ACCESS Development Services

Yale SOM GSE Project

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ACRONYMS

AKMI: Association of Karnataka Microfinance Institutions

AmFA: ACCESS Microfinance Alliance

BRAC: Bangladesh Rural Advancement Committee (now Building Resources Across Communities)

CGAP: Consultative Group to Assist the Poor

CRAB : Credit Agency of Bangladesh

CRISIL: Credit Rating Information Services of India Ltd.

GSE: Global Social Enterprise

I-CAT: Institutional Capacity Assessment Tool

KfW: Kreditanstalt für Wiederaufbau (Reconstruction Credit Institute) German Development Bank

M-CRIL: Micro-Credit Rating International Limited

MFI: Microfinance Institution

MIX: Microfinance Information Exchange

NABARD : National Bank for Agriculture and Rural Development

NBC: Net Bank Credit

NGO: Non-governmental Organization

PSL: Priority Sector Lending

RBI: Reserve Bank of India

RLF: Revolving Loan Fund

SAMN: South Asian Microfinance Network

SHG: Self-Help Group

SIDBI: Small Industries Development Bank of India

SMERA: Small and Medium Enterprises Rating Agency

SOM: Yale School of Management

SPV: Special Purpose Vehicle

TA: Technical Assistance

USAID: United States Agency for International Development'

EXECUTIVE SUMMARY

The prospect of attracting more debt capital to small microfinance institutions ("MFIs") has many obstacles. Small MFIs have lower investment opportunities, but in many cases require the same amount or more due diligence as much larger investments. Additionally, many small MFIs have a short credit history, which increases the perceived investment risk. Finally, small MFIs have less money to spend on operational capabilities and are therefore often have less established internal controls and risk mitigation procedures.

The Yale School of Management ("SOM") Global Social Enterprise ("GSE") Team ("Team") sought to address the question: How can more debt capital be attracted to small MFIs? Examining this problem from the perspective of banks, the Yale SOM Team conducted research and interviews as the basis for developing strategies that ACCESS Microfinance Alliance ("AmFA") can use to increase the flow of bank debt funds to member MFIs.

The highest-priority recommendations to the AmFA focus on efforts that would produce the largest impact with relatively less resource requirements. These recommendations are:

- Align Bank Engagements with Priority Sector Lending Schedule
- Map AmFA's Institutional Capacity Assessment Tool ("I-CAT") & Technical Assistance ("TA") against bank needs
- Use Revolving Loan Fund ("RLF") to Provide Partial Guarantee
- Expand Small Industries Development Bank of India ("SIDBI")-Bank Partnerships.

This document will explore the background, findings, and recommendations associated with nine recommendations, and explore in depth the four priority recommendations.

INTRODUCTION/PROJECT BACKGROUND

Background

Microfinance in India has undergone significant change over the past two years. The two primary channels for lending, Self Help Groups and Microfinance Institutions, have exhibited growth in the number of borrowers of 14% and 60% respectively from 2007/8 to 2008/2009.[1] However, microfinance services still reach only 10% of the poor. The growth in the sector has been driven by expansion of the largest MFIs, while smaller institutions have not grown in outreach or portfolio size, and in many cases, have contracted.[2] Large MFIs such as SKS, Spandana, and BASIX have grown in outreach and balance sheet, driven by equity and debt investments by domestic and international commercial banks, social and private equity investors, and international and domestic development banks and agencies. With the increase in capital, the large MFIs have been able to reach more rural and needy areas, initially concentrated in the south but increasingly in northern regions. In general, smaller institutions that have started up as non-profit entities with small owner equity and limited debt have failed to grow.

Over the next two years, industry experts predict the following trends: [3]

- Continued growth of large and successful MFIs: The success of the large MFIs will breed more success. As they continue to increase the size of their balance sheets, they will become more attractive investment opportunities for commercial lenders and equity investors. This will lead to regional expansion, as the capacity to provide services to more clients will push MFIs into underserved areas.
- Concentration of funds at the top: As the large MFIs continue to grow, investors will continue to invest in these organizations, to the detriment of smaller organizations. Not surprisingly, investors will favor high-performing organizations with large balance sheets and extensive regional outreach.
- More consumer-oriented services: As the large MFIs have become increasingly commercial due to the investment of bank funds, many argue that they have drifted from the original mission of serving the poor. Indeed, this question of “Doing Well and Doing Good” was the theme of the Microfinance India Conference, sponsored by ACCESS. Leaders in the sector are demanding an examination of guiding principles and are placing an emphasis on customer-oriented services. These services may include tailored loan packages and “credit-plus” services, which can include health, livelihoods, or educational support Microfinance organizations, both large and small, will be called upon to respond to customer needs.

The microfinance sector in India is generally divided into Tiers. Interviews with industry players revealed that organizations have their own distinct delineations between tiers often in terms of number of borrowers and lending portfolio. However, firms can generally be broken into three groups:

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[1] Srinivasan, N. Microfinance India State of the Sector Report 2009. Sage Publications India Pvt Ltd, New Delhi, India. 2009.
[2] This assertion is based on anecdotal evidence presented in a roundtable meeting with members of the ACCESS Board of Directors on January 4th, 2009 at the ACCESS office in New Delhi, India.
[3] Ibid.

- Tier 1: 2% of MFIs; 70% of clients
  Large, highly-functioning organizations, with ample flow of debt and equity investment.
- Tier 2 & 3: 98% of organizations; 30% of clients
  Small organizations that often reach underserved and remote areas; often have difficulty in accessing funds; often lack adequate capacity and require technical assistance to attract investment; often provide "microfinance-plus" services.

Given this organizational landscape of the microfinance industry in India, it is important to ask why smaller organizations should be nurtured in this environment. If the large MFIs are growing rapidly, providing customer-oriented services, expanding outreach, and having little trouble accessing funds, why should ACCESS continue to support the small and struggling MFIs? Discussions with the ACCESS team revealed the following rationale for this continued support:

- Small MFIs often are the first to enter a remote or underserved area. Once this path is established, large MFIs will often times enter the market, providing a competitive challenge to the local organizations. Thus, an importance should be placed on supporting these organizations whose missions drive them to provide services to the poorest of the poor, a segment of the population that is increasingly neglected by the larger, more profit-driven MFIs.
- Small MFIs typically offer locally-responsive "credit-plus" services, including livelihoods, health, or education in addition to the lending services. While some of the larger MFIs also offer these services, it is important to support the development and growth of regional organizations that respond to local needs.

Conversations with the ACCESS team revealed that perhaps these arguments are not always strong enough to justify the sustenance of the smallest organizations that struggle to raise funds. Thus, the possibility of converting some of the smallest and least financially-viable MFIs to alternate forms of development organizations, such as business correspondents, should be considered. While this topic falls outside of the scope of this project, we recommend that ACCESS pursue this line of research and action.

About ACCESS

ACCESS Development Services is registered as Not-for-Profit Section 25 company with its headquarters office in New Delhi and branch offices in West Bengal, Rajasthan, Madhya Pradesh, Orissa and Andhra Pradesh. ACCESS focuses on providing fee-based technical services in the microfinance and livelihood sectors.

ACCESS Development has concentrated largely on the institutional strengthening of Tier II and Tier III Microfinance Institutions. Compared to Tier I MFIs, these smaller institutions often have weaker governance, lower quality of human resources, lower capabilities in financial management, and weaker risk/control systems. It follows that these smaller MFIs are perceived as high risk by the capital markets and therefore are generally denied on-lending funds that would stimulate their growth.

About AmFA

AmFA was established by ACCESS in October 2007 to streamline the provision of technical assistance to MFIs and to focus more effectively on helping its clients in obtaining capital to fund their respective operations.. AmFA adopts a three-pronged strategy of providing need-based technical services to its members; building operational and strategic relations with major providers of capital; and developing linkages between funders and MFIs. AmFA currently has 90 members.

Problem Statement

Small MFIs require capital to fuel growth of lending portfolios. This capital may come from many sources, including equity, grants, or loans. This research project focuses on the issue of loans. AmFA members face significant challenges in attracting debt funding from banks for three reasons: 1) investments in fledgling MFIs represent small investing opportunities, often too small to attract the attention of banks; 2) AmFA MFIs often lack credit history; and 3) AmFA members often have less sophisticated operational capabilities.

The main question this consulting project will seek to address is: How can more debt capital be attracted to AmFA's Tier II/III MFIs?

Scope of Work

The Yale SOM and ACCESS Teams met in September 2009 to formulate the project's scope of work. While many potential areas of focus were discussed, including analyzing the menu of services offered by AmFA, expanding relationships with corporate partners, and stimulating various forms of funding to MFIs including equity investment and grants, the Teams settled upon the topic of the flow of debt funding to member MFIs.

INITIAL HYPOTHESIS

In seeking to answer the question of how more debt capital can be attracted to Tier II/III MFIs, the Yale SOM Team focused on decreasing risk and uncertainty to banks and foundations in providing debt investments. The initial hypothesis was that banks and other lending institutions would be willing to provide more capital to smaller MFIs if the risk (both perceived and actual) to their investment was reduced to a level more in line with Tier I MFIs (traditional recipients of bank loans).

Four specific areas of risk reduction were identified and investigated:

- the use of rating/assessment systems
- the use of financial instruments
- operational/organizational capabilities improvement (for MFIs)
- the network benefits of MFI aggregation

Ratings and assessments are evaluations of organizations performed by outside parties which are used by banks as a mechanism to support the findings of conducting their own due diligence analysis of MFI investments. Financial instruments such as guarantees, syndication, and loan aggregation are methods used to decrease risk in financial transactions and have not been utilized to any significant degree to promote the flow of funds to MFIs in India. Technical assistance to strengthen operational/organizational capabilities is at the heart of the value that ACCESS Development traditionally provides to MFIs; increased operational and organizational effectiveness can decrease the risk of default and thus mitigate the risk to banks investing in Tier II/III MFIs. Networks of member MFIs can be used to aggregate information (e.g., Microscan), pool capital, and share best practices, which are all potential methods of lowering risk to banks and foundations for providing funding.

