

Microfinance institutions redefine their focus

E. Kumar Sharma October 15, 2011

Microfinance is the business of disbursing modest, short-tenure loans without collateral to small borrowers, most of them poor. But a year after new regulations in [Andhra Pradesh](#) - the state accounts for about one-third of Rs 20,000 crore industry in India - that sought more control over the business all but killed it, [microfinance institutions](#), or MFIs, have turned to financing bicycles to tractors, cooking stoves to houses.

The aim: try and crawl out of the pit they are in by reducing risk in their portfolios and diversifying revenue streams. This, they hope, will help them overcome losses and start afresh. As G. Padmaja Reddy, Founder and Managing Director of Hyderabad's Spandana Sphoorty Financial, the second-largest MFI in the country, says, "You have to tell your story all over again, convince investors and lenders and try to rebuild the organisation."

MFIs in India are of two kinds: those regulated by the Reserve Bank of India, or RBI, and called nonbanking finance companies, or NBFC MFIs, and those run by non-profit trusts and societies. NBFC MFIs, which have access to relatively cheap financing from banks under the priority sector lending targets of the lenders, account for over 75 per cent of the loans disbursed by the sector.

Exactly a year ago, in October 2010, the Andhra Pradesh government, reacting to reports of coercive loan recoveries by some MFIs - which had allegedly even led some debtors to commit suicide - promulgated an ordinance imposing drastic curbs on MFI functioning. The ordinance, later made into law by an Act of the state Assembly, requires MFIs to register themselves with multiple state government bodies, declare their interest rates upfront, make all details relating to borrowers public, stop seeking weekly repayments and deny additional credit to borrowers who already have loans pending.



You have to tell your story all over again: G. Padmaja Reddy. Finances tractors, offers gold loans

With the RBI-appointed Malegam Committee also echoing the state government's concerns on customer protection, MFIs were done for. Borrowers in Andhra Pradesh, buoyed by the government's new rules, virtually stopped repaying loans, while banks, disturbed in equal measure, almost stopped lending MFIs any more money, not just in Andhra Pradesh but across the country. The result was inevitable: MFIs tumbled into the red. The situation is so bad that

some believe the some Rs 7,000 crore loan outstandings in Andhra Pradesh run the risk of turning into non-performing assets.

The country's biggest MFI, SKS Microfinance, recorded a loss of Rs 70 crore in the fourth

quarter of 2010/11 against a net profit of Rs 63 crore for the same period in the previous year (see www.businessstoday.in/sks). So too Spandana, which had a net profit of Rs 200 crore in March 2010, saw it whittle down to Rs 10 crore a year later. Since then its financial situation has worsened, with losses currently at Rs 50 crore and an outstanding debt of Rs 2,300 crore.

But Spandana - which Reddy started 13 years ago, with Rs 50,000 from her personal savings, but now has a net worth of Rs 500 crore - is fighting back. It has strengthened itself internally by setting up a risk department to check overexposure to any product or region. It is also increasing its focus on businesses that fall outside the ambit of traditional microfinance.

One such is that of financing tractors, which it had started in a small way in August 2009, and where, unlike in traditional microfinance, loan sizes are big and the vehicles have to be hypothecated to the company. Since the microfinance law was passed, the scheme has been extended from Andhra Pradesh, where it began, to Karnataka and Maharashtra, and there are plans to enter Chhattisgarh and Madhya Pradesh as well. Against 500 tractors financed in the first year, the number financed to date has risen to 10,000. Another is disbursing 'gold loans' or loans against pledged gold jewellery. Spandana is also looking at providing housing loans to the poor. "Given the developments in Andhra Pradesh, we want to grow these and other revenue streams," says Reddy.

Our model has been designed to be different from a typical MFI: Brahmanand Hegde and Ramakrishna Nishtala (in front). No longer an NBFC MFI, provides larger loans

Diversification is clearly the new mantra, even though MFIs are permitted to invest only 15 per cent of their total assets in businesses other than conventional microfinance. "What we are seeing now is newer revenue streams emerging as verticals within the microfinance ventures. When taken to scale they could be converted into separate companies," says S. Viswanatha Prasad, co-founder of the Bellwether Microfinance Fund, the country's first microfinance investment fund.

That is just what P.N. Vasudevan has done. After 22 years in retail finance, first with Cholamandalam and then with Development Credit Bank, Vasudevan set up the Chennai-based MFI Equitas Micro Finance India in June 2007. Hit by the Andhra Pradesh law, he launched the operations of two fully-owned subsidiaries in July this year: Equitas Housing Finance and Equitas Finance. The first provides housing loans of Rs 5 lakh to Rs 25 lakh to the self-employed, while the second disburses loans to buy second-hand commercial vehicles. Around the same time Vasudevan also took over another company, Singhvi Investment & Finance. He is awaiting permission from the Madras High Court to transfer all the Rs 700 crore microfinance assets and related liabilities of his main company to Singhvi Investment. The main company, Equitas Micro Finance India, will then be given a new name and made a holding company for all the companies in his group, thus making microfinance just one among his range of commercial interests.



