Disclosure and Financial Performance: A Crosssectional Study of Microfinance Institutions of India

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FINANCIAL PERFORMANCE OF MICROFINANCE INSTITUTIONS OF INDIA

A CROSS-SECTIONAL STUDY

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FOR a country like India, poverty remains to be one of the biggest policy concerns. Amongst various measures to eradicate it, Microfinance, of late, has provided a ray of hope. The Task Force on Supportive Policy and Regulatory Framework for Microfinance constituted by NABARD defined microfinance as "the provision of thrift, saving, credit and financial services and products of very small amount to the poor in rural, semi-urban and urban areas for enabling them to raise their income levels and improve their standard of living" (Sen, 2008).

In numerous studies done across the world, it is generally believed that various microfinance initiatives have been able to make a difference in the target population's lives. However, increasing doubts have been raised over the financial sustainability of microfinance institutions. MFIs need to be economically viable and sustainable in the long run but economic implications of long term sustainability are not being considered (Srinivasan et al., 2006).

At least in India, there does not seem to be any working model of analyzing the financial performance and thereby sustainability of microfinance institutions. This problem is compounded by the absence of a dedicated legislation on working and management of microfinance institutions. The lack of a regulatory mechanism for financial disclosures by microfinance institutions also abets the problem.

The present study is an attempt to analyze the financial performance of various microfinance institutions operating in India. It assumes significance because it is imperative that these institutions be run efficiently given the fact that they are users of marginal and scarce capital and the intended beneficiaries are the marginalized sections of society. MFIs must be able to sustain themselves financially in order to continue pursuing their lofty objectives, through good financial performance.

Key Words: *Microfinance, Financial Sustainability.*

Introduction

Of late many government, businessmen and academicians alike have shown great interest in micro finance for its potential role in poverty alleviation activities. Microfinance Institutions have been expected to reduce poverty, which is considered as the most important development objective (World Bank, 2000). Robinson defines Microfinance as small-scale financial services for both credits and deposits – that are provided to people who farm or fish or herd; operate small or micro enterprises where goods are produced, recycled, repaired or traded; provide services; work for wages or commissions; gain income from renting out small amounts of land, vehicles, draft animals, or machinery and tools; and to other individuals and local groups in developing countries, in both rural and urban areas (Robinson, 2001). Subsidized credit has long been believed to be the panacea for the eradication of poverty for decades

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now. But perhaps the only thing subsidized credit could create was Non Performing Assets (NPAs). The realization that the core issue for the poor was access to credit rather than the cost of credit came very late. Microfinance is often credited with putting an end to the interest rate debate for the poor.

A host of players have entered microfinance space, each having a reason of its own. It is believed that, Microfinance, unlike other developmental efforts, gives quick and tangible results (Srinivasan et al., 2006). Many NGOs that were early entrants gradually metamorphosed into full fledged lenders, developmental professionals left their cushy careers to set up microfinance firms. Even many banks have experimented with working exclusively with self help groups and therefore have 'microfinance branches'. The players range from not-for profits organizations trying to achieve developmental objective through microfinance to commercial banks that view microfinance as 'good, sound banking', a good source of deposits, and low-risk mass lending. In fact the success of self help groups in microfinance led many to use them to achieve many other objectives as well. Many governmental schemes are being routed through microfinance, including a very large project funded by the World Bank and being implemented in a southern state of India. Similarly organizations like Hindustan Lever has looked at the potential of these groups as a channel for retailing and has launched a program called 'Project Shakti' to tap the smaller villages through the micro-credit. They are also being harnessed as an alternative distribution channel. This amounts almost to free riding since these channels have been developed by the MFIs after a lot of persistent hard work and investment. The companies that initiated this are reputed ones like HLL, EID Parry and Philips etc. (Srinivasan et al., 2006).

The persons engaged in championing microfinance are gaining prominence and it is said that some of the leaders, including many women, have been playing a more active role in other social spheres, to the extent of contesting elections for the panchayat and so on.

