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SKS Microfinance Limited: A Funds Tank Study

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Abstract:
Microfinance institutions provide collateral free small value loans and other financial services to the weaker section of the society in order to improve their socio-economic status. In order to achieve this objective, the institutions must be financially sustainable and well capitalised. This paper studies the various sources of funds of SKS Microfinance Limited. The MFI under study is a RBI registered NBFC-MFI. The company is the only microfinance institution to be listed in Indian Stock Exchanges after its successful IPO in 2010. The major source of debt funds of the company is term loans from banks and financial institutions. Apart from its internal source of funds like retained earnings, the company taken cash credit from banks and issued commercial papers and non-convertible debentures from time to time to meet its capital requirement.SKS microfinance has issued equity shares through employee stock options, qualified institutional placements (QIP), preferential allotments and initial public offering (IPO).The rapid growth in the microfinance sector, especially of NBFC-MFIs has led to the search for innovative financial sources other than plain balance sheet borrowing to sustain the growth rate. Three forms of structured financial products have gained significance; these are: bilateral loan assignments, securitization and collateralized debt obligations (CDOs). The RBI has already allowed the NBFC-MFI to raise overseas funds through external commercial borrowing.

Keywords: *Microfinance, initial public offering, qualified institutional placement, non-banking finance company, joint liability group, commercial paper, non-convertible debenture*

1. Introduction

To most, microfinance means providing poor families with very small loans (micro credit) to help them engage in productive activities to grow their tiny businesses. But microfinance includes a broader range of services such as credit, savings, insurance etc. It has been realized that the poor, who lacks access to traditional formal financial institutions needs a variety of financial products.

Microfinance started with the recognition that poor people had the capability to lift themselves out of poverty if they had access to affordable loans. High repayment rates in the industry have changed the perception that the poor are not credit worthy. With the right opportunities, the poor have proved themselves to be productive and capable of borrowing, saving and repaying, even without collateral.

The Indian microfinance sector has come a long way since its inception in the 1990s and has established itself as an important component of the Indian financial system. With the growth and maturity of Indian microfinance institutions (MFIs), their capital requirements have increased manifold. However, their sources of funding remain limited and are subject to various constraints. For instance, certain categories of MFIs are barred from accepting deposits due to regulatory stipulations. Thus, the future remains bleak for MFIs with regard to the use of deposits as the source of funds for meeting operational and other expenses. Loan repayments and interest on loans constitute a significant source of funds for MFIs. However, the high costs of collecting loans and other related expenses deflate the profitability of MFIs. Moreover, widespread defaults in payment/repayments could jeopardize the operations and the very existence of MFIs. Therefore, MFIs have to look for other avenues that can meet the fund requirements on a sustained basis at lower cost. This is the reason why most of the big MFIs are heading towards the capital market.

Apart from the issues of operational and financial sustainability, MFIs need funds to expand geographically in order to cover wider areas and to diversify their operations as well as range of financial products and services. Over the years, MFIs have received the attention of investors across the world, and donor institutions, governments, and corporations have funded them significantly. However, if one looks at the staggering credit requirements of the poor and the total supply of funds by microfinance institutions it is evident that these funds are not sufficient to meet the increasing demand for microcredit. The mismatch is wide. Such a wide gap deserves special attention. It highlights the opportunity for microfinance institutions to expand their operations on a much wider scale. To address such unmet demands, MFIs need to fund their portfolios on a sustained basis. The capital market provides them with the opportunity for funding with wider prospects in terms of the range of products available as well as scalability. Many Indian MFIs have ventured into the capital market and raised equity and investors have welcomed their entry into capital market. In the Indian context, the entry of the microfinance sector into the capital market is significant because according to "*Microfinance in India – Sector Overview FY '14*" by IFMR Investments, India has the largest number of MFI borrowers in the world. In order to meet the credit demands of such a large segment of borrowers, MFIs need to look for different avenues of funding. It is thought that a collaborative integration of the capital markets with the microfinance sector would be mutually beneficial, as it would provide investors with wider choices and adequate returns. Across the world, MFIs have forayed into the capital market and raised capital through local bonds, equity investments, debentures, and commercial papers.

2. Objective of the Study

The objective of the present study is to analyze the various sources of funds of the company.

3. Scope of the Study and Sources of Data

This study is confined to a single MFI, i.e. SKS Microfinance Ltd and the period of the study is from 2005-06 to 2014-15. All relevant data are extracted from the annual financial statements of the company. Some data are also drawn from the web site of the institution under study.

