BWDA decided to follow the route of acquiring a defunct NBFC. The deal was completed in 2003 and the NBFC was renamed

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[6] Bank clearing can take up to 30 days and animators/ members talked of wasted travel time between the village and the bank branch according to a 2008 Microsave report "BWDA &BFL Leveraging partnerships for growth" by Sukhwinder Arora.

[7] Non banking finance companies need to have a minimum share capital of Rs. 20.0 million and are regulated by the country's central bank, the Reserve Bank of India.

"BWDA Finance Limited (BFL)". The parent company, BWDA, continued as a society to manage BWDA's activities that did not relate to microfinance, such as the management of its childcare centre and educational institutions (described in the section on "Microfinance Plus" activities below).

In order to raise the minimum share capital of Rs. 20 million required in the case of NBFCs, BWDA encouraged its employees and SHG members to purchase shares at face value in BFL. It eventually raised Rs. 158 million of which the majority (71%) was from its members. The detailed shareholding pattern of BFL as on September 30, 2009 is given in Exhibit 1**.** The other important shareholders in BFL were Small Industries Development Bank of India (SIDBI), a government-owned financial institution, and Centre for Development Education (CDE), a foundation supported by Rabobank[8]. The board of directors had eleven members including six promoter directors, representatives of employee shareholders and SIDBI and an independent director. A majority of the board members had banking experience.

Though BWDA and BFL were separate legal entities, they had five common directors on their boards. Moreover, Dr. Joslin Thambi was the Chief Executive of both organisations and the staff was co-located at the head office. However, the connection between the entities was not reflected in the shareholding pattern of BFL. BWDA did not own any of BFL's shares, as a non-profit society in India was prohibited from investing in a for-profit company. BFL however had the advantage of BWDA's goodwill, infrastructure and trained staff.

After the formation of BFL, it was proposed that it would be the primary organisation for microfinance activities. However, BWDA had retained loans from organisations such as the government-owned RMK, which preferred to lend to NGOs rather than NBFCs. The main focus of BWDA was now on development activities. The loan portfolio and staff from BWDA were transferred to BFL in a phased manner. As on March 31, 2009, BFL had 373 staff members, while BWDA had 55 staff on its rolls.

Thus BWDA, the NGO, had evolved and now had a more commercial NBFC form, in an effort to expand the scope and scale of its activities, and eventually its outreach and impact. BFL was among the many players in the now growing microfinance sector in India.

The microfinance sector in India

Microfinance loans in India were defined as loans below Rs.50,000 in value. The definition referred to the micro-credit aspect, though increasingly, microfinance providers were also offering micro-insurance, micro-pensions and remittances by tying up with mainstream providers. While it was difficult to precisely delineate the sector as there were institutions which were partially or indirectly involved in microfinance, the microfinance sector was typically defined in India as lending by banks to SHGs and lending by MFIs. Exhibit 2 provides a snapshot of the Indian microfinance sector in 2009.

[8] A Netherlands based multinational financial institution, founded on cooperative principles.

While there were 76.6 million microfinance users in India in 2009, some studies such as the Intellecap[9] study entitled "Inverting the Pyramid" (2007) estimated that the potential market may be 245 million individuals, suggesting that there was still a lot of scope for the sector to grow. The large market potential had motivated the entry of a number of new, commercially oriented players, with no NGO history. Some NGOs, which had transformed into NBFCs, had employed professionals with corporate experience to handle day-to-day operations, with the original NGO promoters taking a back seat. While some industry observers viewed this as a positive development ensuring professionalism and efficiency, others were concerned at the possibility of dilution in social focus.

The growth of microfinance in India showed a regional skew with concentration in the Southern states of Andhra Pradesh, Tamil Nadu and Karnataka. These were the states where microfinance was first introduced, primarily due to availability of relatively better infrastructure, support from state governments and the existence of reputed NGOs. In the case of the SHG model, the share of the Southern states in client outreach was 55% while in the MFI model, it was 54% in March 2009[10]. In terms of loans outstanding, the share of the Southern states in the two models was 69% and 58% respectively. Even though there had been growth in microfinance in other states, particularly in the Eastern and Northern parts of the country, the dominance of the Southern states had continued.