METHODOLOGY

The consulting project as determined by the joint ACCESS / Yale SOM team was research-based, and thus primary and secondary sources of data and analysis were consulted to formulate the recommendations presented in this report. Information was collected using the following four methods: online survey, interviews (phone and in-person), primary data analysis, and secondary research.

I. Online Survey

The team developed a survey consisting of four broad categories, included in Appendix 1. The ACCESS team identified twenty-two people to do the survey; of these, eight completed the survey. The results of the survey are also included in Appendix 1. These were all funding institutions active in the Indian market, both profit- and mission-driven.

II. Interviews

Interviews were conducted with sixteen individuals; of these, nine were conducted by phone and seven were conducted in person. A complete list of interviewees is included in Appendix 2. The individuals interviewed were from three main categories: lenders or investors into MFIs, MFIs within the AmFA network, and industry experts. The questions asked during the interviews elaborated upon responses provided in the surveys, and allowed the team to garner responses on the four initial hypothesis areas, and later, the three additional topics of research for this project.

III. Primary Data Analysis

ACCESS provided the GSE team with raw data on MFIs within the AmFA network. This data was analyzed in the context of our relevant areas of study. The results are presented throughout this report.

IV. Secondary Research

Research specific to microfinance, networks, India's lending environment, and Indian lending institutions was conducted to test and support both the initial hypothesis as well as the follow-on recommendation areas. Among the resources consulted were: Consultative Group to Assist the Poor ("CGAP"), The Microfinance Information Exchange (the "MIX"), various bank and MFI websites, and news media outlets. These resources are referenced throughout this report and a complete list of resources is listed in the bibliography.

KEY FINDINGS

I. Ratings/ Assessments / "I-CAT"

Background

Rating agencies were created both to reduce risk and decrease transaction costs by providing an independent assessment of the credit-worthiness of financial institutions. The idea is that banks and investors can decrease their spending on internal due diligence by using an outside agency that specializes in risk assessment. Major credit agencies for corporate debt include Moody's, Standard and Poor's, and Fitch.

Investors can also benefit from rating agencies that specialize in the evaluation of MFIs or internal assessment tools. Rating agencies are government approved and more professional versions of in-house assessment tools. As microfinance lending has increased, several rating agencies have been created to focus specifically on ratings of MFIs, with Micro-Credit Rating International Limited ("M-CRIL") emerging as an industry leader, especially in India.

Research/Survey Findings

The SOM GSE Team surveyed and interviewed numerous state banks, private banks, and foundations on the topic of ratings and assessment systems. There was almost unanimous agreement that institutions making investments in Tier II/Tier III MFIs rely almost exclusively on their own internally created and administered due diligence systems. While these institutions mentioned that they use reports by M-CRIL, Credit Rating Information Services of India Ltd. ("CRISIL"), and Small and Medium Enterprises Rating Agency ("SMERA"), these rating agency reports are considered to be a secondary resource and serve as a complement that is referenced in investment assessment reports by the reviewing entity. Based on the surveys and interviews conducted, the Team found that none of the banks would consider using any of these rating agency reports as a direct substitute for detailed internal due diligence processes.

The SOM GSE Team also explored the use of assessment tools and more specifically the value of Access Development's I-CAT tool. Two general conclusions emerged from this analysis:

- Most institutions do not utilize certification tools and had not heard of the I-CAT tool (SIDBI being the only exception).
- Of those banks/organizations who had heard of the I-CAT, most did not find it particularly useful (SIDBI again being the only exception).

Implications/Recommendations

Recommendation A: Use I-CAT as an internal tool to indicate what TA services are needed

The above findings indicate that ACCESS Development will have a particularly hard time marketing the I-CAT to banks as a method to evaluate MFI investments. Instead, ACCESS should use the I-CAT as an internal tool to assess what types of technical assistance might be needed by its member MFIs.

Recommendation B: Encourage Tier II network members to attain Standard Ratings

ACCESS should encourage its member MFIs to get rated by M-CRIL (the rating system most banks favored) so these findings can be shared with banks considering such investment opportunities.

II. Networks

Background

Networks in India
According to MIX Market, there are 107 networks of MFIs worldwide.[4] Three Indian networks recognized by MIX Market are the Association of Karnataka Microfinance Institutions ("AKMI"), Sa-Dhan, and South Asian Microfinance Network ("SAMN"), which has members in Pakistan, Afghanistan, Sri Lanka, and India.[5] It is notable that AmFA is not listed by the MIX as a network in South Asia. AmFA management should advocate that the AmFA network be included in the MIX list.

Networks provide a range of services to members, including sharing of information and best practices, capacity building, facilitating access between donors or lenders and grantees/borrowers, policy advocacy, and research. While no Indian network provides all

[4] "Networks". http://www.mixmarket.org/networks (Accessed 27 November 2009).
[5] The MIX website reports that AKMI has one member, Sa-Dhan has 46 members, and SAMN has zero. However, according to the company websites, AKMI has 15 members, Sa-Dhan has 170, and SAMN has 18. Given the unreliability of the MIX numbers, regional and global averages are not analyzed in this report.

of these services, the services provided by each are reflected in the table below. It is notable that AmFA offers a scope of services comparable to other networks in India.

	Sa-Dhan	SAMN	AKMI	Accion	AmFA
Number of MFI Members	170	18	15	3	90
Information Sharing	✓	✓	✓	✓	✓
Capacity Building / TA	✓	✓		✓	✓
Linkages between funders and MFIs		✓	✓		✓
Policy Advocacy	✓		✓		
Research	✓		✓	✓	✓

Sources: The MIX, company websites.

In addition to the existing capabilities of a network, the Team explored the possibility of using the network's position as an intermediary between banks and network MFIs to increase the flow of debt capital.

Priority Sector Lending

A potential strength of the AmFA network is the ability to use AmFA's regional presence to leverage lending to AmFA MFIs that satisfies the PSL requirements set by the Reserve Bank of India ("RBI"). The RBI requires banks to make a certain percentage of its loans to "Priority Sectors". These sectors range from agriculture, for which a specific amount of lending is required, to consumption loans, and micro-credit provided to Self-Help Groups ("SHG"s) and Non-governmental Organizations ("NGO"s), for which there is no specific mandate. Mandated lending percentages appear in the table below. After removing percentages dedicated to other priority sectors, microcredit and microfinance organizations are eligible for 12% of priority sector lending from domestic banks, and 10% from foreign banks.

	Domestic Banks (Public & Private)	Foreign Banks
Total Priority Sector Lending Required	40%	32%
Total Agriculture	18%	-
Small Scale Industries	-	10%
Export	-	12%
Advances to Weaker Sections	10%	-
Total Priority Sector Lending Available to MFIs	**12%**	**10%**

Source: Reserve Bank of India[6]

[6] "FAQs: Priority Sector Lending". http://www.rbi.org.in/scripts/faqview.aspx?id=8, Accessed 29 November 2009.

The interest rate for lending to priority sector institutions is not set by the RBI, and instead is market-driven (the only exception being for loans less than Rs. 200,000, or about US$4,000, on which no more than the prime lending rate can be charged). If a domestic bank does not meet its priority sector lending requirements, the balance of loans are required to be made to the National Bank for Agriculture and Rural Development (NABARD) at a rate set annually. Foreign banks are required to lend any priority sector shortfall to SIDBI at a lending rate of 8% per year. The current prime lending rate in India is 11.0% – 12.0%. Thus, given that the interest rate for priority sector lending is market-driven for loans exceeding Rs. 200,000, it is in the financial interest of banks to make loans to priority sector institutions rather than to NABARD or SIBDI.

Research &Survey Findings

Network Membership

A stated hypothesis of the GSE research project is that network membership increases the attractiveness of a small MFI to potential lenders. The survey results confirm this hypothesis: commercial and socially-motivated lenders responded that there is value in aggregating MFIs into a network. According to the survey, lenders most highly value:

- The provision of technical services
- Sharing of best practices among member MFIs.

Interviews revealed that membership in a network provides an additional stamp of approval, but, not surprisingly, this membership is not enough to trigger investment. Large institutions, such as HSBC, rely on internally established criteria and measurements of institutional strength. One respondent warned that networks must, “flag issues related to competence of [MFI] management and the choice of clients.” The value of a network lies in its ability to evaluate organizational strengths and weaknesses and support the growth organizations through the provision of technical assistance.

Additionally, the interviews indicated that a network should selectively accept members into the network. Without a guaranteed minimum threshold of performance, a network loses its value as an indicator of institutional strength. The question of criteria for membership, both on the high-performing and low-performing sides of the spectrum, was discussed during the meetings which took place with the ACCESS team in Delhi in January. Thus, the question of setting specific organizational criteria for acceptance into AmFA will appear later in the paper as a recommendation for further study.

Priority Sector Lending

Banks demonstrate mixed performance with regard to Priority Sector Lending. Of the banks with data publicly available, HDFC is the strongest performer, having loaned 56% of available net bank credit (“NBC”) to priority sectors in the past year. Axis Bank is the weakest performer, having loaned 28% of NBC to priority sectors.

Priority Sector Lending as a Percent of NBC:

International	
HSBC	33%
Domestic / Private	
AXIS	28%
ICICI	51%
HDFC	56%
Domestic / Public	
Punjab National Bank	42%
State Bank of India	"Target Achieved"
Bank of Baroda	46%

Sources: Bank Annual Reports.

These results indicate that domestic, public banks are meeting requirements for priority sector lending of 40%. The only international bank with information publicly available, HSBC, also meets the lower international requirement of 32%. Domestic private banks show mixed results.