4. SKS Microfinance- an Overview

SKS was started in 1996 by a young entrepreneur, Vikram Akula. When pursuing his Ph.D. in Political Science at the University of Chicago, Vikram had the vision of starting a microfinance institution to uplift the poorer sections of the society in India. His dissertation was in the area of poverty alleviation strategies which focused on ‘How to scale microfinance faster’. While studying in the US, Vikram realized that microfinance institutions could sustain themselves in the long run only by following a for-profit model.

After returning to India from the US, he faced lot of difficulty in starting a new microfinance organization as he couldn’t raise the required funds. Finally, he started SKS by raising an initial amount of Rs. 2.36 million from 357 people (mostly from his family and friends). Vikram was inspired by Bangladesh banker Muhammad Yunus and SKS was established based on Yunus’s Grameen Bank model. SKS was initially registered as SKS Society, a Non-Governmental Organization (NGO), in 1997 and it started its operations in Tumnoor Village in Medak District, Andhra Pradesh, in 1998. SKS expanded its operations rapidly and in course of time, it won several awards for its achievements. Most of the money it received in the form of awards was also reinvested to fund the expansion of its operations.

By the year 2003, Vikram had arrived at the idea of converting SKS into a for-profit organization to fuel its growth. Toward that end, he founded a private company called SKS Microfinance Pvt. Ltd. and five for-profit Mutual Benefit Trusts (MBTs). The objective was to enhance the social and economic welfare of the company and MBTs’ members. Vikram raised US$ 500,000 in 2003 through donations via MBTs and invested the amount in SKS Microfinance Ltd. to become its sole owner.

In 2005, the Company registered with and has since been regulated by the RBI as a Non-Deposit Taking Non-Banking Financial Company (NBFC-ND). In 2009, the Company became a public limited Company. The Company completed its IPO and its equity shares were listed on Bombay Stock Exchange (BSE) Limited and the National Stock Exchange (NSE) of India Limited in August 2010. In November 2013, the RBI re-classified the Company as an NBFC-MFI permitting it to carry on the business of a Non-Banking Financial Company - Micro Finance Institution, a separate category of Non-Deposit Taking Non-Banking Financial Companies engaged in microfinance activities.

The Company is one of the largest MFIs in India by Gross Loan Portfolio (GLP) as also number of Borrowers and branches as on March 31, 2015, and the only microfinance Company to be publicly listed in India. The Company is primarily engaged in providing microfinance to economically weaker individuals in India, who are classified by the Company as its “Members”. Further, the Company classifies Members whose loans are outstanding as “Borrowers”.

The Company’s core business is providing small value loans and certain other basic financial services to its Members. Its Members are predominantly located in rural areas in India, and the Company extends loans to them mainly for use in small businesses or for other income-generating activities and not for personal consumption. These individuals often have no, or very limited, access to loans from institutional sources of financing. The Company believes that non-institutional sources typically charge very high rates of interest.

In its core business, the Company utilizes a village-centric, group-lending model to provide unsecured loans to its Members. This model relies on a form of ‘social collateral’, and ensures credit discipline through peer support within the group. The Company believes this model makes its Members prudent in conducting their financial affairs and prompt in repaying their loans. Failure by an individual Borrower to make timely loan repayments will prevent other Members in the group from being able to borrow from the Company in future. Therefore, the group will use peer support to encourage the delinquent Borrower to make timely repayments or will often make a repayment on behalf of a defaulting Borrower, effectively providing an informal joint guarantee on the Borrower’s loan.

In addition to its core business of providing micro credit, the Company uses its distribution channel to provide certain other financial products and services that its Members may need. The Company offers loans for the purchase of mobile phones and solar lamps. The Company also operates a number of pilot programmes that it may gradually consider converting into separate business verticals or operate through subsidiaries, subject to satisfactory results of the pilot programmes and receipt of regulatory approvals. The existing pilot programmes primarily relate to giving loans to its Members for the purchase of certain productivity-enhancing products such as sewing machines, bio-mass stoves and loans against gold as collateral. The Company intends to expand its involvement in these other financial products and services to the extent consistent with its mission, client-focus and commercial viability.

Borrowers undergo financial literacy training and must pass a test before they are allowed to take out loans. Weekly meetings with borrowers follow a highly disciplined approach. Re-payment rates on collateral-free loans are more than 99% because of this systematic process.