The entry of new players as well as the rapid expansion of existing ones had led to concerns that in certain pockets of the South, there was multiple lending, meaning that many MFIs were lending to the same customers. This is turn had lead to a warning of a potential "bubble" in certain pockets[11]. In the absence of a credit bureau, there was no way for MFIs to ascertain the indebtedness of individuals applying for loans. Efforts were underway to establish a credit bureau for the sector.

With the growth of the microfinance sector, regulation of this sector was on the government agenda.

Products offered and Markets served

BFL provided three kinds of loans, namely, SHGs loans, micro-loans and property loans. The product details are shown in Exhibit 3.

The SHG loan, described above, was the predominant product which accounted for 97% of the total financing during 2007-08. A festival loan product for SHG members was introduced in 2002-03, as it was noticed that the SHG members had to incur considerable expenses during festivals. An SHG member could take a festival loan of up to Rs. 2,000 once a year on any one of four identified festive seasons – Diwali, Pongal, Christmas or Eid.

[9] Intellecap is a social sector advisory firm based in India.
[10] N. Srinivasan, "Microfinance State of the Sector Report 2009", Sage Publications.
[11] Ketaki Gokhale, "A global surge in tiny loans spurs credit bubble in a slum", Wall Street Journal, August 13, 2009.

Individual loans were introduced in 2003-04 to meet the demand for larger loans from some SHG members who had the need and the capacity to service them. Initially, no collateral was insisted upon, and sanctions were based on recommendations of the SHGs. The loans were repayable over a 14-28 week period. However, this product was discontinued due to poor loan portfolio quality. Detailed procedures for individual lending were developed thereafter.

Two kinds of individual loans were now given. Micro-loans of amounts up to Rs. 20,000 were given to micro-entrepreneurs who could obtain personal guarantees from one or two worthy persons such as government employees or those having an established business. Property loans were given for where the property was taken as collateral. The amounts in the case of these loans exceeded Rs. 20,000.

In addition to the above main loan products, in a small way, institutional loans were given to support small NGOs, SHG federations and other institutions unable to borrow directly from financial institutions. Loans of up to Rs.1 million of this nature had been sanctioned by BFL since 2005-06. BFL financed only those institutions that have been in operation for at least three years and were willing to offer collateral security and post-dated cheques.

BFL offered loans at interest rates of 18% p.a. to 21% p.a., for tenures of 10 months to 48 months. Interest rates were calculated on a reducing balance basis. 1% of the loan amount was charged as processing fee and another 1% was charged as death relief fund, which implied that the loan outstanding was waived in case of the death of a member. In addition, the MFI also collected 5% of the total amount as security deposit. BFL was an agent for the Life Insurance Company of India, though purchase of life insurance policies for members was optional.

While SHGs were initially started in rural areas, in the year 2000, they were extended to nearby urban locations. By 2008, 16% of the SHGs were in urban areas. Unlike many MFIs, BWDA/BFL also promoted SHGs with male members and they accounted for 15% of the membership.

While BWDA started operations in Tamil Nadu, and the state continued to account for 97% of the loan portfolio, it had been expanding geographically. In November 2004, it expanded into the neighbouring union territory of Pondicherry. In February 2008, it started operations in the union territory of Andaman and Nicobar Islands.

Organisation Structure and Operations

Each branch of BWDA had 10-12 CCs, each of whom oversaw 75-100 SHGs (about 1,500 to 2,000 members). Each branch had a Field Monitor (FM) to whom the CCs reported. Each branch manager also had an Accountant and an Assistant Internal Inspector reporting to him or her.

