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A Study on Financial Performance of MFIs in India

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Abstract:
Microfinance initially has been a form of voluntary help to most deprived population. However, today it represents a market solution to mitigation of poverty and acts as a development and economic tool in bringing about financial inclusion in India. Microfinance has emerged as a viable alternative to reach the hitherto unreached for their social and economic empowerment through social and financial intermediation. The institutions that are providing microfinance services such as savings, credit, insurance and remittance services to poor are called Microfinance Institutions (MFIs). The study aims at analyzing the financial performance of MFIs in India. The data have been collected from the Microfinance Information Exchange from the fiscal year 2007 to 2011. The statistical tools, namely, Descriptive statistics and growth rates have been used for analyzing the data.. In terms of overall financial performance, Indian MFIs has better ROE and OSS. Indian MFIs have exhibited higher financial revenue by assets, the yield on gross portfolio (nominal) and lower operating expense by assets, but still it couldn't cover the total expense and financial expenses. In fact, Indian MFIs have revealed better efficiency and productivity as measured by operating expense by loan portfolio, average salary by GNI per capita and loans per staff members.

Keywords: *Financial Performance, Microfinance, MFIs*

1. Introduction

Finance is an extraordinary effective tool in spreading economic opportunity and fighting against poverty. Access to finance allows the poor to use their rich talents or open avenues for greater opportunities. Providing sustained credit services is one of the means to increase income and productivity of poor. Though the banking system in India witnessed unprecedented growth and achieved phenomenal outreach, notwithstanding this, empirical studies in the 1980s have revealed that a very large number of poorest of the poor continue to remain outside the reach of formal banking system. It is realized that existing banking policies, procedures and system not have been well suited to meet the credit needs of poor. And, it is in this situation micro finance has come as a solution. Starting with the Grameen bank founded by Mohammed Yunus in 1970s microfinance represented a method of lending that is to be tailored specifically to the world's poorest population. Microfinance initially has been a form of voluntary help to the most deprived population. However, today it represents a market solution to mitigation of poverty and acts as a development and economic tool in bringing about financial inclusion in India. The institutions that are providing microfinance services such as savings, credit, insurance and remittance services to poor are called Microfinance Institutions (MFIs). MFIs have come up as a bridge between banks and poor, whose only source of credit has so far been the money lender.

2. Statement of the Problem

India is a developing economy and poverty is a common problem. It becomes imperative to formulate specific situational poverty alleviation policies and programmes for generation of minimum level of income for rural poor which forms substantial percentage of national population in developing societies. Microfinance is an option to resolve this problem of poor people. The microfinance industry in India started with informal Self Help Group (SHG) to access the much – needed savings and credit services in the early 1980's and today it has evolved into a vibrant industry exhibiting variety of business model. To provide microfinance and other support services MFIs should be able to sustain for long period. In order to sustain operations, MFIs must generate enough revenues from financial services to cover their financial and operating cost and in many cases, build institutional capital through profit. Financial performance becomes a watchword in the governance of MFIs. The present study is an attempt to assess the financial performance of Microfinance Institutions operating in India during fiscal year period 2007 to 2011 (2007-08 to 2011-12).

3. Objectives of the Study
The study focuses on the objective:

- To analyse the financial performance of MFIs in India

4. Scope of the Study
The study is pertaining to microfinance institutions in India.The comprehensive financial performance indicators model used by Microfinance Information Exchange (MIX) has been chosen for the study. The variables, such as institutional characteristics, financing structure, outreach indicators, overall financial performance indicators, revenue and expenses, efficiency and risk and liquidity have been considered to analyse the financial performance. Macro-economic indicators are not included in this study.

5. Research Methodology

5.1. Source of Data
The study is primarily based on secondary data. The data have been collected from Microfinance Information Exchange (MIX) i.e., www.mixmarket.org. The period undertaken for the study is from fiscal year 2007 to 2011 (2007-08 to 2011-2012).

5.2. Sample and Sampling Design
The MFIs which have fulfilled the disclosure guidelines laid down by Consultative Group to Assist the Poor (CGAP), the global body of dominant donors of MFI space, providing details on all indicators of financial reporting is considered in this study. There are 122 MFIs in India which have reported their financial information to CGAP through MIX in the fiscal year 2011. The MFIs for which the financial details have been reported atleast for 5 years continuously have been identified. It is noted that only 71 MFIs of which 46 MFIs in India have fulfilled the requirement and all these MFIs are taken for the study.