5. Sources of Debt Funds

A strong Capital base, impeccable asset quality and experienced management enables SKS to raise debt capital to fund its ambitious growth plans. Historically, the MFI sector has relied on priority sector funding from commercial banks. In addition to such funding, SKS is also able to fund the growth of operations and loan portfolio through issuances of equity and private and publicly traded debt securities, loans with various maturities raised from domestic and international banks, and the securitization of components of the loan portfolio. SKS has also diversified the lenders among public sector domestic banks, private sector domestic banks, private sector foreign banks, and institutional investors. The company has banking relationship with over 45 banks today.

SKS has also demonstrated raising debt by introducing mainstream financial instruments into microfinance. These instruments are useful in not just increasing the options for raising debt but also give SKS the edge in smart management of its finances.

The basket of sources is comprised of several financial instruments, such as term loans, cash credit, non-convertible debentures, commercial papers, rated pool assignment and sale of receivables. It is truly a mix that mitigates concentration risk.

5.1. Term Loans

Term Loans are the counter parts of Fixed Deposits in the bank. Banks lend money in this mode when the repayment is sought to be made in fixed, pre-determined instalments. This type of loan is normally given to the borrowers for acquiring long term assets i.e. assets which will benefit the borrower over a long period (exceeding at least one year). Purchase of plant and machinery, constructing building for factory, setting up new projects, financing for purchase of automobiles, consumer durables, real estate and creation of infrastructure come under this category.

5.2. Cash Credit limit

A cash credit is a short-term cash loan. A bank provides this type of funding, but only after the required security is given to secure the loan. Once a security for repayment has been given, the business that receives the loan can continuously draw from the bank up to a certain specified amount.

5.3. Commercial Papers

Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note. It was introduced in India in 1990 with a view to enabling highly rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors. All eligible participants shall obtain the credit rating for issuance of Commercial Paper either from Credit Rating Information Services of India Ltd. (CRISIL) or the Investment Information and Credit Rating Agency of India Ltd. (ICRA) or the Credit Analysis and Research Ltd. (CARE) or the FITCH Ratings India Pvt. Ltd. or such other credit ratingagencies (CRA) as specified by the Reserve Bank of India from time to time. Commercial Papers can be issued for maturities between a minimum of 7 days and a maximum of up to one year from the date of issue. However, the maturity date of the Commercial Papers should not go beyond the date up to which the credit rating of the issuer is valid. Commercial Papers can be issued in denominations of ₹ 5 lakh or multiples thereof.

5.4. Non-Convertible Debentures (NCDs)

The debentures which can't be converted into shares or equities are called non-convertible debentures (or NCDs). Debentures are long-term financial instruments which acknowledge a debt obligation towards the issuer. Some debentures have a feature of convertibility into shares after a specified time period. The debentures which can't be converted into shares or equities are called non-convertible debentures (NCDs).

Non-convertible debentures are used as tools to raise long-term funds by companies through a public issue. To compensate for this drawback of non-convertibility, lenders are usually given a higher rate of return compared to convertible debentures.Besides, NCDs offer various other benefits to the owner such as high liquidity through stock market listing, tax exemptions at source and safety since they can be issued by companies which have a good credit rating as specified in the norms laid down by RBI for the issue of NCDs. In India, usually these have to be issued of a minimum maturity period of 90 days.

SKS is the first MFIs in India to complete a rated bond issuance, issue commercial paper, assign a rated pool, sell a "weaker section" portfolio, list debt instruments on the Bombay Stock Exchange (BSE), get a long term subordinated debt (Tier II) for a term of 8 years and complete an assignment of receivables with a public sector bank.

During 2009-10, SKS Microfinance and Standard Chartered Bank have completed a unique transaction in the debt capital market, by enabling the country's first listed Non Convertible Debenture (NCD) Issue by a microfinance institution. SKS Microfinance has raised ₹ 75 crores through an issue of 1-year NCD at a coupon rate of 10 percent. The NCDs have been listed on The Stock Exchange, Mumbai. This has become the largest debenture issue by a MFI till date and first MFI to be listed in a stock exchange.SKS is the first non-banking finance company (NBFC) in the micro finance space to use Commercial Papers for fund raising.

6. Long Term Debts
The long term debt of SKS Microfinance Limited consists of term loans from banks, financial institutions and NBFCs and NCD. Relevant figures with their percentage break up are shown in the following table.