Branches typically covered a radius of about 15 kms in rural areas and about 5 kms in urban areas. CCs usually covered their areas of operation by using public transport, though a few of them have personal two wheelers. Most Field Monitors and Branch Managers used motorcycles. BFL provided loans to interested field staff for purchase of two wheelers.

A software-based loan tracking system was used at the branch level which enabled branches to issue computer generated collection receipts to their borrowers. The branches sent consolidated information reports to the head office on a monthly basis, though collections and cash balance details were sent on a daily basis. The head office consolidated all the data manually on a monthly basis.

At the head office, the CEO, Dr. Thambi, was involved in day-to-day activities of both BWDA and BFL in executive as well as governance capacities. To assist him, there was a General Manager (GM) for Credit and Operations and another one for Human Relations. The Chief Financial Officer (CFO), who was a qualified company secretary, looked after funding and relationships with funders. The two GMs and the CFO were recruited in the last couple of years in response to suggestions from funders regarding professionalizing the management. While the two GMs were recently retired senior bankers, the CFO was a recently retired corporate finance professional. There were Assistant General Managers (AGMs) for credit, internal inspection and training. These AGMs were BWDA staffers who had been with the NGO since inception. There were senior managers for training, management information systems (MIS) and accounts.

For purposes of standardization of procedures, an Operation Manual and a Human Resources (HR) Manual were made available to all staff which were updated regularly. Dr. Thambi, was particular that the old NGO staff not feel alienated due to the entry of newer, more professional staff, a scenario he had witnessed in some other organisations. He took personal interest in ensuring uniformity in procedures (Exhibit 4A).

There was a credit approval mechanism with loans being sanctioned at the level of branch manager, senior manager, AGM or GM depending on the loan amount. An internal audit team verified documents, loan applications and other records at the branch as well as at the group level. Branch compliance reports were maintained at the head office.

"Microfinance Plus" activities

While microfinance institutions which only provided credit delivery were known as minimalist institutions, those that tried to provide livelihood development in a more holistic manner were said to be following a "microfinance plus" model. BWDA followed the latter model and this feature distinguished it from many other MFIs in India.

While all MFIs provided group training, since BWDA used the SHG model, additional special training was given to the animator on book-keeping and other aspects relating to maintenance of the group. The group was also trained on making decisions relating to allocation of loans to individual members and to ensure that records of the group were being maintained in a proper manner by the animator.

In the state of Tamil Nadu, SHG animators/members from 10 to 20 neighbourhood groups within a 2-4 km radius were encouraged to form a "Panchayat Level Federation[12]" to enable interaction with the government on local issues. BWDA staff also actively participated in meetings of these federations. In addition, BWDA staff regularly attended monthly meetings with district officials to ensure close coordination on government programmes with other NGOs operating in the same district.

Moreover, on a regular basis, training programs were organized to impart specific skills that could be used by SHG members for income generation. Some examples of recent training programs held included sessions on beauty parlour skills and demonstrations of preparation of products from milk. Interested members could attend the course free of charge and were also provided a daily stipend to compensate them for the loss in the day's income on account of the training.

As many BWDA members complained of an increase in prices of items typically purchased for festivals, during the festival period, BWDA started bulk ordering these items well in advance and parcelling them for sale to members. As a result, it was able to provide these items to its members at very reasonable prices. Typically, BWDA charged Rs. 500 for a package, which would cost Rs. 550-620 in the local market. Even though the logistics of bulk purchase, packaging and distribution became burdensome over time, the popularity of the scheme had resulted in its continuation.

In addition, BWDA ran a childcare centre for children of low-income working women. Summer camps were held for rural children during the school summer holidays which were attended by 25,000 to 30,000 children every year. Regular medical camps as well as veterinary camps were also held. BWDA had also started three schools where the fees were minimal. Cash awards had been introduced for SHG members' children scoring above a certain benchmark level to incentivize good performance by them. An arts and science college had been started where the children of SHG members received a 25% waiver of fees and 50% waiver of hostel expenses.