5.3. Tools for Analysis
The following statistical tools have been used for analyzing the data:
Descriptive statistics, namely, Mean, Standard deviation and Coefficient of Variation (CV per cent). The growth measures such as, Annual Growth Rate (AGR), Linear Annual Growth Rate (LAGR) and Compounded Annual Growth Rate have been computed to study the trend of ratios and overall growth of ratios during the study period.

5.4. Limitations of the Study
The study is subject to the following limitations:

- The limitations inherent in statistical tools apply to this study also.
- Non availability of continuous data from MIX for more than five years has restricted the period and number of MFIs in this study.

6. Review of Literature
There is plethora of literature on performance of MFIs across globe, though only few studies have been carried out on the topic related with performance of Indian MFIs. The methodologies to study financial sustainability are also fewer. It is seen that without sound financial performance the sustainability of these MFIs is not possible.
Michael Tucker and Gerard Miles (2003)[1] through their study on “Financial performance of Microfinance Institutions - A comparison of performance of Regional commercial banks by geographic regions” has analysed and compared the performance of regional commercial banks with MFIs. The study has analysed and compared five financial ratios from three different categories - the first category measures the efficiency through operating expenses to assets ratio; the second category, gauges profitability including returns on assets, return on equity and net profit margin and the final category focusing on leverage, measured through debt to equity ratio. The study has obtained the data of commercial bank from FIS online, covering four geographic region: Africa (14 banks), Asia (61 banks), Eastern Europe (10 banks), and Latin America (72 banks), and 148 MFIs for the period 1999-2001. The study has found that there are 57 self-sufficient MFIs which are profitable and even performing better than developing world commercial banks in the sample.
Abdul Qayyum and Ahmad M (2006)[2], in their study on “Efficiency and sustainability of microfinance institution in South Asian” has aimed to identify the most efficient/best practice MFIs in south Asian region. The study has evaluated the efficiency of 85 MFI from south Asia shared as follows: 15 Pakistanis, 25 Indians, and 45 Bangladeshi MFIs. Data envelope analysis has been used to analyze the efficiency of microfinance institution in these selected South Asian countries. The performance indicators taken for the study are outreach, institutional characteristics, financing structure, overall financial performance, efficiency and productivity and risk and liquidity. They have also found that 10 MFIs from Pakistan, 9 from Bangladesh and 9 MFIs from India are not sustainable. They also found from sustainability indicator that Indian MFIs are better than Bangladeshi MFIs. The study has revealed that the majority of inefficiency of MFIs in Pakistan, India, and Bangladesh is mainly of technical nature and to improve their efficiencies, these MFIs have been invited to heighten the managerial expertise and to improve the technology.
Sen Mitali (2008)[3], in his study on “Assessing Social Performance of MFIs in India” examined the design and effectiveness of public policy tools relating to the rapidly developing micro finance institutions. The study has revealed that even financially self-sufficient MFIs maintain a high ratio of equity to total assets. It has been found that the form of support for MFIs may significantly affect the performance of these institutions and value to society. The study has concluded that there are good reasons to provide support for MFIs largely because of an informational advantage, the MFIs can be more efficient than either other