Year	NCD	Term Loan from Banks	Term Loan from FIs	Term Loan from NBFCs	Total	Net Raised/Repaid
2005-06	0	(71%) 49.22	(29%) 20	(0%) 0	69.22	
2006-07	0	(81%) 201.45	(19%) 47.57	(0%) 0	249.02	179.8
2007-08	0	(75%) 593.51	(25%) 196.33	(0%) 0	789.84	540.82
2008-09	0	(75%) 1444.07	(21%) 411.64	(4%) 81.67	1937.38	1147.54
2009-10	0	(71%) 1625.15	(26%) 609.65	(3%) 68.33	2303.13	365.75
2010-11	0	(79%) 1424.89	(18%) 322.17	(3%) 45.94	1793	-510.13
2011-12	0	(80%) 717.94	(18%) 157.5	(2%) 13.89	889.33	-903.67
2012-13	0	(83%) 871.28	(17%) 173.9	(0%) 2.42	1047.6	158.27
2013-14	0	(86%) 1032.73	(14%) 164.59	(0%) 1.59	1198.91	151.31
2014-15	(7%) 200	(86%) 2271.95	(7%) 197.61	(0%) 0.63	2670.19	1471.28
Average		(79%)1023.22			1294.76	

Table 1: SKS Debt Funding: Long Term ₹ Crore
Source: Balance Sheets-SKS Microfinance

A perusal of the Table 1 shows that term loan from banks constitutes the major portion of its long term debt. On an average it forms 79 per cent of the total long term debts. The second major source is the term loan from financial institutions. The table also states that SKS Microfinance started borrowing from non-banking financial companies from 2008-09.
In 2005-06, the total long term debts of the company under study were ₹ 69.22 crores. It went on increasing till 2009-10. In the very next year it reduced substantially. However, from 2011-12, again it began to rise and by the end of the concluding year of the study it was ₹ 2670.19 crore.

7. Short Term Debts
The short term debt funding of SKS Microfinance comes from banks in the form of short term loan, cash credit and overdraft. Its other sources of short term loan are NCD, CPs and NBFCs.

Year	NCD	Bank OD	CC	STL from Banks	STL from NBFCs	CPs	TOTAL	Proceeds
2005-06	0	0	0	0	0	0	0	
2006-07	0	0	0	0	0	0	0	0
2007-08	0	0	0	0	0	0	0	0
2008-09	25	149.75	0	0	0	24.44	199.19	199.19
2009-10	175	101.43	0	0	0	115.1	391.53	192.34
2010-11	0	147.49		225	0	68.64	441.13	49.6
2011-12	0	0	125.9	5	0	0	130.9	-310.23
2012-13	0	0	164.69	405.83	0	0	570.52	439.62
2013-14	0	0	97.03	191.42	43.91	0	332.36	-238.16
2014-15	0	0	123.55	306.5	90.14	89.44	609.63	277.27

Table 2: SKS Debt Funding: Short Term ₹ Crore
Source: Balance Sheets-SKS Microfinance

The data as presented in Table 2 shows that the MFI understudy has;

i. Resort to short term debt from non-convertible debenture only in the year 2008-09 and it discontinued its operation in the year 2010-11 onwards. Thus NCD were issued during two years under study.
ii. Arranged bank overdraft for three years i.e. from 2008-09 to 2010-11.
iii. After discontinuance of bank overdraft, it resorted to cash credit system from 2011-12 onwards.
iv. Short term loan from banks were arranged from the banks from 2010-11 onwards.
v. Availed short term loan from NBFCs during the concluding two years of the study.
vi. Commercial Papers were in use for four years during the study period.

Thus it seems that the MFI under study does not have a clear cut policy w.r.t. the arrangement of short term loan. Further, the total column of short term loan indicates that the borrowing from short term loan does not reveal a clear cut trend. In other words, it shows a fluctuating character.

8. Equity Capital

SKS is conscious of the fact that the funds required for alleviating poverty are available only with commercial funders. It accesses these funds to fulfil its social mission of empowering the poor. In its efforts to attract commercial funding into the microfinance sector, SKS has been in the forefront. It has raised equity from a wide range of investors – from Government-backed development funds from SIDBI to Angel Investors, Venture Capitalists, Private equity and recently from mainstream financial institutions. Vinod Khosla, SIDBI, Bajaj Allianz, Yatish Trading, Kismet Capital, Sandstone Capital, Silicon Valley Bank are among the existing equity partners of SKS Microfinance. SKS microfinance has issued equity shares through employee stock options, qualified institutional placements (QIP), preferential allotments and initial public offering (IPO).During 2010-11, SKS microfinance successfully completed its Initial Public Offering (IPO) of equity shares and has achieved a rare distinction of becoming the first microfinance institution in India to be listed on the Bombay Stock Exchange and the National Stock Exchange on August 16, 2010.