All these developmental activities were retained at BWDA and only microfinance activities were transferred to BFL. The primary means of finance for activities retained at BWDA was donor funds.

[12] SHGs which are located in areas that fall under the same local government unit or "Panchayat" came together to form a "Panchayat level federation".

BWDA members attending a beauty parlour course
(Photograph from BWDA files)

BWDA's Outreach and Financial Performance

BWDA's outreach had been growing at more than 20% annually over the last three years as a result of its geographic expansion. While most of the portfolio had been transferred to BFL by 2009, as some government-owned institutions preferred to lend to an NGO, these loans remained on the books of BWDA though managed by BFL. Exhibit 5 has a summary of BWDA's outreach. Total disbursements plateaued after March 2008.

A summary of BWDA's Income and Expenditure statements and Balance Sheets for the last three years and key financial ratios are provided in Exhibits 6 and 7 respectively**.**

Operating Expenses of the BWDA Model

BFL's operating expenses were comparable to that of other large SHG-based MFIs. The operational costs of MFIs using the SHG model usually tended to be lower than that of MFIs using the JLG model, because the former had a monthly repayment structure with disbursement and collection of funds being done at the branch level. MFIs using the JLG model typically had weekly repayment with disbursements and collections being done by field officers at group meetings in the borrower's neighbourhood.

In general, SHG models had lower personnel expenses too, as a number of functions of the field worker in JLG models were carried out by the animator of the group. In fact, while handling cash, both for disbursement and after collection, was the primary responsibility of field staff in the JLG model, the field staff of BWDA/ BFL did not handle any cash. For disbursement of loans, all the members receiving loans personally come to the BWDA/BFL branch. On a monthly basis, when repayment of the loans took place, the animator visited the BWDA/ BFL branch and deposited cash. The animator also kept records of the group's account and the BWDA/ BFL field officer had to merely check the accounts periodically.

For these services, the animator received a 0.5% incentive of the loan amount if the loan was repaid on time. In addition, the animator got an incentive from the SHG, in the nature of an additional 10% share in profit, when after every 3 to 5 years, SHGs took stock of their funds and distributed profits obtained from internal lending. Despite the incentive paid to the animator, this model resulted in lower personnel costs as the MFI needed to have fewer field officers. Moreover, the costs and risks of cash handling and its transportation to remote areas were also avoided.

While overall operational costs of BWDA/BFL were comparable with that of other SHG-based MFIs, BWDA/BFL's personnel costs were higher and its administrative costs were lower than the average. The reason for personnel costs being higher was that its field staff oversaw all transactions of the SHGs even though it directly benefitted from only those that related to the BWDA/ BFL loan. Further, more than 50% of its members had not availed of loans from BWDA/BFL, thus reducing the productivity of the field officers. The reason for administrative costs of BWDA/BFL being lower was that most of the branches operated out of owned premises.

A study by Sa-dhan, the association of microfinance institutions in India, had recently been done comparing different models of MFI lending on the basis of cost structure and it showed that the SHG model had a lower operating cost ratio than the JLG model but also had a lower portfolio yield (Exhibit 8**).**

Portfolio Quality

While there was deterioration in the quality of the portfolio of BWDA/BFL, as evidenced by the increase in portfolio at risk in 2007-08, this had been reined in to some extent in 2008-09 by more stringent monitoring. The reason for the deterioration was attributed by BFL to the competition from other MFIs such as Grama Vidiyal and SMILE, which had started operations in BWDA/BFL's areas of operation. Many of them had also lent to BWDA/BFL members, straining their repayment capacity.

Capital Adequacy

BWDA/ BFL's present capital adequacy ratio of 15.92% was comfortable when compared to the required ratio of 15% for "systematically important"[13] non-deposit taking NBFCs which was to be enforced from March 2011. However, BFL had a practice of paying out dividends, necessitated by the large shareholding by its members, who on account of their low awareness level expected equity, like debt, to provide regular returns. This practice to an extent prevented net worth accretion.