Conversations with bankers reveal that PSL transactions are concentrated at the end of the year. In the few months before the end of the fiscal year, bankers scramble to find suitable loans to meet annual targets. If loans are not made by banks themselves, loan packages are traded among banks, adding transaction costs to the cost of meeting priority sector requirements. Systematic schedules and processes for making priority sector loans throughout the year do not exist, and instead, risk evaluations are made quickly at the end of the year or traded, with money disbursed just before the end of the fiscal year deadline.

In public sector banks, PSL is decentralized to regional offices and local branches. In our interviews, bankers mentioned that bank personnel at the local level generally concentrate on the traditional PSL sectors like agriculture and small industries. As a result they tend to ignore MFIs as a target segment for PSL.

Implications/Recommendations

Recommendation C: Create opportunities for information sharing across the network

Lenders emphasized the value of learning across institutions. Thus, AmFA should leverage the benefit of having MFIs clustered at the state level to facilitate cross-institutional learning. If AmFA can demonstrate to banks and other institutions that organizations within the network successfully share and execute on best practices, these providers of debt capital will be more willing to lend to the institutions within the network.

The current regional meetings provide opportunities for local branches of banks and MFIs to come together at the local level. This is a very important type of meeting that should be continued. In addition, a new type of regional meeting should be launched wherein member MFIs come together to share locally-relevant information and strategies. By removing the banks from the meeting, MFI members will be able to speak more openly about current challenges. The regional AmFA representative can structure the meeting around any pressing challenges, for example, multiple borrowing by MFI clients from several different MFIs, and creating an agenda which encourages member MFIs to share best practices.

The focus group conducted with regional AmFA team members revealed that many of the regional officers have nearly weekly, if not daily, interactions with member MFIs. Given the frequency of this interaction, we recommend that AmFA create opportunities for cross-institutional learning by inviting a representative from one MFI to attend meetings or capacity development visits to other MFIs within the same state or district. In this way, the Director of one MFI can share best practices from his or her organization while learning about processes at another organization.

AmFA should also consider launching a website. accessible only to AmFA members. that allows for sharing of information among members. Several international information sharing websites exist, for example Microfinance Gateway, but an AmFA-specific website would provide additional value by allowing members to raise locally-relevant issues and point to local resources. This website could be built off the current ACCESS website, and would provide an inexpensive and potentially high-impact mode of sharing among network members.

Recommendation D: Align Bank Engagement with Priority Sector Lending Schedule

AmFA should implement a strategy across all regions that will systematically bring AmFA network members to the attention of regional banks as potential recipients of priority sector lending.

The focus group conducted with AmFA team members revealed that a systematic approach for presenting investment options to regional bankers does not exist. The following strategy for approaching regional bankers will satisfy both AmFA's desire to systematize the approach to banks, and maximize the potential benefit of priority sector lending requirements.

Regional AmFA managers should set a meeting with the local branch representative of the domestic private and state-owned banks and the foreign-owned banks. In particular, regional AmFA representatives should make appointments with all target bank(s), particularly those that have missed their priority sector lending in the previous year. A meeting should be set for November to establish contact early on in the priority sector lending season. At this first meeting, the AmFA representative should present the bank with data on the spectrum of local MFIs in need of funding. The Microscan publication, the document published by AmFA that contains financial information on select MFIs within the network, should be presented at this time. If ratings are available for the MFIs, these should be presented to the lending institution. In addition, meetings between the MFIs and the banks can be arranged during this time period should this meeting facilitate the loan process. The AmFA representative should select a reasonable number of local network member MFIs, perhaps three or four, and in December, ensure that information for these organizations is compiled into information decks, and financial audits are being completed. In January, this information should be presented to the banks with full explanation of the financial and performance status of the MFIs. The AmFA representative should come to the meeting with as much data as possible on the bank's recent performance on priority sector lending; for example, if the bank missed its target, by how much did it miss? A clear link between priority sector lending opportunity and lending to AmFA members should be made.

The representative should remind the banker by email or meetings of the eligibility of MFIs for priority sector lending until the deadline of the fiscal year end in March.

The schedule outlined above is summarized in the table below.

One time	November	December	January	February	March
Standard ratings MFI Information deck template (in discussion with banks)	Awareness campaign Distribute MicroScan to Banks. Organize Bank-MFI meets	MFI to prepare Information decks for banks. Finalize Financial Audits	Presentation to Banks	Loan approvals/ Documentation	Loan disbursement

Going forward, AmFA should collect data on regional bank lending and track which banks both achieve and do not achieve their priority sector lending targets.

III. Services to MFIs

Background

In order to assess which AmFA services were valued most highly by banks and other funders, the Yale team distributed surveys and conducted interviews with various banks, financial institutions, and foundations. Respondents were asked to rank the following nine key investment criteria:

1. Financial Strength of MFI
2. Size of Loan Portfolio of MFI
3. Strength of Corporate Governance
4. Quality of Management Information Systems
5. Historical Loan Delinquency Rates
6. Rating from External Rating Agency

7. MFI Portfolio Growth
8. MFI Management Team
9. Profile of MFI Clients (Geography, Line of Business)

Research/Survey Findings

Of the nine, the highest ranked were the financial strength of the MFI, the MFI's Management Team, and the strength of corporate governance. Additionally, there was an emphasis placed on the size of the MFI loan portfolio, MFI's portfolio growth, and the historical loan delinquency rate.

Respondents also provided feedback on areas outside of the nine outlined criteria that were highlighted during their respect due diligence processes. One particular area given high prominence included process stability, particularly in the area of internal controls and other established operational procedures. Of particular interest, was that of human resource quality, not only in terms of hiring employees but also in the training provided and the degree to which each organization's evaluation of individual and group performance was conducted effectively on a periodic basis. On the foundation side, there is a strong priority on alleviating poverty, particularly in those areas that are currently underserved by MFIs, which is paramount over many other considerations. While this focus is heavily emphasized, many foundations have been charged with careful evaluation of a threshold where the business case considerations must be met to ensure sustainability over a longer term and potential for profitable growth. Other areas assessed during the evaluation procedures are the track record of management and governance, along with core management practices and the transparency with which decisions are made.

Implications/Recommendations

Recommendation E: Map I-CAT and TA against bank needs

The findings above have several implications for AmFA with respect to the strategies it can employ across several of its business areas. Most simply, it can utilize the information to establish criteria in targeting a preferred MFI base of customers in order to best position its network to attract funding from various sources. Additionally, it can highlight aspects of its services to enhance the value provided through the measurement of key organizational capabilities which are assessed in the due diligence process of various interested parties.

With respect to foundation and public funding sources, ACCESS should assess the prospect of targeting MFIs with particular goals in line with the areas of each funder's core priorities. This will help to increase the attractiveness of the overall cluster of clients to these foundations and enable ACCESS to more efficiently and fully develop relationships that will facilitate funding going forward.

These additional metrics identified should be incorporated into the I-CAT evaluation system. One option is to develop alternative versions of the I-CAT at various price points in order to attract a wider variety of interested parties who may have different criteria that they wish to assess, particularly in the case of foundations. This adjustment to the I-CAT will help in enhancing the system's credibility and allow it to be utilized by those MFIs for whom a rating may not be appropriate.

Finally, a systematic evaluation of technical services offered by AmFA should be undertaken to confirm that the services it offers its members support the metrics most valued by banks. The scope of this engagement did not allow for a mapping of this kind, but a subsequent study should look closely at the services offered, services actually provided, and services most valued by banks.

IV. Use of Financial Instruments

Background

In recent years tools developed in private capital markets have been adapted to the microfinance industry with the goal of increasing capital available to MFIs. A number of instruments, including securitization and guarantees, have been used with various degrees of success.

Definitions used:

- Securitization is the aggregation of debt instruments into a pool or Special Purpose Vehicle ("SPV"), and the issuance of new securities backed by this pool.

- A guarantee is a promise by a third-party to assume a debt obligation in the event the borrower defaults.

After an evaluation of the financial instruments available to ACCESS, it seems that the biggest opportunity lies in the area of credit enhancements or guarantees. However, due to the need for detailed information and the high level of competition for private capital, ACCESS needs to continue its efforts in assisting MFIs with their internal operations before financial instruments will greatly increase the private funding into Tier II/III MFIs. In addition, ACCESS should expand its current partnership with SIDBI to attract more private debt capital into the network MFIs.

Research/Survey Findings

Securitization
Securitization enables issuers (MFIs in this case) to access additional funding, as well as the ability to transfer to investors certain risks of the underlying assets (such as credit, prepayment, interest rate, etc.). In most deals the issuer usually continues servicing the loan portfolio on behalf of the investors.

For investors, purchasing a security is easier and has lower transaction costs than investing in the issuing organization (if it is possible at all) or purchasing the loan portfolio. For example, through securitization investors can rely on ratings provided by agencies and lower their dependence on more costly internal research[7].

There are a number of requirements needed to successfully securitize any asset including MFI loans[8]:

- Large loan portfolio: securitization has large fixed transaction costs (fees to investment bank, rating agency and regulatory agencies to name a few), economics of scale are needed, necessitating a large portfolio.
- Robust management information system: information is needed to categorize loans, monitor performance and calculate bond payments. Information needed includes loan size, date of issuance, interest rate, location, loan purpose. MFIs need a powerful management information system to provide this information to investors.
- Enabling environment: a legal framework is needed for securitization, including a regulatory agency to provide investors with added assurance and a market to provide liquidity.