financial institutions in bringing benefits to the parts of society. The study has suggested that MFIs often improve their profitability as they mature, primarily by lowering their average cost.
Pankaj K. Agarwal and S.K.Sinha (2010)[4], in their study on "Financial performance of microfinance institutions of India: A cross sectional study", has analyzed and compared the financial performance of MFIs primarily from a sustainability stand point. The study has been conducted during 2008 with a sample of 22 MFIs which are five stars rated and data have been collected from mix market. The financial performance has been done based on six parameters, namely, financial structure, revenue, expense, efficiency, productivity and risk. The difference of means test has been used to compare the performance of star performers. The study have concluded that the most of the best performing firms were following different business model in India, this has been reflected in 13 out of 22 parameter studied.
Bayeh Asnakew Knide (2012)[5], in this article on "Financial sustainability of microfinance institutions in Ethiopia" has aimed at identifying factor affecting financial sustainability of MFIs in Ethiopia. The study has followed a quantitative research approach using a balanced panel data set of 126 observations from 14 MFIs over the period 2002 to 2010. The indicators, namely, financial sustainability, subsidy and sustainability, breadth of outreach, depth of outreach, capital structure and efficiency have been taken for analysis. The data has been analysed using descriptive statistics and econometric test. The study has found that microfinance breadth of outreach, depth of outreach, dependency ratio and cost per borrowing has affected the financial sustainability of micro finance institutions in Ethiopia. The study has concluded that capital structure of micro finance institutions and staff productivity has created significant impact on financial sustainability of MFIs in Ethiopia for study period.
Zohra Bi, Ajita Poudelm Junaid Saraf (2013)[6] in their paper titled "Performance and Sustainability of MFIs in India" have aimed to study the contribution and growth of Indian microfinance system, outreach of Indian MFIs and operating efficiency and portfolio quality of Indian MFIs. The indicators, namely, outreach, portfolio size and operating efficiency have been used for analysis. They have highlighted that MFIs have been concentrating in southern region of India and majority of MFIs have been NBFC. The study also found that large NBFC MFIs have maximum outreach due to their efficiency and sustainability.
The review of literature has revealed that the sustainability of MFIs is not possible without sound financial performance.

7. Financial Performance of MFIs in India

Financial performance analysis is the process of identifying the financial strengths and weaknesses of the firm by properly establishing the relationship between the items in statements. It also helps in short-term and long term forecasting. Growth can be identified with the help of financial performance analysis. Understanding the financial performance helps to improve profitability and sustainability of MFIs. A MFI can deduce its financial performance in terms of ratios and indicators from its operations and financial position. Seven categories of parameters as established by MIX have been taken to assess the financial performance of MFIs. Each category of parameters consists of several variables expressed as absolute financial value as well as financial ratios. Forty three variables in total under these parameters have been considered as performance indicators. The trend and growth pattern of these variables during the study period have been analyzed based on the mean value.

INSTITUTIONAL CHARACTERISTICS										
Year	**2007**	**2008**	**2009**	**2010**	**2011**	**Mean**	**S.D**	**C.V**	**AGR**	**LAGR**	**CAGR**
Offices (no.s)	126	143	202	248	219	188	51.4	27.4	16.47	29	17.98
Personnel (no.s)	830	1277	1809	2125	1761	1560	508.51	32.59	23.95	271	22.3
Assets (US $)	34224774	49849214	96699407	107178558	83161296	74222650	31084925	41.88	32.02	15520239	28.93
FINANCING STRUCTURE											
Capital asset ratio (%)	14.8	18.91	17.05	19.72	24.38	18.97	3.57	18.8	14.31	2	10.96
Debt Equity Ratio (%)	23.63	10.24	8.6	7.26	5.08	10.96	7.33	66.86	-29.57	-4.01	-28.95
GLP to Total Assets (%)	82.04	84.2	82.69	82.84	85.53	83.46	1.4	1.68	1.07	0.56	0.67
OUTREACH INDICATORS											
Number of active borrowers	197453	327636	512382	603779	487060	425662	161790.2	38.01	30.21	85536	27.34
Per cent of female borrower	93.39	94.23	95	95.27	96.11	94.8	1.04	1.09	0.72	0.65	0.69
Number of loans outstanding	222601	364414	599785	660608	555063	480494	181806.9	37.84	30.61	96112	27.41
Gross Loan Portfolio	27542229	43142019	86157568	98424640	77062291	66465749	29918481	45.01	37.22	15432274	33.41
Average loan balance per borrower	143.23	123.09	154.02	152.57	154.49	145.48	13.33	9.16	2.85	5.2	3.73
Average loan balance per borrower/ GNI per capita	15.02	11.5	13.6	10.46	10.19	12.15	2.09	17.19	-7.71	-1.07	-8.34
Average outstanding	139.48	376.8	144.28	145.65	142.26	189.69	104.62	55.15	26.76	-22.56	-8.71