[13] Non banking finance companies with an asset size in excess of Rs. 1 billion are said to be "systematically important" and have to comply with certain requirements stipulated by the country's central bank, the Reserve Bank of India.

Need for growth

In a ranking by CRISIL[14] of the top 50 MFIs in India on the basis of loan outstanding, BFL had been placed in the 16th position.

Dr. Thambi wanted BFL to advance to a higher position in the following year, because he knew that there was an urgent need for it to provide a larger number of loans to extend its outreach. In addition, a number of sources had indicated the need for larger quantum of loans to existing members. When loans provided by BWDA did not meet their requirements, members depended on moneylenders who charged rates of interest of between 24% to 60% p.a., that too not always calculated in a transparent manner (Exhibit 4B). Increased financing by BWDA would not only enable greater social impact but was also important for BFL to retain existing customers.

However growth would need funding and so BFL was seeking both equity and debt. Dr. Thambi looked at his note book where he had noted down suggestions for BFL by visiting bankers and potential funders, not all of which he agreed with.

1. Increase interest rates so that margins are more comfortable.
2. Buy out community shareholding with private equity to save record keeping and transaction costs and also so that regular dividend payment is no longer necessary.
3. Hire a professional with retail financial services experience to run the company.
4. Focus personally on improving grass roots level services and governance aspects.
5. Increase borrower to member ratio by withdrawing from non borrowing groups or making borrowing a condition for membership
6. Improve MIS system and ensure accurate cost allocation and accounting for transactions between BWDA and BFL.
7. Better funds management and planning.
8. Train staff to enable a more systematic decision making process.

It was apparent that while BFL had benefitted greatly from the goodwill that BWDA had built up over the years, it also faced a few challenges that resulted from its NGO roots.

Just then the phone rang. It was an official from a foreign bank. He mentioned that his bank was keen to increase its exposure to the microfinance sector in India as it seemed like a good way to combine commercial and social objectives. He had heard a lot about BWDA and was seeking to

[14] CRISIL is one of India's leading credit rating agencies.

explore business opportunities with it. He indicated that the bank's interest rates were in the range of 13 to 14% p.a. In his usual polite and friendly manner, Dr. Thambi welcomed him to visit BWDA. The quest for funding growth, so as to have a larger impact on society had to go on.

(Photograph from BWDA website, http://www.bwda.org.in/)

Exhibit 1

Shareholding Pattern of BFL (as on September 30, 2009)

Promoters and Directors	2.05%
Staff of BWDA and BFL	10.90%
BFL members	70.10%
SIDBI	5.75%
Centre for Development Education Trust	11.20%
TOTAL	**100.00%**

<u>Exhibit 2</u>

Snapshot of Indian Microfinance Sector (as on March 31, 2009)

	SBLP	**MFI**
Number of individuals reached	54.0	22.6
Rate of growth of outreach over previous year	14.6%	60%
Loans Outstanding (in Rs. Billion)	241.96	117.34
Rate of growth in loans outstanding over previous year	42%	97%

(Source: Microfinance India State of the Sector Report 2009)

Exhibit 3

Key Features of BFL's Products[15]

Loan Features	SHG Loan	Individual Loans
Loan Size (Rs.), Repayment period and Sanctioning Authority	1st loan cycle: Maximum Rs.100,000 (subject to <30 times SHG savings and Max. Rs. 7,500 per member) Repayment period: 12 months Sanctioning Authority: Branch Manager 2nd loan cycle: Maximum Rs.200,000 Repayment period: 18 months Sanctioning Authority: Senior Manager 3rd loan cycle: Maximum Rs.300,000 Repayment period: 18 months Sanctioning Authority: Regional Manager/ Assistant General Manager 4th loan cycle: Maximum Rs.400,000 Repayment period: 24 months Sanctioning Authority: General Manager at Head Office 5th loan cycle and onward: Rs.500,000 (subject to <7 times SHG savings and Max. Rs.25,000 per member) Repayment period: 24 months Sanctioning Authority: General Manager at Head Office	Micro loan: Maximum Rs.20,000 (except for house renovation : Rs.30,000) Repayment period; Customized according to need, maximum 24 months, usually 20 monthly instalments Sanctioning Authority: Senior Manager Property loan: Greater than Rs.20,000 depending on value of property given as collateral Repayment period: According to requirement Sanctioning Authority: Assistant General Manager at Head Office