Conceptual Framework

As microfinance firms are viewed predominantly as instruments of social change, their performance has been often measured by non-financial parameters. The concept of social performance has seemed to overshadow the state of financial health of these enterprises. However, the accepted criteria in a number of studies to study the performance of any MFI have been the twain of Financial Performance and Outreach (Chaves and Gonzales-Vega 1996, Ledgerwood 1999, Yaron, 1992, Yaron 1994, Yaron et al., 1998, as cited in Arsyad, 2005). However, there exist various social performance assessment tools and institutionalized rating processes but assessment of financial performance has yet to gain ground. Some of the more popular tools include MFC Social Audit, ACCION SOCIAL, USAID SPA Audit, M-CRIL, Micro-finanza Rating, Micro Rate (SPA), CGAP-Grameen-Ford Progress out of Poverty Index (PPI) etc. (Sen, 2008). These tools often focus on outreach indicators. Outreach indicators are considered as proxies for impact of MFI on development (Yaron el al., 1997).

The financial performance assessment is devoid of such a multitude of options and methodologies despite critical importance of financial sustainability. Though an ambition for sustainable institutions has been often articulated, there was also an opinion that most microfinance institutions working in this field have been unsustainable (Copisarow, 2000 as cited in Dayson et al., 2006). Research studies have shown that this is predominantly connected to the perception of micro borrowers' risk and creditworthiness, and the diseconomies of scale in making small loans (Quach, 2005, As cited in Dayson et al., 2006).Microfinance has been attractive to lending agencies because of demonstrated sustainability and low cost of operations. In India, the engagement of NABARD and SIDBI shows that they see long term prospect for this sector (Srinivasan et al., 2006).

However, the methodologies to study financial sustainability are fewer. Review of studies reveal that amongst those available, most of the tools available cover social as well as financial performance. Principal among them are CAMEL model by ACCION, PEARLS model by WOCCU, GIRAFE Rating by PlaNet and MicroRate (CGAP, 2001 as cited in Arsyad, 2005). Amongst these, except the PEARLS methodology by World Council of Credit Unions (WOCCU), all others are hybrid models using both qualitative and quantitative data (Arsyad, 2005). These methodologies are proprietary and not available for use in public domain.

It is noted with surprise that in India, a review of the studies done on microfinance sector has revealed that there is hardly any study focusing on the financial health of MFIs.

It seems this is due to the branding and common perception of MFIs as not for profit organizations. However the long term viability of any business model depends as much on the financial viability as on its ability to deliver its avowed objectives.

It can be seen that without sound financial performance the sustainability of these microfinance institutions is not possible. Increasingly questions are being raised over the cost of funds for these enterprises and their ability to earn margins sufficient to cover their operational costs and still leave some profit (Arsyad, 2005). It has been pointed out repeatedly that MFIs need to be economically viable and sustainable in the long run (Srinivasan et al., 2006). In fact studies have found strong linkage between the financial sustainability of microfinance institutions and achievement of their social objectives. Low income customers are more likely to borrow from institutions they see as financially viable (Zeller et al., 2003).

The extant business model of most of the MFIs involves huge operational costs since a lot of contact is required with the intended beneficiary. Also as for as the cost of funds are concerned, as the scale of operations goes up, MFIs need funds beyond the grant/soft loans etc. The commercial funding requires them to have risk capital with market interest rates.

In this backdrop the sustainability of MFIs needs to be looked at very carefully even from a social performance standpoint. The results achieved in poverty alleviation by MFIs can not be an event and given the endemic nature of poverty, requires a continuous and long term commitment from these enterprises.

Morduch (1999) as cited by Crabb (2008), describes the need for more empirical work on the sustainability of MFIs. He points out: "Empirical understandings of microfinance will also be aided by studies that quantify the roles of the various mechanisms in driving microfinance performance…." The present study attempts to analyze and compare the financial performance of the MFIs primarily from a sustainability standpoint.