In recent years, there have been a number of landmark transactions securitizing MFIs loans in India, for example:

- May 2004: SHARE Microfinance securitized a portfolio of approximately Rs. 20 Crore (or US$4.3 million), ICICI Bank purchased the portfolio. The transaction was the largest at the time and ground breaking in India[9]
- March 2009: Equitas Micro Finance India Pvt. Ltd securitized a portfolio of Rs. 157 million (or US$ 3.4 million). CRISIL rated the portfolio, IFMR Capital structured & arranged the transaction[10]
- April 2009: SKS (one of the largest microfinance institutions in India) securitized a portfolio of RS. 100 Crore (or US$ 22 million). The deal received the highest safety rating from CRISIL and was arranged by a local private bank, YES Bank[11]

Securitization of MFIs loans in India is at an early stage with some private sector Indian banks active in the space. Due to the requirements of a large portfolio and deep borrower knowledge, securitization has only occurred with the largest and most established MFIs in India. Securitization of loan portfolios from multiple MFIs has not happened to date;

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[7] Braganza, Royston and Shrivastava, Shahi, *Primer on Securitization,* www.garmeencapital.in
[8] Stieber, Sharon, *Is Securitization Right for Microfinance?* Innovations winter & spring 2007
[9] Counts, A, Grameen Foundation USA Announces Historic $4.3 Million Securitization Deal in India, http://www.microfinancegateway.org/p/site/m/template.rc/1.26.8473/
[10] Equitas announces the first ever rated micro-loan pool backed securitization transaction http://www.thaindian.com/newsportal/uncategorized/equitas-announces-the-first-ever-rated-micro-loan-pool-backed-securitization-transaction_100164906.html#ixzz0cPAek5HF
[11] "SKS Microfinance lines up yet another securitisation deal for Rs 100 crore," April 02, 2009, www.business-standard.com

the main issue preventing this is the lack of standardization of lending and reporting standards across Indian MFIs.

Guarantees
Guarantees of MFIs' borrowing are generally provided by parties interested in increasing the flow of capital into MFIs and/or surety companies. For example, the securitization by ProCredit Bank in Bulgaria had guarantees from The European Investment Fund and Germany's KfW (a state-supported development bank). Surety Companies' sole business is providing guarantees for a fee, their involvement in the transaction being to provide investors with added confidence due to their AAA rating[12].

Grameen Capital is very active in the area of guarantees for MFIs. It was announced on October 2009 that they have partnered with USAID to make available US$162.50 million to MFIs throughout the developing world. The 12-year program will be the largest credit guarantee to date for USAID. Grameen Foundation will be manage the credit risk and vet the organizations who want to ACCESS the funds. Both organizations will issue joint guarantees[13].

Throughout the interviews, there were multiples references to how Grameen Capital has used guarantees in the past. Private banks are very supportive of the idea; as they see it as a way for sponsors to "put their money where their mouth is".

Revolving Loan Fund
ACCESS grew out of a large microfinance program funded by the United Kingdom's Department for International Development ("DFID") and implemented by CARE. At the end of the program a USD 3 million bank balance, Revolving Loan Fund ("RLF") could not be transferred from CARE to the new Indian-registered Not-for-Profit Section 25 Company. The Indian government places international funding restrictions on such companies in the first years of incorporation. This waiting period will be over in 2010 and it is expected that CARE will transfer the money to ACCESS.

SIDBI-ACCESS Relationship
As part of its strategy for scaling up operations of emerging MFIs within the AmFA network, ACCESS initiated a major strategic agreement with SIDBI to provide on-lending support to Tier II and Tier III AmFA members. Through this agreement, SIDBI will provide up to Rs. 100 Crores to these smaller institutions, and help them scale up their operations. The role of ACCESS in this partnership is to identify potential MFI partners, provide capacity building and mentoring support, and facilitate on-lending support from SIDBI. The weak areas of the institutions are identified through ACCESS's I-CAT and a business plan is subsequently elaborated accordingly. Following the identification of the gaps, ACCESS provides technical assistance and capacity building to

[12] Stieber, Sharon, *Is Securitization Right for Microfinance?* Innovations winter & spring 2007
[13] "USAID Joins with Grameen Foundation to Launch Largest Guarantee in Program's History," Press Release USAID, October 21 2009

the MFI. Along with this, ACCESS also assists the institution with submission of loan applications to SIDBI and ensures a follow-up of the process

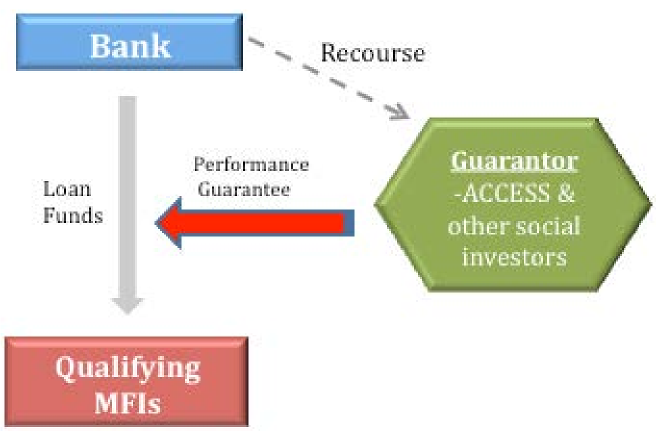
Recommendations

Recommendation F: Encourage standard financial reporting across network members to facilitate future securitization

While the packaging and securitization of loans from different ACCESS network members is not a viable option at the moment, ACCESS should take steps to ensure its members are ready when the time is right. As ACCESS is not a financial institution it will not be able to package and sell the securities. However, it can work with network members to standardize procedures, definitions and lending criteria, helping to enable the packaging of loans across MFIs in the longer term.

Recommendation G: Use funds from RL) to provide partial guarantees

The availability of financial instruments to minimize the credit risk to lending institutions has historically been limited with Tier II/III MFIs. Based on our interviews to date, the most significant opportunity in this area will likely take place through the use of guarantees.



A similar structure could be used by ACCESS for its MFI members.

ACCESS could use some of the RLF funds it expects to receive to provide a third-party guarantee to partially cover the risk exposure banks take in lending to AmFA members. While the USD 3 million will not cover all the funding requirements for AmFA members, it enables the creation of new relationships between banks and network members.

Recommendation H: Leverage relationships to encourage donor guarantees

ACCESS can leverage its existing contacts to encourage donors to provide guarantees for network MFIs. While the other instruments will require continued technical assistance to the network MFIs, a guarantee will be a game-changer giving confidence to the loan issuer. On the other hand, guarantees can be dangerous if the incentives of financial institutions to conduct the necessary due diligence on the transaction are taken away. Hence, it is imperative that guarantees do not shift all the credit risk to the guarantor and financial institutions are still exposed to some of this risk and thus will be incentivized to conduct the proper due diligence and monitor loan performance.

Recommendation I: Expand SIDBI Partnership and utilize to attract institutional debt capital

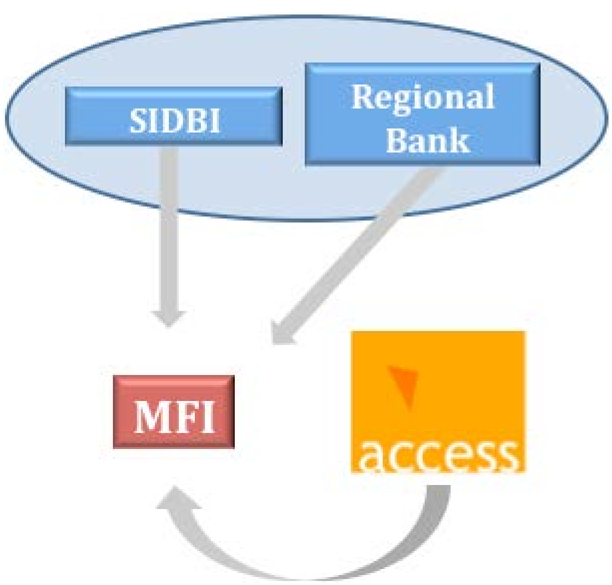
.

The current arrangement with SIDBI can be leveraged to attract commercial banks to lend to these same MFIs. Under the current arrangement SIDBI provides an initial grant to the MFI to pay for the technical services from ACCESS. This enables the MFI to strengthen its systems and processes and become sufficiently creditworthy for SIDBI to provide funding.

Typically, SIDBI would enter into a lending relationship with the MFI by taking a relatively large exposure and as a result end up as the largest lender to the MFI. From SIDBI's perspective, this results in significant risk exposure to a small MFI. This risk exposure is heightened because lending to an MFI is typically not backed by collateral. In addition, MFIs usually have insufficient equity because of the use of significant financial leverage to generate returns. In the absence of collateral the loan repayment, recovery is dependent on the strong operating performance of the MFI.

One way to mitigate these risks is to bring a second lender into the relationship that can conduct an independent due diligence on the MFI. Commercial banks generally prefer to be one among multiple lenders to a single borrower as compared to being a sole lender. The second bank would conduct an independent due diligence exercise at periodic intervals, which would also provide better credit monitoring of the MFI.

The illustration below shows how the proposed tie-up would work:



The second lender should initiate its lending relationship to the MFI with a small exposure, for example 25% of the total loan funds extended to the MFI under the SIDBI arrangement. This would enable the MFI to start a concurrent relationship with a commercial bank, while rewarding SIDBI for creating the bank linkages by retaining its status as the main lender to the MFI. A key consideration to keep in mind while considering this option is that the borrowing capacity of Tier II & III MFIs is not significant and as a result, the size of the loan made by the second lender may be very small. This may discourage some of the larger commercial banks into partnering with SIDBI in these kinds of transactions. However, ACCESS should aim to target the local branch managers and/or regional bank managers that are looking at creditworthy opportunities within the priority sector. These bank branches would find it attractive to take a small exposure in an MFI where SIDBI has already committed to be the largest lender.

This program would allow SIDBI to share the risk in their investments in MFIs by partnering with a local bank to split the investment and enhance the credit monitoring of its investment.