[15] Adapted from a 2008 Microsave report "BWDA &BFL Leveraging partnerships for growth" by Sukhwinder Arora.

Loan Features	SHG Loan	Individual Loans
Client Profile	• Living below the poverty line and/or monthly family income below Rs.5,000 per month • Age limit of the clients between 18 and 55 years • Members from same area/ village • Priority given to married women. • There should be no blood relation within the group • Willing to save, attend group meetings and training programmes • Willing to start income generating activities • Can prove their identity (Election identity card, Ration Card, Passport etc)	Micro Loan • Living below the poverty line and/or monthly family income below Rs.5,000 per month • Members of successful SHGs ready for bigger loans, family members of SHG members running micro enterprises • Age limit of the clients between 18 and 50 years • Can prove their identity (Election identity card, Ration Card, Passport etc) • Should be able to provide personal guarantees from one or two worthy persons as decided by the branch manager Property Loan: Same as Micro loan, but instead of personal guarantee, should be able to offer property as collateral.
Price	• Interest rate: 18% per annum on a declining basis • Other processing fee: 1% of loan amount • Death Relief Fund: 1% of loan amount	• Interest rate: 18% per annum on a declining basis • Other processing fee: 1% of loan amount. • 1% Death relief fund – optional.
Process	• Loan to group after completion of minimum 3 months successful savings, in case of weekly meetings. (In case of fortnightly/monthly meetings, minimum of 6 months) • Ranking / Rating of SHGs before loan sanction	• Post dated cheques are required to be provided for both micro loans and property loans.

<u>Exhibit 4A</u>

From NGO to NBFC

Ms. Shanthi joined BWDA in November 1992 as a cluster coordinator, forming SHGs for the IFAD programme. Today she is an AGM in charge of Internal Inspection at the BWDA Head Office leading a team of 6 members.

She recalls her early days in BWDA when the organisation was often cash strapped and employees at times paid organisational expenses out of their pockets. There were delays in obtaining reimbursements and salaries. She notes with pride that today BFL has grown in stature and is helping members not just socially but also by providing funds. She particularly feels a great sense of satisfaction that BFL shares are held by SHG members and that they benefit from the dividend given out by BFL. She adds that as an employee she now felt an even greater sense of responsibility, feeling accountable for every penny.

She notes that there is an “old NGO culture” as well as a “new professional culture” within BWDA but says there is no conflict between them. The NGO staff do realise that the new systems introduced by the latter are important for the organisation’s further growth. However she feels that the sense of loyalty to the organisation is far greater among the NGO staff and needs to be strengthened in the new staff.

Ms. Shanthi recalled a recent incident of fraud by an animator of a group she had herself formed many years ago. As a head office resource, she was requested to help. She found that it was a case of willful default, as the lady had the means, but was adamant in not repaying. Ms. Shanthi and her colleagues matched her adamancy with theirs, and were able to convince the lady to repay. Ms. Shanthi smiles thinking about the incident, saying she is not sure if she was successful because of her NGO roots or because she had become “commercial”.

Exhibit 4B

NEED FOR MORE FUNDING

Mrs. Saroja has been a BWDA member since 1992. She recalls how hard it was to form a group in those days, as most women were afraid to join as they were unsure how it would be. She herself joined mainly because she wanted to save for her children’s education. Both her mother in law and her sister in law (husband’s brother’s wife) criticized her greatly for doing so. Today both of them are themselves SHG members.