Badly Bruised

The microfinance sector's growth has been stunted

| March 2010 | March 2011 |
|----------------------------------|------------|
| LOAN OUTSTANDINGS (₹ CR) | |
| 18,300 | 21,000 |
| LOAN OUTSTANDING GROWTH RATE (%) | |
| 57 | 13.5 |
| CLIENT BASE (CR) | |
| 2.66 | 3.20 |
| CLIENT BASE GROWTH RATE (%) | |
| 46 | 20 |

Source: Sa-Dhan

Even MFIs without any stake in Andhra Pradesh are responding similarly. In Allahabad, Sonata Finance, run by Anup Kumar Singh - an MBA and former employee of Cashpor, the first major MFI in north India - has begun offering loans to buy bicycles and cooking stoves. It has tied up with bicycle manufacturer Hero Cycles for the first and marketing company Gajam India for the second; Sonata gets a small commission on each sale. Bicycle loans have to be repaid with interest over 35 weeks, while cooking stove loans - which are also interest free - carry a 10 to 16 weeks tenor.

Sonata has also begun another scheme where it delivers foreign remittances at people's doorsteps, having tied up with the United Arab Emirates Exchange and Western Union to do so. All those living in the vicinity of Sonata's 123 branches across Uttar Pradesh, Uttarakhand and Madhya Pradesh can use the facility. "The aim is to diversify revenue streams," says Singh, who is also eyeing entry into commercial vehicle finance. "But if these new initiatives gather scale and we need to look at them as separate businesses, we are open to spinning them off as separate companies too."

With bank funding for MFI loans drying up, the ripples from Andhra Pradesh are being felt in eastern India too. Kolkata's Arohan Finance, for instance, run by Shubhankar Sengupta - a graduate from the Institute of Rural Management, Anand, who worked with leading MFI, BASIX, for years before starting his own - found itself with little money to disburse. Its outstanding loans declined from Rs 124 crore in September 2010 to Rs 75 crore now.

The aim is to diversify revenue streams and grow each business to scale: Anup Kumar Singh. Offers loans for bicycles, stoves

Alongside conventional microlending, Arohan has started funding microenterprises, giving loans to small-time furniture makers, welders' workshops and the like. Sengupta next plans insurance policies and pension schemes for the poor. "The crisis in the microfinance sector has exposed the vulnerability of being a mono-product company," he says. "With borrower mentality having changed and banks reluctant to lend, there is need for product innovation and a wider engagement with the borrower."

Some MFIs have departed from conventional microfinance activities altogether. One such example is Vistaar Finance, set up in Bangalore in March 2010 by Brahmanand Hegde and Ramakrishna Nishtala, both formerly with Fullerton India Credit, a leading NBFC. From small livelihood loans earlier, Vistaar has moved to loans of larger amounts, so that is now simply an NBFC and no longer an NBFC MFI. The size of its loans has risen from an average of Rs 35,000 earlier to Rs 2.5 lakh.





Regulations require different business arms for specialised funding:
P.N. Vasudevan

A Microfinance Bill, regulating all aspects of the sector including thrift, payments and insurance, and applicable across India, is pending before Parliament and many believe the current uncertainty will persist till it is passed. "The regulatory atmosphere continues to be uncertain," says M.S. Sriram, an adjunct professor at the Indian Institute of Management, Ahmedabad, and an expert on MFIs. "Even the RBI seems to have adopted a wait-and-watch approach towards MFI regulations. Possibly once the bill is passed, the RBI will clarify its own regulatory position."

He expects the number of MFIs to shrink as the sector consolidates in a bid to use size as a bulwark. Already there is market talk that Spandana and two other Andhra Pradeshbased MFIs, Share Microfin and Asmita, may merge.

With so much diversification, do MFIs still deserve to be called MFIs? "Unfortunately, players in this sector, who were supposed to be specialised entities focused on building access to the poor, may be forced now into becoming general players, which may not be in the best interests of the sector," says Achla Savyasaachi, Vice President, Sa-Dhan, an association of finance institutions engaged in community development.

Spandana's Reddy agrees, though she is less alarmed by the prospect. "Five years from now, instead of MFIs, we may call ourselves rural-focused organisations that are into diversified activities and businesses across geographies," she says.

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