8.1. Employee Stock Options

Employee Stock Option Plan (ESOP) is a plan through which a company awards Stock Options to the employees based on their performance. Under an ESOP, the employees have right to buy the shares of the company at a predetermined price. The objective of ESOP is to motivate the employees to perform better and improve shareholders' value. Apart from giving financial gains to the employees, ESOP also creates a sense of belongingness and ownership amongst the employees.

8.2. Initial Public Offering

A company's first issue of shares as per SEBI guidelines to the general public is referred to as Initial Public Offer.Initial Public Offer (IPO) is a source of collecting money from the public for the first time in the market to fund for its operations and projects. In return, the company gives the share to the investors in the company. In this process a private limited company becomes a public limited company. After the issue gets over the shares are listed in recognised stock exchanges for trading.

8.3. Qualified Institutional Placements

Qualified Institutional Placement (QIP) is largely a fund raising tool for the listed companies. QIP is a process which was introduced by Securities Exchange Board of India (SEBI) so as to enable the listed companies to raise finance through the issue of securities to Qualified Institutional Buyers (QIBs). Earlier, since raising finance in the domestic market involved a lot of complications, Indian companies used to raise funds from the overseas markets. So to prevent this, SEBI introduced this process so as to make the raising of funds easier in the domestic market.

8.4. Preferential Allotments

Preferential Allotment is the process by which allotment of securities/shares is done on a preferential basis to a select group of investors. For raising funds, it is not always preferable or feasible for a company to issue securities to the public at largebecause it is not only time consuming but also expensive too. In such situations, the securitiescan be offered to a comparatively smaller group of individuals, such as the directors or the existing shareholders. This entire process is known as preferential allotment.
Table 3presents the equity funding of SKS Microfinance from 2005-06 to 2014-15.

Year	Eq Sh Cap	Sec Premium	Pref Sh Cap	Appl Money	Total	Proceeds
2005-06	13.91	0	0		13.91	11.85
2006-07	26.64	40.89	0		67.53	53.62
2007-08	44.33	147.13	0		191.46	123.93
2008-09	47.91	504.82	9.15		561.88	370.42
2009-10	64.53	614.33	0		678.86	116.98
2010-11	72.32	1312.46	0	0.03	1384.81	705.95
2011-12	72.36	1313.25	0	4.51	1390.12	5.31
2012-13	108.21	1532.56	0		1640.77	250.65
2013-14	108.21	1532.57	0		1640.78	0.01
2014-15	126.29	1909.31	0	0.00648	2035.606	394.82648

Table 3: SKS Equity Funding ₹ Crore
Source: Balance Sheets-SKS Microfinance

During 2005-06, SKS issued 1, 18, 47,100 equity shares through private placement and during 2006-07 the company issued 1, 27, 35,877 equity shares of ₹ 10 each at premium making the proceeds from issuance of shares to ₹ 53,62,63,529.
During 2007-08, SKS issued 1, 74, 95,434 equity shares equity shares of ₹ 10 each fully paid up at premium and 38,63,415 equity shares of ₹ 10 each partly paid up (₹ 0.5 per share) making the proceeds from issuance of shares to ₹ 123,93,05,874.
During 2008-09, SKS has raised ₹ 366 crores, the largest private equity investment in any microfinance institution till date in India. The fact that this investment has come during the global economic meltdown is proof of the confidence that investors have in the institute and more importantly of the resilience and entrepreneurial abilities of the poor not only to survive in periods of economic crisis but actually to prosper because the poor are largely de-coupled from global trends. The Company issued 3,051,875 equity shares

and 91, 55, 625, 0% compulsorily convertible preference shares of ₹ 10 each, compulsorily convertible on December 26, 2009 with an option to the holder to convert the holding at any time before.

It has issued some shares/options to its employees as mentioned under "Employee Share Purchase Scheme and Employee Stock Option Plan". The Company further received strategic domestic investment of ₹ 50 crores from Bajaj Allianz Life Insurance Company subscribing to 416,666 equity shares and 1,250,000 Compulsorily Convertible Preference Shares of the Company.