She feels a strong sense of belonging towards her BWDA group. “When we all wear our “uniform” saris which BWDA has provided us at a reasonable cost, we have a strange sense of power. When we visit the BWDA branch or go for meetings we wear our uniform and everyone even on the street looks at us with respect.”

With loans from BWDA over the years she was able to keep livestock and supplement her husband’s agricultural income. She feels it is this additional income that helped them fund their sons’ education (one has done his Masters in Computer Applications and another has done a diploma in Catering).

She feels BWDA is more than a funder. For every festival, it provides the items required at reasonable rates, in addition to giving a loan. She says BWDA’s care is touching and almost like what a woman would expect from her parental home.

Her only wish for BWDA is for it to increase its loan amounts, as needs of members have now grown substantially.

Exhibit 5

Outreach Summary of BFL

For	Year ended March 2007	Year ended March 2008	Year ended March 2009	Half Year ended Sept 2009
Members (No.)	236,388	292,729	358,840	415,154
Loans Disbursed (No.)	192,807	203,085	155,142	50,696
Branches(No.)	16	21	26	32
Villages Covered (No.)	896	1012	1934	1934
Districts (No.)	8	9	10	10
Percentage of women borrowers	86	85	87	88
Disbursements (own) in Rs. Mn.	1006	1142	1180	568
Disbursements (of BWDA managed by BFL) in Rs. Mn.	--	--	50	3
Total disbursement in Rs. Mn.	1006	1142	1230	571
Loan outstanding (own) in Rs. Mn.	722	851	973	973
Loan outstanding (of BWDA managed by BFL) in Rs. Mn.	--	--	46	29
Total loan outstanding in Rs. Mn.	722	851	1020	1002

Exhibit 6A

INCOME AND EXPENDITURE STATEMENT

(in Rs.million)

	2007	2008	2009
Fund Based Income			
Interest income from loans	85.05	119.39	149.28
Income from investment and deposits	1.08	2.97	3.4
Total fund based income	**86.13**	**122.36**	**152.68**
Interest and finance charges			
On Borrowings	46.21	73.67	93.91
Other interest and financial charges	1.27	1.31	2.42
Total Interest and finance charges	**47.48**	**74.98**	**96.33**
Gross Spread	**38.65**	**47.38**	**56.35**
Fee Based Income	15.01	27.26	20.99
Total Income	**101.14**	**149.62**	**173.67**
Gross Surplus	**53.66**	**74.64**	**77.34**
Expenses			
Personnel Expenses	6.7	21.57	30.56
Administrative Expenses	30.72	20.26	18.91
Total Expenses	**37.42**	**41.83**	**49.47**
Provision for loan loss	0.22	1.39	1.07
Write-off of bad debts			
Depreciation	0.58	0.98	1.5
Profit before non operating income	**15.44**	**30.44**	**25.3**
Add: Grants	7.39	3.06	12.07
Add: Non financial operating income	3.6	3.14	4.96
Less: Expenses on non financial operation	4.27	3.32	4.02
Tax	8.43	11.06	14.37
Profit after Tax	**13.73**	**22.26**	**23.94**

Exhibit 6B

BALANCE SHEET

(in Rs.million)