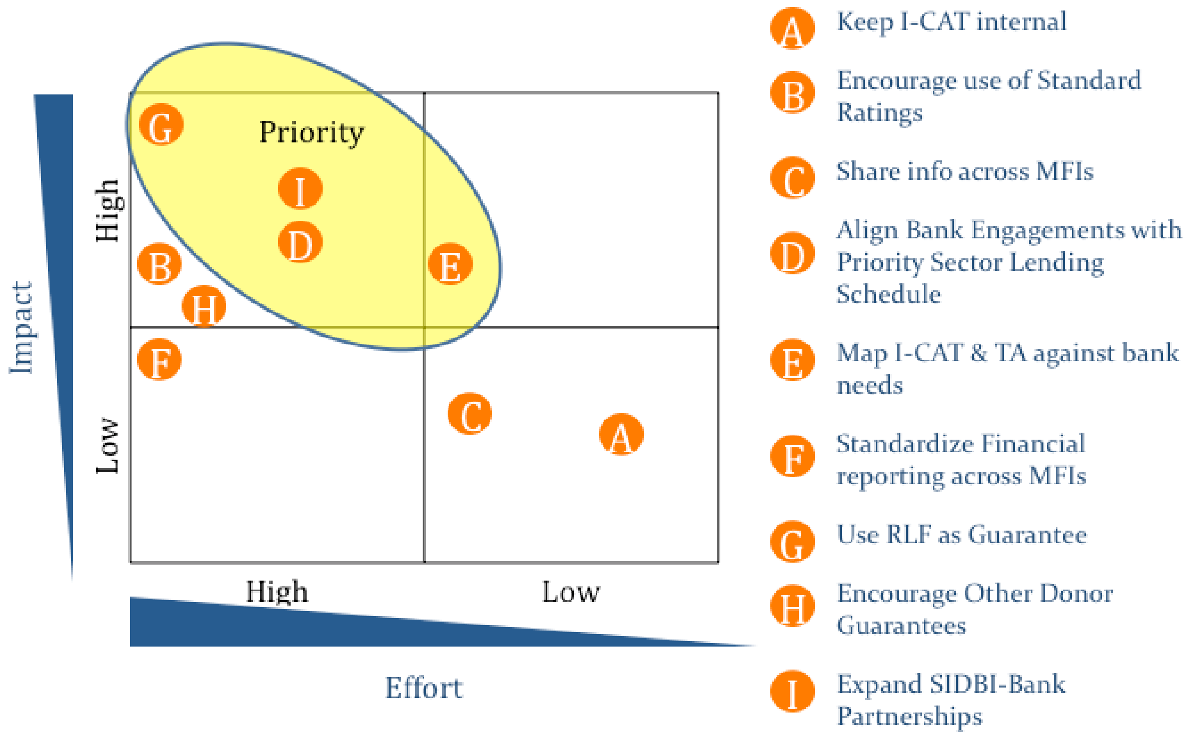
The program would also create relationships between MFIs and local banks that would create a history of lending that could be expanded in the future, hopefully without the need of further capital from SIDBI. This would further SIDBI's goal of creating sustainable MFI-Bank linkages for Tier II & III MFIs throughout the country. Local banks benefit because they are able to share the risk with SIDBI, establish relationship with MFIs, and add valuable investments to their portfolio without excessive transaction costs (doing their extra due diligence as they do not have the assurance that another bank has approved a loan to the MFI). MFIs, despite receiving the same aggregate capital allocations, will benefit by establishing relationships with local and regional banks. In the future, the amount of investment by banks would gradually increase as the history of repayment increases.

PRIORITY RECOMMENDATIONS and ACTION PLAN

Throughout the course of this analysis, nine (9) recommendations have been presented. These recommendations vary in potential impact as well as in the effort required.

To prioritize these recommendations, the Yale SOM GSE Team alongside the ACCESS Team[14] mapped them into a two-by-two framework that measures impact against effort. Moving to the right along the x-axis signified a decrease in level of effort required, in terms of personnel hours, institutional change, and persuasion of other actors. The upper right quadrant contains the ideal recommendations: low effort, high impact.

[14] Meeting between Yale SOM GSE Team and ACCESS January 4 2010, ACCESS Headquarter Office in New Delhi



The relevant effort and impact of each of the nine recommendations was evaluated by the joint team, and the activity mapped on the two-by-two matrix. For example, standardizing financial reporting (Recommendation F) is a task requiring significant provision of technical services as well as buy-in from MFIs; the potential impact of such actions is medium, as securitization will not necessarily begin in response to standardized practices across practices. Thus, this activity falls into the low impact / high effort quadrant. On the other hand, it seems that it would be comparatively lower-effort to map the I-CAT and technical assistance (Recommendation E) to bank needs. The potential benefit of this action is quite high, as it would directly target the areas that the banks highlighted as most pressing to increase their confidence of Tier II/III MFI's.

Mapping the activities yields four activities that we consider "priority," as they fall in the highest impact, and relatively lower effort requirement for each level of impact. These four activities are:

- Align Bank Engagements with Priority Sector Lending Schedule
- Map I-CAT & TA against bank needs
- Use RLF to Provide Partial Guarantee
- Expand SIDBI-Bank Partnerships

We recommend that AmFA undertake these four high priority activities in the short-term.

AREAS FOR FUTURE RESEARCH

The problem of how to attract more debt capital into Tier II/III's MFIs is interconnected with larger issues of the financing and viability of these organizations. Throughout our research and in particular during the meetings in ACCESS in early January 2010 the following areas of future research were identified:

- The identification of all ACCESS partners and a clear protocol of how they collaborate with them. Partners include: investors, banks and cooperating institutions.
- Equity investing in MFIs (a higher leverage is possible than with guarantees)
- Alternative business models for Tier III MFIs, for example encouraging them to become business or banking correspondents
- Viability of packaging MFIs loans into a vehicle that would be attractive to Project Finance teams of large banks

These topics were beyond the scope of this project, but we recommend that ACCESS investigate them further.

APPENDICES

APPENDIX 1: Sample Survey and Survey Results

1. This survey should take approximately 15-20 minutes to complete. It asks questions about your bank's relationship with ACCESS Development, your use of Certification/Rating tools to evaluate MFIs, the use of financial instruments for decreasing Risk, and the perceived value of MFI aggregation. Thank you for taking the time to take this survey. We look forward to speaking with you in greater depth during the interview.

2. Name of your organization?

Text Response
ACCESS Development Services
Maanaveeya Holdings & Investments Private Limited (Indian Subsidiary of Oikocredit)
AXIS BANK LTD
SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA (SIDBI)
HSBC
HDFC Bank Ltd
Grameen Foundation
ICICI Bank
IFMR Mezzanine Finance

3. Name of person filling out Survey?

Text Response
Abhishek Anand
Sundara Rao
NEERAJ SATI
R M NAIR
Pramod Marar
K. Manohara Raj
Gaurav Kumar
Vaibhav Agarwal
Puneet

4. Title of Employee and name of department?

Text Response
Senior Programme Coordinator

Managing Director
ASSISTANT VICE PRESIDENT, MICROFINANCE ADVANCES
GENERAL MANAGER CHENNAI MICRO FINANCE B OFFICE
Senior Vice President & Head – Microfinance
Senior Vice President and Business Head – Microfinance
India Portfolio Manager
Head Credit & Collections
CEO, IFMR Mezzanine Finance

5. Email address of person filling out survey?

Text Response
abhishek@ACCESSdev.org
srao@oikocredit.org
neeraj.sati@axisbank.com
rmnair@sidbi.in
pramodmarar@hsbc.co.in
manohara@hdfcbank.com
gsingh@grameenfoundation.org; gaurav.y.singh@gmail.com
vaibhav.agarwal@icicibank.com
puneet.gupta@ifmr.co.in

6. What is the approximate current size of the Microfinance Portfolio (Total in INR)?

Text Response
NA
INR 2,400,000,000
900,00,00,000.00
Rs.2400 cr
Regret. Cannot share this information in line with our internal guidelines.
9.50 billion
Rs.27.00 Bn
0

Statistic	Value
Total Responses	9

7. What is the projected size of the Microfinance Portfolio (Total in INR) in 1 year?

Text Response
X
NA
INR 3,500,000,000
1250,00,00,000.00
Rs.3500 cr
Regret. Cannot share this information in line with our internal guidelines.
12.00 billion
Rs.40.00 Bn
INR 800 million

Statistic	Value
Total Responses	9

8. What is the projected size of the Microfinance Portfolio (Total in INR) in 3 years?

Text Response
X
NA
INR 7,000,000,000
2000,00,00,000.00
Rs.5000 cr
Regret. Cannot share this information in line with our internal guidelines.
14.00 billion
Rs.60.00 Bn
INR 3500 million

Statistic	Value
Total Responses	9

9. What is the projected size of the Microfinance Portfolio (Total in INR) in 5 years?

Text Response
x
NA
INR10,000,000,000
4000,00,00,000.00

Rs.7000 cr
Not projected for such a time period.
17.00 billion
Rs.75.00 Bn
INR 7000 million

Statistic	Value
Total Responses	9

10. Do external Ratings systems of MFIs lower a banks transaction costs (time, $, etc)? Please qualify responses.

#	Answer		Response	%
1	Yes		6	67%
2	No		3	33%
3	I am not familiar with Rating systems.		0	0%
	Total		9	100%

Yes	No	I am not familiar with Rating systems.
It helps in screening the proposals at first. Very important for the first time lending.	Not time or cost. But for an increased credit appetite.	
Besides reducing cost, time and deployment of human resources, external ratings serves as a Third Party validation of an MFI which gives much credence from the lender's point of view		
It does to an extent but eventually the financial institution has to do its own due diligence		
Cost is reduced. We are currently using in-house rating for got MFIs		
however, it needs to be proper rating system that gives a commentary on risk. A simple relative grading of MFIs does not quality as a rating		

11. Do external or internal Certification systems of MFIs lower a banks transaction costs (time, $, etc)? Please qualify responses.