During the year 2009-10, SKS microfinance issued 12,955,948 Equity Shares of Rs. 10/- each, which included 10,405,625 Equity Shares of Rs. 10/- each issued on conversion of 10,405,625 Compulsorily Convertible Preference Shares (CCPS) of ₹ 10/- each in the ratio of 1:1. Further 3,863,415 Equity Shares of Rs. 10/- each (paid-up ₹ 0.50 per Equity Share) were made fully paid-up. Accordingly, the issued, subscribed and paid-up equity share capital increased to ₹ 64.53 crore by the end of 31st March, 2010 as compared to previous year share capital of ₹ 57.06 crore. The above issue of shares includes strategic investment of ₹ 499,999,800/- by Bajaj Allianz Life Insurance Company Limited, a leading insurer offering life insurance products. This was the first-ever investment by an insurance company in any Indian Microfinance Institution (MFI). Another strategic investment of ₹ 281,331,000/- was made by Catamaran Fund 1-A and Catamaran Fund 1-B (represented by their Trustee, Catamaran Management Services Fund Private Limited). The above strategic capital infusions gave the Company greater stability and credibility, as well as a stronger capital base to extend its reach to serve more poor customers.

During the year 2010-11, SKS microfinance successfully completed its Initial Public Offering (IPO) of equity shares and has achieved a rare distinction of becoming the first microfinance institution in India to be listed on the Bombay Stock Exchange and the National Stock Exchange on August 16, 2010.The Company completed an IPO of 1,67,91,579 equity shares of ₹ 10 each for cash consisting of a fresh issue of 74,45,323 equity shares at a premium of ₹ 975 each to Qualified Institutional Buyers and Non-Institutional Buyers and at a premium of ₹ 925 each to Retail Individual Buyers as well as an offer for sale of 93,46,256 equity shares at a premium of ₹ 975 each to Qualified Institutional Buyers and Non-Institutional Buyers and at a premium of ₹ 925 each to Retail Individual Buyers. The IPO was done in accordance with the terms of the Company's prospectus dated August 5, 2010. During the year under review, 74,45,323 equity shares were issued as part of the IPO and 3,51,368 equity shares were issued under SKS ESOP (Independent Directors) 2008 and SKS ESOP 2009 Plans. Thus, the issued, subscribed and paid-up equity share capital increased from 6, 45, 27,219 to 7, 23, and 23,910 as on March 31, 2011.

During the year 2011-12, 32,985 equity shares were issued under the ESOP plans of your Company. Thus, the issued, subscribed and paid-up equity share capital increased from 72,323,910 to 72,356,895 as on March 31, 2012.

During the year 2012-13, 9, 07,734 equity shares were issued under the Company's ESOP plans. Additionally, the Company concluded a qualified institutional placement (QIP) of 3,04,98,069 Equity Shares to Qualified Institutional Buyers at a price of ₹ 75.40 per Equity Share and a Preferential Allotment of 44,50,000 Equity Shares to Kumaon Investment Holdings, a wholly owned subsidiary of one of the Promoters, West Bridge Ventures II LLC, at a price of ₹ 75.40 per Equity Share – both, in accordance with the provisions of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009. Thus, the issued, subscribed and paid-up equity share capital increased from ₹ 72.36 crore to ₹ 108.21 crore as on March 31, 2013.

During the year 2013-14, only 264 equity shares were issued under the ESOP plans of the Company raising ₹ 39600 only in this period.

The Company has successfully completed fund raising through a Qualified Institutional Placement ("QIP") by way of issue of 17,670,534equity shares in May 2014, resulting in a capital infusion of ₹ 397.6 crore. The QIP was oversubscribed multiple times. The net worth of the Company as on March 31, 2015 was ₹ 1,046.5 crore and capital adequacy as on March 31, 2015 was 31.7%, well in excess of the mandated 15%. This has enhanced the credit quality of the Company's debt instruments and helped it in obtaining competitive pricing. In addition to the aforesaid QIP, the Company also issued 408,997 equity shares consequent to the exercise of stock options by the employees under the Company's various employee stock option plans. The Company's cost of borrowings reduced to 12.8% in 2014-15 as compared to 13.6% for 2013-14. This reduction was mainly driven by a sustained turnaround, capital raise, rating upgrade and diversification of sources of funding. Therefore, in line with the Company's policy of passing on the cost advantages accruing from economies of scale, operational efficiency and reduction in the cost of borrowing to its borrowers, the Company reduced the rate of interest by 1% in October 2014 and again by 1.55% in July 2015.With the aforesaid reduction, the rate of interest charged by the Company is the lowest rate among Non-Banking Financial Company -Micro Finance Institutions ("NBFC-MFIs") on its core Income Generating Loans ("IGL").In addition to the listing of equity shares, the NCDs issued by the Company are listed on the wholesale debt segment of BSE Limited.