balance											
Average outstanding balance/GNI per capita	14.56	35.06	12.75	9.86	9.73	16.39	10.63	64.86	13.29	-3.49	-18.74
OVERALL FINANCIAL PERFORMANCE											
Return on Assets (%)	0.22	1.79	1.52	1.38	-3.95	0.19	2.39	1245.8	-#-	-0.88	-#-
Return on Equity (%)	6.3	24.87	21.99	12.63	592.69	131.7	257.81	195.76	1208.33	116.05	131.88
Operational Self-Sufficiency (%)	117.24	119.43	119.78	112.65	93.9	112.6	10.83	9.62	-5.11	-5.35	-4.9
REVENUE AND EXPENSE											
FR/A (%)	22.3	22.43	21.93	23.09	19.14	21.78	1.53	7.04	-3.37	-0.57	-2.73
PM	-2.93	9.84	7.19	5.24	-44.31	-4.99	22.49	-450.34	-#-	-8.74	-#-
YGP (N) (%)	24.93	24.5	24.24	26.17	21.54	24.28	1.7	7	-3.13	-0.51	-2.24
YGP (R) (%)	17.47	14.94	13	12.66	9.77	13.57	2.86	21.07	-13.23	-1.77	-12.44
TE/A (%)	21.72	19.7	19.17	21.1	22.52	20.84	1.39	6.68	1.2	0.3	1.42
FE/A (%)	7.98	8.9	8.18	9.85	9.04	8.79	0.75	8.49	3.91	0.31	3.57
PLI/A (%)	0.91	0.47	0.94	1.08	1.35	0.95	0.32	33.66	22.89	0.15	17.6
OE/A (%)	12.92	10.94	10.33	10.24	10.57	11	1.11	10.06	-4.64	-0.54	-4.57
PE/A (%)	6.59	5.84	5.59	6.03	6.43	6.1	0.41	6.77	-0.29	-0.01	-0.17
AE/A (%)	6.19	4.78	4.49	4.27	3.79	4.7	0.91	19.26	-11.25	-0.53	-10.36
EFFICIENCY INDICATORS											
OE/LP (%)	18.13	14.27	14.02	13.33	13.79	14.71	1.94	13.22	-6.13	-0.96	-5.97
PE/LP (%)	9	7.23	7.2	7.68	8.16	7.85	0.75	9.56	-1.79	-0.12	-1.35
AS/GNI per capita	1.76	1.66	1.79	1.8	1.79	1.76	0.06	3.29	0.54	0.02	1.15
CPB (US$)	22.14	19.28	18.74	20.04	19.48	19.94	1.32	6.61	-2.89	-0.46	-2.15
CPL (US $)	19.88	18.4	18.28	18.28	17.6	18.49	0.84	4.54	-2.95	-0.47	-2.47
BPSM (no.s)	234	251	260	270	274	258	16.06	6.23	4.03	10	3.96
LPSM	255	264	312	290	301	284	24.46	8.61	4.68	12	4.38
BPLO	612	726	568	639	608	631	59.13	9.38	1.12	-10	-1.4
LPLO	635	748	605	663	660	662	53.14	8.03	1.96	-3	-0.42
PeAR	58.24	59.46	59.52	55.1	54.48	57.36	2.41	4.2	-1.59	-1.19	-2.07
RISK AND LIQUIDITY											
PAR>30 days (%)	2.07	1.66	1.64	11.87	37.7	10.99	15.56	141.59	205.09	8.15	117.52
PAR>90 days (%)	1.01	1.08	1.24	9.22	32.56	9.02	13.62	150.95	229.61	7.12	148.2
Write-off ratio (%)	0.26	0.16	0.66	1.1	2.85	1.01	1.1	108.9	124.95	0.61	95.75
Loan loss rate (%)	0.23	0.11	0.62	1.04	2.82	0.96	1.1	114.07	162.59	0.61	106.67
Risk coverage (%)	192	1088.46	4497.54	3506.92	337.38	1924.46	1958.57	101.77	166.93	270.92	25.83
NELA as a per cent of total assets (%)	11.32	16.3	18	16.78	18.83	16.25	2.93	18.03	14.97	1.55	11.04

Table 1: Financial Performance of MFIsIn India
Source: computed

- **Institutional Characteristics**
  Institutional characteristics, namely, offices, personnel and assets of MFIs in India have been increasing at a higher rate during the study period but with a marginal decrease in the year 2011. This has shown that the MFIs in India have been exhibiting a penetrating growth. The coercive collection practices and usurious interest rate adopted by MFIs forced the Andhra Pradesh state Government to issue an ordinance which severely limited the operation of MFIs. This crisis in the year 2010 has created a negative impact and fear about MFIs among the general public has resulted in the downfall of the number of offices, personnel and assets in the year 2011.