#	Answer		Response	%
1	Yes		4	44%

2	No		5	56%
3	I am not familiar with Certification Systems		0	0%
	Total		9	100%

Yes	No	I am not familiar with Certification Systems
Lenders do carry out an appraisal of the MFIs before extending any credit. Rating by a recognized Rating Agency (independent view) enables a judicious credit decision	We do not follow any certification.	
Time consumed to process credit is reduced.		
Again depends on the rigorousness of the certification body. Most entities engaging in rating of MFIs do not give a good sense of absolute quality of systems and when (in what circumstances) can one expect systems to creek		

12. How important are Ratings of Microfinance Institutions for making investment decisions for Tier II/III MFIs? (1-100 Scale)

#	Answer	Average Value	Standard Deviation	Responses
1		57.00	27.31	9

13. How important are Certifications of Microfinance Institutions for making investment decisions for Tier II/III MFIs? (1-100 Scale)

#	Answer	Average Value	Standard Deviation	Responses
4		48.13	23.99	8

14. What Ratings/Certification systems does the bank use for investment decisions for Microfinance Institutions? (List all that apply)

Text Response
Approved (by Reserve Bank of India) Rating Agencies
External rating of the MFI by ACCESS/Care/CRISIL/M-CRIL.
Capacity Assessment Rating Reports from M-CRIL, CRISIL, SMERA AND I-CAT FROM ACCESS and Internal Rating using ACCION-CAMEL Rating tool
Internal Credit module
M-CRIL, CRISIL
Own due diligence
We are currently not investing in MFI
External ratings by MFI rating agencies, process audits, IT systems audits. But at the moment internal due

diligence forms the primary basis for decision making

Statistic	Value
Total Responses	8

15. Have you heard of ACCESS Development's I-CAT tool for evaluating Microfinance Institutions?

#	Answer		Response	%
1	I have heard of I-CAT, but have never utilized the tool. (Please specify why not)		3	38%
2	I have heard of I-CAT, and have used it. (Please specify how)		1	13%
3	I have never heard of this tool		4	50%
	Total		8	100%

I have heard of I-CAT, but have never utilized the tool. (Please specify why not)	I have heard of I-CAT, and have used it. (Please specify how)
We have our internal appraisal & rating system	I have closely associated with ACCESS' MFI programs and have sanctioned assistance to a few MFIs
Don't know how it can be useful to our mission and selection of MFIs	

16. If you have used the I-CAT, how would you rate its effectiveness? (1-100 Scale)

#	Answer	Average Value	Standard Deviation	Responses
1		60.00	0.00	1

17. What elements of the I-CAT tool are most effective? (please write in elements that are most important).

Text Response
Capacity assessment, managerial and operational data analysis

18. Has your bank used Financial Instruments to reduce risk of investing in Tier II/Tier III Microfinance Institutions? (For Example: Guarantees, Syndication, and/or Securitization). If Yes, please mention which ones.

#	Answer		Response	%

1	No we have not used these instruments and we do not believe that these would be helpful in reducing risk to investments. (Please explain why you feel this way)		0	0%
2	No we have not used these instruments but we recognize they may be valuable. (Please explain why you have not used it)		2	22%
3	Yes we have used financial instruments but with little success in reducing risk (Please list which instruments)		3	33%
4	Yes we have used financial instruments and have had success in reducing risk because of them (Please list which instruments)		4	44%
	Total		9	100%

No we have not used these instruments and we do not believe that these would be helpful in reducing risk to investments. (Please explain why you feel this way)	No we have not used these instruments but we recognize they may be valuable. (Please explain why you have not used it)	Yes we have used financial instruments but with little success in reducing risk (Please list which instruments)	Yes we have used financial instruments and have had success in reducing risk because of them (Please list which instruments)
	Though there are large no of MFIs operating in India, only few MFIs are acting as II Tier institutions	We have taken exposure in 2 cases basis guarantees.	Personal Guarantees from promotes/ Institutional Guarantee
	The total transaction cost on account of such interventions is exorbitant for the MFIs.		We are providing guarantees to Banks for the loans that they give to MFIs
			Guarantees, Securitization (Direct & Rated Paper)
			FLDG, ACCESS spread trapping, securitisation, guarantees, pooled portfolios

19. In evaluating your bank's decision for investments in Tier II/Tier III Microfinance Institutions (MFI), please rank the following criteria. 1= most important, 11= least important.

#	Answer	1	2	3	4	5	6	7	8	9	10	11	Responses
1	Financial strength of MFI.	4	1	0	1	1	1	1	0	0	0	0	9
5	Historical Loan Delinquency Rates	1	0	1	0	2	1	2	2	0	0	0	9
8	MFI Management Team	3	1	0	2	1	0	0	1	1	0	0	9
7	MFI Portfolio Growth	0	1	2	0	0	1	2	2	1	0	0	9
11	Other	0	0	0	0	0	0	0	0	0	1	3	4
10	Other	2	1	0	0	1	0	0	1	1	1	0	7
9	Profile of MFI Clients (Geography, Line of Business)	0	2	1	0	1	1	0	1	1	2	0	9
4	Quality of Management Information Systems	0	1	0	2	4	1	1	0	0	0	0	9
6	Rating from external rating agency	0	0	1	0	1	2	0	1	2	1	1	9
2	Size of Loan Portfolio of MFI	0	1	1	1	3	0	0	0	1	2	0	9
3	Strength of Corporate Governance	1	1	3	1	2	0	1	0	0	0	0	9
	Total	11	9	9	7	16	7	7	8	7	7	4	

Other	Other
External borrowing profile of the MFI	Market information
Human Resource Quality	
Poverty Focus	
Lenders list.	Investors in the company.
Process stability	

Statistic	Financial strength of MFI.	Size of Loan Portfolio of MFI	Strength of Corporate Governance	Quality of Management Information Systems	Historical Loan Delinquency Rates	Rating from external rating agency	MFI Portfolio Growth	MFI Management Team	Profile of MFI Clients (Geography, Line of Business)	Other	Other
Mean	3.11	5.89	3.67	4.78	5.56	7.44	5.89	3.89	6.11	5.14	10.75
Variance	5.86	9.11	3.25	1.94	5.53	6.78	6.61	9.11	10.86	15.14	0.25

Standard Deviation	2.42	3.02	1.80	1.39	2.35	2.60	2.57	3.02	3.30	3.89	0.50
Total Responses	9	9	9	9	9	9	9	9	9	7	4

20. Does your bank see value in bringing together small MFIs into a Network like the ACCESS MicroFinance Alliance”

#	Answer		Response	%
1	Yes (Please explain in what way)		7	88%
2	No (Please explain why not)		1	13%
	Total		8	100%

Yes (Please explain in what way)	No (Please explain why not)
These networks are mutually benefiting all the partner MFIs. Small size MFIs are not able to see the latent risk in the microfinance operations as operating in a limited geographical areas. Sharing of experience is key to mitigate these risks.	I am not familiar with the structure in order to respond to this.
The Net work will enable information sharing, addressing common issues, create a common platform to take up issues of relevance with respective State Governments and Central Government on Policy related issues etc.	
If it can assist these MFIs in policy advocacy, institutional development and act as a sector guide for other stakeholders.	
Improve industry standards, capacity building, networking	
Deepening their sources of finance. Sharing best practices. Resolving existing problems.	
The key challenge is that most smaller MFI need support structures, without which the costs of capacity building may go out of hand. These associations may also act as a regular feedback on process quality and stability which is extremely critical. However, in the current context most associations do not play a very constructive role. The primary role is limited to doling out grant funds and in subsidizing training programs. Such networks typically never flag issues related to competence of managements, their choice of clients, motivation for provision of finances, etc. Making a large number of such associations seems like an aggregation of poorly managed entities.	

21. Have you used ACCESS Development's MicroScan tool?

#	Answer		Response	%
1	Yes, but we have not used it. (Explain		1	14%

	why not)			
2	Yes, and we have used it. (Explain how)		0	0%
3	No (Why not?)		6	86%
	Total		7	100%

Yes, but we have not used it. (Explain why not)	Yes, and we have used it. (Explain how)	No (Why not?)
		Not forming part of our credit appraisal system.
		Not aware what this tool is.
		I am not familiar with MicroScan.
		Don't know about it.

APPENDIX 2: List of Interviews

Interviews Conducted

Organization	Name	Title	Date
CGAP	Ms. Kate McKee	Senior Advisor on Policy, Poverty Outreach and Aid Effectiveness	10/28/09
Citibank	Mr. Alok Prasad	Director	10/23/09
DFID	Mr. Mahesh Mishra		10/23/09
Grameen Capital	Nigel Biggar	Director, Social Performance Management Center (SPMC)	10/27/09
Grameen Foundation	Mr. Gaurav Kumar		10/20/09
HDFC Bank	Manohara Raj		11/3/09
HSBC	Pramod Marar		10/19/09
HSBC	Unmesh Brahme	Sr. VP for Corporate Sustainability	multiple
ICICI Bank	Vaibhav Agarwal		10/19/09
KPMG	Mr. Ajay Sud	Executive Director of Advisory – International Development Services	10/23/09
Manveeya Holdings	Mr. Sundara Rao		10/19/09
Rabo Bank	Mr. Arindom Datta	Director & Head, Rural and Development Banking	10/28/09
Sangini	Mr. Sunil Patel	Founder	10/27/09
SIDBI	Mr. Srivikant Das		10/26/09
UNDP	Mr. Ratnesh		10/23/09
We The People	Mr. Ajaya Mohapatra	Founder	10/27/09

Interview reports for eleven of these interviews are included below (listed alphabetically by organization)

Interview Report:
CitiBank and Yale SOM
Mr. Alok Prasad (Citi); Sarah Smith (Yale) & Satya Choubey (Access)
<u>Friday October 23, 2009</u>

Industry Overview
Over the past 18 months, banks have become more risk-averse, and funding has been directed to Tier I MFIs. Mr. Prasad does not see any dramatic change on the horizon; there has been upwards of 80% growth in Tier I institutions, so there is no need to look below this level. A few Tier II MFIs will enter into the upper tier, especially if they can be financed by their shareholders. Some Tier IIs will slip down to the bottom tier. He does not see a promising future for Tier IIIs as they will have difficulty accessing capital. He predicts that 100 MFIs will cover the field.