9. Retained Earnings

Like an individual, companies too, set aside a part of their profit to meet future requirements. The portion of profits not distributed among the shareholders but retained and used in the business is called retained earnings. It is also referred to as ploughing back of profit. This is one of the important sources of internal financing used to finance fixed as well as working capital need. It helps to increase the value of shareholders in case of a growing firm.

Unlike other sources of financing, the use of retained earnings helps avoid issue- related costs. Use of retained earnings avoids the possibility of change/dilution of the control of existing shareholders that results from issue of new issues. Use of retained earnings does not require compliance of any legal formalities. It simply requires a resolution to be passed in the annual general meeting of the company.

Table 4 shows the retained earnings of SKS Microfinance from 2005-06 to 2014-15 along with the percentage growth rate.

Year	Retained Earnings (₹ Crore)	Growth Rate (%)
2005-06	0.37	
2006-07	3.31	782.48
2007-08	16.63	402.49
2008-09	80.83	386.19
2009-10	220.00	172.16
2010-11	111.63	-49.26
2011-12	-1360.60	-1318.84
2012-13	-297.14	-78.16
2013-14	69.85	-123.51
2014-15	187.66	168.66

Table 4: Retained Earnings
Source: Profit and Loss Accounts-SKS Microfinance

The retained earnings of the firm under study was only ₹ 0.37 crore by the end of 2005-06. Then it started rising up to ₹ 220 crores during 2009-10. In the very next year it reduced to half. In subsequent two years the firm had negative retained earnings owing to the onset of the Andhra Pradesh Microfinance crisis. During 2013-14, again the retained earnings became ₹ 69.85 crore. In the very next year it went up to ₹ 187.66 crore recording an increase of 169 percent over the previous year.

10. Assignment and Securitisation

The rapid growth in the microfinance sector, especially of NBFC-MFIs has led to the search for innovative financial sources to meet the financial requirements of the sector. The need for securitization is common to all financial intermediaries, but when it comes to microfinance, the growing asset size (which is the very essence of microfinance economics) puts pressure on the Balance Sheet. Hence, off-Balance Sheet methods of funding, or any devices other than plain Balance Sheet borrowing are needed to sustain the growth rate. Three forms of structured financial products have gained significance; these are: bilateral loan assignments, securitization and collateralized debt obligations (CDOs).

In the case of assignment, the loan pool receivables are directly assigned to the assignee or the purchaser, usually a bank. These deals are also rated but no specific instrument like pass-through certificate (PTC) is issued. Effectively these could be loan pools originated by the buyer (bank itself). Banks often prefer this route as the loans need not be marked-to-market (as they are on the banking books), whereas the securities against those loan pools (as in the case of securitization), if issued by the same seller will have to be marked-to-market (as they are securities and hence will be on the bank's trading books). Besides this, banks will be able to pick and choose the loans that qualify for priority sector lending norms, and hence such transactions fit exactly into their objective. So, banks usually go in for bilateral assignment during the fag-end of the financial year, based on their requirement for such loan pools. Further, most banks also offer competitive rates if they are keen to have such loans on their books. While such financing for MFIs from banks is not a continuous source of funding, the cost of funding for the MFI is much lower than if it approaches the bank in the routine way.

Securitization typically involves the conversion of assets which have predictable future cash flows (for example, a pool of microloans) into standardized, tradable securities. The securitization process allows MFIs to pool the receivables from loans and sell the same to third parties like banks, mutual funds and insurance companies. This is an opportunity for MFIs to increase their funding sources.

The primary objective of securitization is to obtain financing for a company's ongoing business needs. However, a properly structured financial asset securitization also permits a company to obtain a lower cost of financing compared to secured or even unsecured debt. Securitization allows the originator to remove the asset and all corresponding risks associated with it completely from its Balance Sheet. It also reduces the need to hold capital against the asset. The broad structure of transactions (as in the case of securitization) – including bankruptcy remoteness, limited recourse to originator, performance of servicing function by the originator, and permissible commingling of pool collections with servicer's own funds – are common to both assignment and securitization.