- **Financing Structure**
  MFIs financing structure includes long term debt and equity. This financial structure is a mixture that directly affects the risk and value of the MFIs. It is observed from the results that though the MFIs in India have maintained sufficient the financial leverage during initial years of study period, but in 2011 the MFIs capital asset ratio has crossed the standard proposed by Sa-Dhan. Hence, the MFIs have to be more efficient in using its capital to cover its expenses and debt obligations. It is observed from the GLP to total assets that the MFIs in India have increased their allocation of the assets to its lending activity during the study period, which is considered to be the core activity of MFIs. The financing structure of MFIs in India has been satisfactory during the study period.
- **Outreach Indicators**
  Outreach means the number of clients served. The MFIs in India have been able to reach more clients and the commitment of MFIs towards women empowerment, social welfare and poverty alleviation has been fairly high. It has also been clear that the unpaid principal balance on loan disbursed has been high during the study period, for which the MFIs in India should take effective steps to reduce the loan outstanding. The gross loan portfolio has revealed that the MFIs in India have granted various types of loans to clients during the study period. The average loans available for clients has increased but the average loan balance per borrower/GNI per capita has decreased during the study period. The average outstanding balance has included only loan amounts that clients have not yet repaid, which has increased during study period, whereas average outstanding balance/GNI per capita has decreased during study period. Hence the outreach of Indian MFIs has been better during the study period.
- **Overall Financial Performance**
  Sustainability plays a determining role in the number of microfinance clients reached and pace at which this pool of clients expands. In order to sustain operations, MFIs must generate enough revenue from financial services to cover their financial and operating costs and in many cases build institutional capital through profits. It is evident from the table that ROA of MFIs in India has been below the standard as proposed by ACCION audit i.e., greater than 3 per cent. This has shown that MFIs have not used their assets effectively to generate returns to attain higher profitability. ROE has shown a remarkable increase during study period and has been greater than the standard proposed by ACCION audit i.e., at a rate greater than 15 per cent. This has shown the ability of MFIs to generate income from its core financial activity and reward shareholders' investment. Indian MFIs outperform with small equity base. The OSS of MFIs in India has been maintained at more than the standard proposed by Sa-Dhan i.e., greater than 100 per cent. This reveals that the MFIs have earned sufficient revenue to cover the total cost. The overall financial performance of MFIs has been better.
- **Revenue and Expenses**
  Revenue is the amount of money that a MFI actually receives during a specific period viz., financial revenue by assets, profit margin, yield on gross portfolio nominal and yield on gross portfolio real. The higher the revenue better will be the performance of MFIs. Expense is the money spent or cost incurred by MFIs in efforts to generate revenue, representing the cost of doing business. The lower the expenses better will be the performance of MFIs.
  It is concluded from the table that the MFIs in India are able to generate revenue from gross loan portfolio and investment. But the profit margin has indicated that the MFIs ability to control cost has been poor. Indian MFIs are able to sustain even with this weak profit margin only with the help of subsidies. High rate of interest levied by Indian MFIs have enabled them to generate more financial revenue as revealed by the yield on gross portfolio nominal. The MFIs in India must concentrate to control the total expenses by assets, financial expense by assets and provision for loan impairment by assets as they have shown an increasing trend during the study period. But the expenses related to operations, such as, personnel expenses, rent and utilities, transportation, office supplies and depreciation have witnessed a decreasing trend during the study period, which is a positive sign of growth. Revenue and expense indicator of MFIs have shown a mixed trend during the study period.
- **Efficiency**
  Efficiency measures the cost of providing the services to generate the revenue. It has been found from the result that the operating expense by loan portfolio which is considered to be the best indicator of the overall efficiency of a lending institution has been below 20 per cent, indicating the administrative efficiency of MFIs to be greater. The decrease in personnel expense by loan portfolio, average salary by GNI per capita, cost per borrower and cost per loan of MFIs in India during the study period have revealed the higher efficiency of Indian MFIs. It is also found that the borrowers per staff member, borrowers per loan officer, loans per staff member, loans per loan officers and personnel allocation ratio have increased during the study period this has shown the overall productivity of MFIs' personnel in managing clients is high. It can be concluded that the efficiency and productivity of Indian MFIs have improved during the study period.
- **Risk and Liquidity**
  Risk and liquidity of MFIs has been measured with the variables, namely, Portfolio At Risk (PAR) > 30 days, PAR > 90 days, write off ratio, loan loss rate, risk coverage and non-earning liquid assets as a per cent of total assets. It has been found from the results that the risk and liquidity indicators of MFIs in India have increased during the study period. Portfolio quality is an important variable which reflects the risk of loan delinquency and it has been maintained at appropriate level by the MFIs in India. Sa-Dhan has recommended that the PAR should be less than 10 per cent and it is observed both PAR > 30 days and PAR > 90 days have been maintained at appropriate level during the study period. The percentage of MFIs' loans that has been removed from the balance of gross loan portfolio which are unlikely to be repaid has been high. Indian MFIs have to take effective measures to reduce the write off ratio, loan loss rate and to control