As on March 31	2007	2008	2009
LIABILITIES			
PAID UP SHARE CAPITAL	50.47	99.97	147.09
SHARE APPLICATION MONEY		4.51	11.68
RESERVES AND SURPLUS	8.64	17.75	24.73
NET WORTH	59.11	122.23	183.5
BORROWINGS	706.43	809.81	1066.74
MANAGED BORROWINGS			49.99
TOTAL LONG TERM BORROWINGS	706.43	809.81	1116.73
UNUTILISED GRANTS		16.94	8.42
INTEREST DUE	3.14	5.7	3.31
PROVISION FOR LOAN LOSS	0.59	1.86	2.18
OTHER CURRENT LIABILITIES	59.15	37.79	39.45
TOTAL CURRENT LIABILITES	62.88	62.29	53.36
TOTAL LIABILITIES	828.42	994.33	1353.59
ASSETS			
LOAN OUTSTANDING -OWN	721.73	851.42	969.83
LOAN OUTSTANDING-MANAGED			49.99
TOTAL LOAN OUTSTANDING	721.73	851.42	1019.82
INVESTMENTS - MUTUAL FUNDS	0.55	2.86	3.46
CASH AND BANK BALANCES	39.25	24.47	86.05
DEPOSITS WITH BANKS/ FI	40.50	28.00	104.85
OTHER CURRENT ASSETS	5.17	27.47	27.43
TOTAL CURRENT ASSETS	84.92	79.94	218.33
TOTAL FUNDS DEPLOYED	807.2	934.22	1241.61
NET FIXED ASSETS	21.21	60.11	111.98
TOTAL ASSETS	828.41	994.33	1353.59

Exhibit 7

Key Financial Ratios[16]

For	Year ended March 2007	Year ended March 2008	Year ended March 2009
Cost of funds (Interest paid/ Average Borrowings) (%)*	6.72	9.89	10.00
Spread on lending (%)	3.95	4.16	4.03
Operating expense ratio[17] (%)	4.71	4.92	4.69
Personnel expense ratio (%)#	0.83	2.48	2.81
Administrative expense Ratio (%)	3.88	2.44	1.88
Operating Cost Ratio[18]	12%	14%	15%
Portfolio Yield[19]	14%	18%	17%
Operational Self Sufficiency (%)[20]	118.01	125.54	117.05
Profitability (Net profit/ Funds Employed) (%)	1.70	2.56	2.20
Asset Quality (Provisioning/ Average Loan Outstanding)	0.08	0.24	0.23
Portfolio at risk (PAR) (>90 days)[21]	1.28	2.15@	2.15@
Capital Adequacy Ratio	7.91	12.98	15.92

***** The cost of funds has increased as a result of market conditions for loans to MFIs during the period.

As personnel were transferred from BWDA to BFL over a period of time till 2008, the personnel expenses at BWDA were lower and correspondingly administrative expenses were higher for the year ended March 31, 2007, compared to subsequent years. This is because as part of the staff was with BWDA, administrative charges were paid to it for services rendered.

@ In both these years, there was restructuring of part of the loan portfolio by BWDA. Before restructuring, the PAR was 5.28 and 3.98 for 2008 and 2009 respectively. The restructured loans are reportedly being repaid promptly as per the new schedule.

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16 The financial analysis is based largely on CRISIL's grading report on BWDA/BFL dated December 2009.
17 Operating expenses divided by average gross loan portfolio.
18 Total costs of operation including financial costs as percentage of loans outstanding.
19 Total income as percentage of loans outstanding.
20 Operating revenue divided by the sum of financial, operational and loan loss provision expenses.
21 Refers to the outstanding amounts of all loans for which instalments have been due for more than 90 days, as a percentage of the gross loan portfolio.

Exhibit 8

Portfolio yield and operating cost, by lending methodologies

Model		**2007**	**2008**
SHG	Portfolio Yield	20%	18%
	Operating Cost Ratio	15%	11%
JLG	Portfolio Yield	24%	24%
	Operating Cost Ratio	27%	19%
Hybrid	Portfolio Yield	18%	20%
	Operating Cost Ratio	12%	12%
Individual Lending	Portfolio Yield	21%	17%
	Operating Cost Ratio	11%	10%

(Source: Side by Side 2008, a report by Sa-dhan, the association of Microfinance institutions. Data are based on a sample of 220 MFIs out of which 90 use SHG model, 43 JLG model, 11 individual lending and 76 hybrid methodologies. Portfolio yield and operating cost ratio are unweighted averages over number of MFIs in the sub-sample.)