Assignment and securitization can be in two forms, namely, (a) with recourse and (b) without recourse. When the assignment/securitization is with recourse, the MFI remains fully exposed to the risk of default of the underlying loans though the loans themselves are not reflected in its financial statements. When the assignment/securitization is without recourse, the MFI has no exposure on the loan portfolio but it is customary for the MFI to offer credit enhancement in the form of a dedicated fixed deposit or in other forms. When banks acquire assigned or securitized loans, they become the owners of those loans. They have therefore an obligation before they acquire the assigned or securitized loans, to ensure that the loans have been made in accordance with the terms of the specified regulations.

Year	Amount (₹ Crore)	Growth Rate (%)
2009-10	1840.88	
2010-11	811.09	-55.94
2011-12	866.48	6.83
2012-13	1194.67	37.88
2013-14	1693.15	41.73
2014-15	1432.54	-15.39

Table 5: Loans assigned/Securitised
Source: Annual Reports-SKS Microfinance

Table 5above shows the amount of loans assigned/Securitized from 2009-10 to 2014-15. An amount of ₹ 1840.88 crore raised during 2009-10. In next two years the amount got reduced to ₹ 811.09 and ₹ 866.48 crore respectively. Then the amount again started going up. In the concluding year of study, the amount was ₹ 1432.54 marking 15.39 percent less than the previous year.

11. External Commercial Borrowings (ECB)

India's central bank, the Reserve Bank of India (RBI), defines ECBs as commercial loans in the form of bank loans, securitized instruments, etc. from non-resident lenders with a minimum average maturity of 3 years. ECB can be accessed either under the 'Automatic' route or 'Approval' route.

Microfinance Institutions (MFIs) are eligible for ECBs under the 'Automatic' route. Such MFIs should be registered as Societies, Trusts, Co-operatives or Non-Banking Financial Companies- Microfinance Institutions (NBFC-MFIs). However, MFIs registered as Section 25 companies (NGOs), Societies, Trusts and Co-operatives should have a satisfactory borrowing relationship for at least 3 years with a commercial bank in India which is authorized to deal in foreign exchange. Such MFIs would require a 'fit and proper' certificate relating to status of their Board/Committee of management from the designated bank.

As per the RBI Master Circular on External Commercial Borrowings and Trade Credits, dated July 1, 2014, as amended, MFIs are also allowed to obtain External Commercial Borrowings, subject to a maximum cap of US $10 million in a financial year for permitted end-uses under the “automatic route”. As stated in the Bharat Microfinance Report 2013, External Commercial Borrowings could emerge as a strong source of capital for NBFC-MFIs in the near future.

The current framework of overseas borrowings for MFIs in India has many challenges. This has resulted in not even a single ECB transaction being facilitated for MFIs in India since the revised ECB guidelines were issued.

12. Conclusion

The Indian microfinance institutions are the important component of the Indian financial system. The capital requirement of this industry is continuously rising with its growth and maturity. However, the various sources of funds are limited and are subject to various constraints. Loan repayments and interest on loans are the major sources of funds for MFIs but the high costs of collecting and recovering the loans with interest reduce the profitability of MFIs. So MFIs look for other sources of funds on a sustained basis at lower cost. MFIs need funds not only for operational and financial sustainability but also for its expansion and diversification. To meet the increasing demand for micro credit the traditional sources of funds such as retained earnings, term loans, cash credit and overdraft from banks and financial institutions are not sufficient.

The capital market provides the industry with the opportunity for funding with wider range of products and scalability. Many Indian MFIs including SKS microfinance have entered into the capital market and raised equity capital. SKS microfinance successfully completed its Initial Public Offering (IPO) of equity shares in the year 2010-11 and has become the first microfinance institution in India to be listed on the Bombay Stock Exchange and the National Stock Exchange on August 16, 2010.Across the world, MFIs have forayed into the capital market and raised capital through local bonds, equity shares, debentures, and commercial papers.

The rapid growth of NBFC-MFIs like SKS microfinance has led to the search for innovative sources like loan assignments and securitization to meet the increasing financial requirements of the industry. Reserve Bank of India vide its circular dated July 1, 2014 has already allowed the Indian NBFC-MFIs to raise funds from overseas investors through external commercial borrowing.

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