NELA as a per cent of total assets. The PAR of MFIs in India has been given appropriate coverage by impairment loss allowance.

8. Summary of Findings and Suggestions

8.1. Findings

- Indian MFIs are growth oriented. Equity holders will be more interested in investing in Indian MFIs.
- MFIs allocation of assets to their lending activity is greater for India. The gross loan portfolio of Indian MFIs has accounted for more than 7 per cent of the sector's worldwide loan portfolio size.
- The growth rate of number of active borrowers of Indian MFIs is higher.
- The per cent of women clients justifies the social commitment of MFIs.
- Indian MFIs have reached the depth of outreach.
- Profitability in terms of return on equity is better for Indian MFIs.
- Financial revenue by assets is high and Profit margin is weak for Indian MFIs
- Indian MFIs are charging higher interest rate from borrowers.
- Financial and total expenses are high for Indian MFIs.
- Provision for loan impairment and operating expenses as supported by assets are low for Indian MFIs.
- Indian MFIs are more efficient as represented by operating expense/loan portfolio, average salary/GNI per capita, loans per staff member and personnel allocation ratio.
- Risk coverage is high for Indian MFIs.

8.2. Suggestions

- Government can take measures to give financial Institutional status (status of Bank) based on the consistent performance of MFIs (to those who quality the conditions)
- RBI can set up regulatory authority to monitor the performance of microfinance Institutions. Though the microfinance Institutions follow the norms and standards set by RBI, a separate regulatory authority would more efficiently monitor performance of MFIs. Similar practice can be followed in those countries where the information availability is limited.
- MFIs in India can become sustainable through efficient asset management, cost management and leverage management resulting in robust growth in Return on assets, Return on equity and operational self-sufficiency; Increasing gross loan portfolio to total assets, lesser rate of financial expense to asset and operating expenses to assets; greater rate of financial expense to assets. Leverage management can be effective with well-maintained capital asset ratio and debt equity ratio within the limit fixed by the apex bodies.

9. Conclusion

Microfinance has been an important tool in poverty alleviation, empowerment of women and in bringing about financial inclusion. India has the highest number of households, about 145 million, which are excluded from banking system. Also, out of 6 lakh villages in India, only approximately 50000 have access to finance as on January 2011. Hence there exists a great opportunity for the microfinance sector to provide credit to the low income population, thereby, reducing poverty and thus in the development of country as a whole. Technological innovations, product requirements, and ongoing efforts to strengthen the capacity of Indian MFIs are needed to reduce costs, increase outreach and boost overall profitability. Although the microfinance sector has reported an impressive growth, sufficient regulatory and governance would help achieve the goal of poverty alleviation and financial inclusion and this could be achieved with combined cooperation of banks, donors' government, NGO and other players in the country. Thus, continuous efforts are required to diversify the sources of funding available for the MFIs in order to attract foreign Investment for well-established MFIs in order to serve the rural low income population, alleviate poverty and also, make them profitable.

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