Target Population
Citi is most concerned with creating returns for their shareholders; target population is not a consideration when making lending decisions.

Lending Decisions
Decisions to lend are based on capital and governance.

Ratings
Citi looks at MCRIL and CRESIL ratings, but does not depend on these. In the end, only internal ratings are depended upon.

Tier I/II/III Definitions
Tier I: > 100k borrowers (largest growth; funded by debt & equity)
Tier II: 50k – 100k borrowers (slow growth)
Tier III: <50k borrowers (generally have poor balance sheets and governance; “bleak picture”)

Other comments
Tier II and III institutions will need to apply more stringent financial ratios; the input numbers are not available at this point.
Many Tier II and III MFIs are run by one promoter or CEO, and the institution will fail when this person leaves.

Resources / References
- Cash Por; founded by D. Gibbons; successful story of non-profit plowing returns back into the organization and growing organically. Note that this took him over 10 years.

Interview Report:
DFID and Investment and Yale SOM
Mr. Mahesh Mishra(DFID); Sarah Smith (Yale) & Satya Choubey (Access)
Friday October 23, 2009

Organizational / Program Details
Between 1998 and 2008, DFID focused on building MFIs and increasing their institutional capacity. DFID made wholesale loans to SIDBI, which placed £16.5million in 150 MFIs, and DFID provided technical assistance to the MFIs. This investment yielded organizations with 23 million borrowers and £1 billion in lending capital. For DFID, the most important elements of the MFIs were 1) MIS, 2) transparency to borrowers (full disclosure of lending rates and terms), and 3) professional management. DFID's strategy was to increase the credit worthiness of the MFIs in order to attract capital from banks.

The new phase of DFID's work in microfinance focuses on reaching the poorest of the poor in lagging states by strengthening the support institutions (ratings agencies, investment funds), and supporting technology advances (mobile technology, smart cards).

Ratings / Certification
MCRIL ratings for microfinance in India were developed with financing support from DFID. DFID also created tools to evaluate Self Help Groups (SHGs), but these tools were later internalized by the NGOs themselves.

"MCRIL has monopolized the rating space," said Mr. Mahesh. At one point, demand for ratings exceeded supply; in 2005, it took MCRIL 5 months to produce a rating. Since this time, others have entered the market, including Accion, Microsave, and IMFR (though these are not formal rating tools). While he cannot comment on banks' preferences of ratings vs. certifications, Mr Mahesh is glad to have more raters and certifiers enter the market, to increase competition. Anecdotally, he reports that MFIs have complained about poor treatment by MCRIL.

Financial Instruments
DFID has provided funds to SIDBI, who in turn lent funds to MFIs. DFID funds also have gone directly into capacity development of enabling institutions and capacity building for MFIs. Funds have been provided to MFIs through "transformational loans," which give the lender the ability to transfer debt to equity. Finally, DFID has bought equity stakes in MFIs. The funds that DFID put into MFIs (directly and through SIDBI) were leveraged; by 2008, only 20% of the debt portfolio of investee MFIs was from DFID.

Network of MFIs
Networks should consider providing credit history for its borrowers. The problem of *multiple borrowing* has arisen in certain areas with many MFIs, resulting in multiple defaults. When there are many players in a certain area, corners are often cut and the proper due diligence is not carried out. IFC is leading an effort called SIBIL (of which Access is a participating member) to explore the possibility of a credit bureau.

Networks should also lay out “graduation paths”, to apply a systematic growth trajectory to small MFIs.

Expansion into Rural Regions

DFID’s experience in Orissa has demonstrated a successful way of bringing in microfinance to underserved areas: lure in a big player (ie SKS) with a credit guarantee to demonstrate market potential. The market has flourished in Orissa, as there are now three MFIs with >500k borrowers.

A network could replicate this opening of new markets by pulling one large MFI into a region, as other companies will follow. Networks should consider what these pull factors might be, particularly in the context of the north, which is sparsely populated and has less-developed civil society. Technology solutions should also be explored. Mr. Mahesh assures that he is not fixated on large MFIs, but rather that is necessary to lure these companies first in order to pave the road for smaller MFIs.

Other comments

Resources / References:

- “Task Force on Financial Reform,” by Rajan (?), defines the path MFIs should follow to become banks.
- Gates Fdn. work in microfinance in India

Interview Report:
Grameen Foundation and Yale SOM
Mr. Gaurav Kumar (Grameen Foundation); Julia Park & Igor Khayet (Yale)
Tuesday October 20, 2009

Target Population
Grameen Foundation is an international non-profit organization (not an MFI or bank). The foundation targets the poorest people in the country, mostly in rural populations.

Impact Measurement
Grameen Foundation's has developed several tools to measure the increased living standards of individuals by looking at the type of housing establishments. For example, the Cash Flow Housing Index (CHI), looks at what material houses are made of. Based on this, clients get a score and the foundation can decided who needs to be served.

Lending Decisions
Grameen Foundation does not provide on-lending funds to MFIs. They do however provide loans for capacity building.

Lending Criteria
Grameen Foundation does not provide on-lending funds to MFIs. They do however provide loans for capacity building.

Ratings
Whenever ratings performed by an Indian rating agency are available, they are taken into consideration. However, ratings are used when available but are not the sole decision driver. Grameen Foundation uses M-CRIL, CRESIL tools but are still reliant on internal due diligence systems.

Ratings are used to place emphasis on the areas that Grameen Foundation should focus on in their due diligence. However, a rating system alone would not be enough to provide a guarantee; Grameen Foundation has a poverty focus and that is their main criteria.

Certification
Grameen Foundation does not use certification systems because they do not provide the key criteria that Grameen is interested in (poverty reduction).

Financial Instruments
Grameen Foundation has used Guarantees and looked into other financial instruments but have never utilized them.
In a particular case study, SKS, Grameen Foundation provided a guarantee and the MFI was able to secure 22 times the amount of on-lending funding and better terms (compared with offer without guarantee). However, this is a rare occurrence and the normal multiple with a guarantee is around 5 times.

The internal due diligence process includes:

1. Most Important- Whether the organization is serving poor people
2. Financial Statements, Management, Sustainability/Profitability, Human Resources, etc.

Tier I/II/III Definitions

I- Above 100,000 Clients
II- Below 100,000 Clients
III- 30,000 Clients

Grameen Foundation focuses on the amount of clients to decide Tier level of MFIs and does not consider portfolio size.

Network of MFIs
There is a value in aggregating MFIs in a network. The advantages include support, capacity building, training, etc. One of the current problems is that the information available is not utilized in the most appropriate way.

MicroScan
Grameen Foundation has never heard of Microscan.

Other comments
Access can be successful if they:
1) Collect the right information about the MFI organizations (financials, outreach, growth, etc.)
2) Information should be distributed to financial institutions in an accessible method.
3) Find methods to expose banks to smaller MFI organizations.

Interview Report:
HSBC and Yale SOM
Mr. Pramod Marar
<u>Monday October 19, 2009</u>

Current portfolio

- Loan size - Upto USD 2.5M - 12M
- Target MFIs – large and mid sized MFI
- No. of relationships - 28 relationships (13 credit) – USD 10-12M – Top 15 MFIs.

Do ratings reduce transaction costs -

- As a bank they do their own due diligence. The grading report does not link to te performance of the MFI.
- It is done by a third party, it can act as a verifiable information, but nothing more.
- The sector only has grading, and not rating.
- Grading – sustainability and scalability of the MFI and not the safety of the investment
- MCRIL and CRISL only do grading and not rating.
- Would use grading tool as a guide for further investigation of the MFI on the issue highlighted by grading report.

Internal rating

- Assess an MFI as an NBFC
- Pure financial assessment
- Templated lending scorecard for mid market MFIs (lending less than USD 12M)
- Key financial metrics - Solvency, Not too concerned with liquidity current ratio, Gearing (<7.5x, typical 6.5x), Capital Adequacy (12%)

Human resource quality – Mid level and junior management quality. Keeping risk and operating manuals is not sufficient. Does the company has resources to manage growth. Does the MFI hire local talent to manage the local operations. Does the MFI has a training center for ongoing training programs for skill upgrading as employees get promoted and gain more responsibility.
Networks

- Developmental needs – ability to identify credit plus activities in addition to regular lending.

Most of the nationalized banks have joined MFI bandwagon right now an they may found AMFA network as an attractive proposition. But this may not be too relevant for HSBC as lender because HSBC is more established as an MFI lender tey have already scanned 70-80 MFIs in the country.
Therefore connecting with nationalized bank would be more useful.
Reports they use
Sa-Dhan – networking agency for all MFis in india
CRISIL – Top 50 MFI reports.
MIX market data – not too updated. (audited financials)
Use the data from the reports for mid year financials.

Interview Report:
KMPG and Yale SOM
Mr. Ajay Sud, Executive Director of Advisory – International Development Services; also member of Access Board; Sarah Smith (Yale) & Satya Choubey (Access)
<u>Friday October 23, 2009</u>

Market Opportunities
Currently in conversation with MNC interested in entering MFI market. Will experiment with three approaches: 1) serve as integrator: like AmFA, provide TA and wholesale loans; 2) enter as retail lender, use group lending model; 3) enter through entrepreneur development prospective.

Also in conversation with international MFI lending entity wishing to enter Indian market and make $100m in investments either through debt or equity.

I-CAT
Potential for linkage between KPMG and Access / I-CAT. KPMG might be interested in I-CAT tool as way of identifying need for capacity enhancement in MFIs, for which KPMG could provide TA. The Planning Commission mandates that firms (what kind?) pay 1% towards evaluation; KPMG trying to create presence in this field.
Together, KPMG could present a strong joint brand for the I-CAT.

Network
Networks provide opportunity for provision of high quality TA to member organizations.

Other
- Mr. Ajay predicts consolidation of smaller MFIs; very small MFIs will disappear; but market is not yet saturated.
- Payment structure for TA: consider retainer / milestone model used by some consulting, lawyers in India: if achieve milestone, pay fee
- Potential for collaboration between Access, KPMG, and Yale: case studies on 5 MFIs; write up best practices; how can these best practices be applied across geographies?

References / Resources:
- Equitus: successful urban MFI with strong process, using mobile technology

Interview Report:
Maanaveeya Holdings and Investment and Yale SOM
Mr. Sundara Rao (Maanaveeya); Santiago Ferrer & Sarah Smith (Yale)
<u>Monday October 19, 2009</u>

Relationship with Oikocredit:
Maanaveeya Holdings & Investments Private Limited is the Indian subsidiary of Oikocredit. Oikocredit is a cooperative society that offers loans or investment capital for microfinance institutions, cooperatives and small and medium-sized enterprises in developing countries. The idea of Oikocredit came from a 1968 meeting of the World Council of Churches. Following this, Oikocredit was established in 1975.

Target Population
Maanaveeya targets the poorest of the poor. It aims to reach lower half of the poor using livelihood programs implemented through MFIs.

Impact Measurement
Maanaveeya's main measure of success is the social impact of its projects. To assess their impact they rely on formal assessments, as well as case studies of individual borrowers who have turned their lives around.

Lending Decisions
Maanaveeya has a network of regional representatives that conduct comprehensive surveys of MFIs prior to making the lending recommendation, the recommendation is then considered by the credit committee and it makes the final decision.

Lending Criteria
The main lending criteria (in order of importance) is as follows:

1. Profile of MFI clients, Maanaveeya targets poor population and areas currently underserved by MFIs
2. Management and governance track record
3. Management practices followed and transparency

Ratings
Whenever ratings performed by an Indian rating agency are available, they are taken into consideration. However, ratings are used when available but are not the sole decision driver and it does not pay for ratings. Maanaveeya uses M-CRIL, CRESIL tools; they are open to the possibility of using other ratings tools available. They would not be willing to pay for these ratings (or certifications).

Maanaveeya is interested in attaining social performance measures from third parties, and would be willing to pay for this service. In the upcoming quarter, a report on social performance rating will be released by Maanaveeya.

Certification

Maanaveeya does not use certification tools such as I-CAT as it has its internal certification system. This is likely due to the fact that Maanaveeya has its own rating tool, and the ICAT is not widely promoted. The internal certification tool is called EPT (Electronic Program Transcript). It gathers information such as:

- Area operating
- Population served
- Nature and background
- Products they offer
- Management
- Governance
- Practices
- Detailed risk analysis
- Financials

Financial Instruments
Maanaveeya does not use financial instruments.

Tier I/II/III Definitions
I – Business, not sensitive to the needs to the poor people
II – 50,000 members, 500 million rupees portfolio
III- 10,000 100 million rupees portfolio

Network of MFIs
Have two-fold value:

- Helps mobilize resources for MFIs
    - Including promoting livelihoods along microfinance
- Provide technical assistance to members
    - "Handholding" members
    - Services provided depends on needs of MFIs
        - Sometimes written manuals
        - Product development
    - ACCESS implements, Maaanaveeya identifies needs and ask ACCESS to carry out what is needed

MicroScan
Maanaveeya not used because have own system that is used internationally. ACESS should contact international office to incorporate into common system.

Other comments
Importance of combining livelihoods programs with microfinance, need to promote more this combo.

Interview Report:
Rabo Bank and Yale SOM
Mr. Arindom Datta, President, Rabo Bank; Sarah Smith (Yale)
<u>Wednesday October 28 2009</u>

Organizational / Program Details
Rabo Bank has two arms: a commercial side that places funds in Tier I MFIs (including debt, equity, convertible, hybrid bonds); and a Foundation, that lends Tier IIIs.

Currently involved in study with Basix in which conducting handholding with 12 institutions at 3 different stages. They are trying to use this study to come up with a predictive study; ie, with an investment of 100,000, an institution should look like x in 1 or 3 years.

Foundation Investment Decisions
The foundation's investment criteria include: outreach, systems, management, products, governance, and current clients. Grants and TA are provided, with the goal of positioning small MFIs to receive funding from banks.

Ratings / Certification
Rabo Bank uses its own internal rating tools, and has not used the ICAT. In general, banks have their own policies and will only validate a potential loan based on internal evaluation.

Financial Instruments
See Grameen Foundation's guarantee program. Donor programs should be involved in guarantee schemes.

Syndication will work only for Tier I and upper Tier II institutions. It will NOT work for smaller institutions, as the cost of syndication is too high.

Other comments
Resources / References:
- See Basix's experiments with applying Tier I tools to Tier III institutions
- See MicroSave's best practices

Interview Report:
Sangini and Yale SOM
Mr. Sunil Patel, Sangini; Sarah Smith (Yale)
Tuesday October 27 2009

Organizational / Program Details
Sangini is a member of AmFA.

The organization started out working with tribal and low caste people; in 1995, started accepting savings. In 2002, the MFI was supported by CASHE, and developed into a community owned and professionally managed MFI. Three services are offered: savings, credit (entrepreneur loan and emergency loan), and insurance (from third party). Currently there are 6000 borrowers and 8000 savers. Dividends are paid of up to Rs 200. Four of the nine members of the governance board are borrowers.

Sangini received an A+ on the ICAT [unverified]. Sangini receives management advice, monitoring, and internal audit support from AmFA.

Funding
The MFI's first loan came from Friends of Women's World Banking. Subsequent loans came from SMCS (with a high interest rate of 18%), and SIDBI (Rs 450,000).

"Somehow bankers are not yet comfortable with the cooperative because they are not comfortable with the cooperative governance."

Recently, Bank of India, Development Credit Bank (?), and Axis Bank have asked for proposals. These have come after SIDBI made the loan, and the MFI has demonstrated success in deploying this capital.

Interview Report:
SIDBI and Yale SOM
Mr. Srivikant Das (SIDBI, Bhopal); Sarah Smith (Yale)
<u>Monday October 26, 2009</u>

Target Beneficiary
The target beneficiaries of SIDBI are the poorest borrowers. Only SIDBI and NABARD are making loans to institutions of this size. Priority sector requirements on commercial banks will push some lending to smaller MFIs, but they will for the most part stick to the commercial agenda.

Ratings / Certification
Tier I institutions must use formal ratings, whereas Tier II and III need softer terms and indicators; they would not stand up to a formal rating process. Small institutions get a small loan from SIDBI to build internal capacities; once these capacities are improved, they can go for commercial loan.

Financial Instruments
Syndication can only be used for large institutions. SIDBI has done syndications with SKS and other lenders, but never for small MFIs.

Other Lenders
Oiko Credit and other institutions with not purely commercial goals look for long-term potential of MFIs, and are most concerned with prospect for growth, vision, and governance.

Network
SIDBI is a big supporter of the ICAT. It has an agreement with AmFA to increase exposure to AmFA's MFI members. This will demonstrate to other banks that these MFIs should receive funding.

Interview Report:
UNDP and Yale SOM
Mr. Ratnesh; Sarah Smith (Yale) & Satya Choubey (Access)
<u>Friday October 23, 2009</u>

Organizational / Program Details
To achieve RBI's goal of financial inclusion, UNDP seeks to link regional rural banks with consumers. In 2005, regional rural banks introduced the idea of "no frills accounts", or accounts without a minimum and relaxed "know your customer" rules, to try to encourage everyone to enter the formal banking system. A study in 2008 showed that 70% of these accounts are dormant. UNDP is trying to revise the regional bank approach by improving implementation through a branchless banking system. In this system, bank correspondents facilitate the line between people and banks.

Mr. Ratnesh believes that microfinance institutions are playing a numbers game, and often lure borrowers into taking out loans they do not need. He also identifies the "Walmart approach" of MFIs. MFIs are not able to reach the poorest of the poor, and if they do not immediately find success in a region, they move on. MFIs lack the breadth (limited product offering) and depth (penetrating to poorest of the poor) that consumers require. Banks can provide a broader range of products: microinsurance, micropension, savings.

Critical to the success of UNDP's goal of extending the reach of state-run rural banks is financial literacy. Citi, SEWA, and the Indian School of Microfinance for Women are teaming up to develop training for borrowers in local dialect and provide education on financial planning.

Target Population
Focus on poorest in 7 states: Bihar, Jharkind, MP, UP, Chatiskar, Orissa, Rajasthan.

Tier I/II/III Definitions
Tier II: Re-finance institution, for example, SIDBI; invests into MFIs; provide ground-level staff to place loans; provide technical assistance to MFIs
Tier III: Does not exist in India

Network of MFIs
Networks should codify best practices among members.
An online community could be used to share good and bad experiences (like UNDP's Source Solutions).
AmFA must differentiate itself on the commercial side from SaDahn, who focuses more on policy.

Financial Instrument
AmFA should explore the possibility of syndicating loans of member MFIs.

Interview Report:
We The People and Yale SOM
Mr. Ajaya Mohapatra, We The People; Sarah Smith (Yale)
<u>Tuesday October 27 2009</u>

Organizational / Program Details

We The People is a member of AmFA.

WTP is involved in "livelihoods finance"; provide institutional and capacity building to small businesses. It provides "microenterprise services", not just credit: credit, insurance, savings. The first loan of Rs 5 – 10k given is used for entrepreneurial skill development; the second round of funding is considered a growth loan, in the range of Rs 25k – 50k. 75% of borrowers have graduated to this level. WTP is planning to enter third phase of funding, with a larger loan, for successful enterprises. There are currently ~ 2000 borrowers.

Auxiliary programs have to do with employment, using a web-based platform.

Funding

The first funding was owner's equity. The first loan came from HDFC: Rs 1,000,000. Ajaya says this is because of a personal relationship with the banker. He visited the bank repeatedly, and eventually convinced the bank that his institution was worthy of the loan. [NB: It is quite unusual to have the first loan be a commercial one.]

Follow-on loans have come from Indian Bank, Basix, FWWB, and SIDBI (who has commissioned an ICAT).