Data and Methodology

Meyer (2002) indicated, "Measuring financial sustainability requires that MFIs maintain good financial accounts and follow recognized accounting practices that provide full transparency for income, expenses, loan recovery, and potential losses." One of the biggest problems in conducting this kind of study with MFIs in India is that for want of mandatory disclosure requirements and lack of dedicated legislation governing MFIs; it is very difficult to get reliable and actionable data on the financials. On the lines of MIX and rider attached by foreign donors on the MFIs to seek voluntary disclosure before they can be considered for grants, some of the Indian MFIs have started to report their financials to MIX (*www.mixmarket.org*). By far Mix Market is most reliable database currently available on MFIs. Mix market has a system of classifying the reporting firms into star categories. This ranges from one to five stars. This is based on their level of disclosure, vintage, quality of disclosure, financial parameters etc.

Out of over a hundred MFIs currently reporting to Mix Market, we have chosen only five star rated MFIs. They are 22 in number.

Thereafter their financial performance has been compared on 22 different ratios. These ratios have been chosen again from the reporting format of Mix Market. The reporting format broadly analyzes the companies on six parameters of financial performance:

1. Financial Structure
2. Revenue
3. Expenses
4. Efficiency

5. Productivity
6. Risk

These parameters are most comprehensive and globally accepted indicators of financial health of a MFI as Mix market uses it across the world for classification. Apart from the above five parameters another parameter named "Overall Performance" has been used to capture the holistic picture. It covers three ratios viz. Return on Assets, Return on Equity and Operational Self-Sufficiency.

Since the sample is only 22 MFIs and data has been utilized for 2008 only it is too small to lend itself to rigorous multivariate analysis. Therefore the methodology used is difference of means test for the purpose of comparing the performance of these star performers.

Data Analysis

The application of difference of means test has been done at á =0.05. For various categories the analysis is as follows:

1. Financing Structure

Capital/Asset Ratio	
Mean	0.1282318
Standard Error	0.0188295
Medium	0.105
Standard Deviation	0.0883183
Sample Variance	0.0078001
Kurtosis	0.3010499
Skewness	1.062769
Range	0.2957
Minimum	0.0262
Maximum	0.3219
Sum	2.8211
Count	22
P value	0.0391581

The p value of 0.039 is significant and therefore it can be concluded that most of the MFIs are following disparate risk management practices. They are maintaining divergent capital to assets ratio.

Debt/Equity Ratio	
Mean	11.5386
Standard Error	1.994785
Median	8.52645
Standard Deviation	9.356373
Sample Variance	87.54172
Kurtosis	1.531284
Skewness	1.397253
Range	35.0938
Minimum	2.1063
Maximum	37.2001
Sum	253.8491
Count	22
p value	4.148383

However financing mix has not varied widely across firms and p is not significant. This has mainly

emanated from increasing reliance of firms on commercial funds being made available by banks and other agencies.

Deposits to Loans	
Mean	0.009305
Standard Error	0.00684
Median	0
Mode	0
Standard Deviation	0.032085
Sample Variance	0.001029
Kurtosis	13.72621
Skewness	3.672233
Range	0.1383
Minimum	0
Maximum	0.1383
Sum	0.2047
Count	22
p value	0.014226

Here again p is significant. Most of the firms are not yet dependent on deposits as a source of funds in a big way.

Deposits to Total Assets	
Mean	0.007705
Standard Error	0.005594
Median	0
Mode	0
Standard Deviation	0.026238
Sample Variance	0.000688
Kurtosis	12.79956
Skewness	3.56863
Range	0.1113
Minimum	0
Maximum	0.1113
Sum	0.1695
Count	22
p value	0.011633

This result is also in line with the previous analysis. However when we look at gross loan portfolio to total assets we find that most of the firms have different ratios and p value is significant. The low availability and nascence of the industry seem to be major reasons.

So we may conclude that most of the firms have similar gearing but different overall financial

structure as measured by other ratios. This has born purely out of practice rather than any prudential reasons.

Gross Loan Portfolio/Total Assets	
Mean	0.832981818
Standard Error	0.019930408
Median	0.83935
Standard Deviation	0.093481899
Sample Variance	0.008738865
Kurtosis	1.479519446
Skewness	-0.91646793
Range	0.4052
Minimum	0.5718
Maximum	0.977
Sum	18.3256
Count	22
p value	0.041447552

2. Overall Performance

Return on Equity (%)		***Return on Assets (%)***	***Operational Self Sufficiency***
Mean	0.374195	0.030431818	1.263754545
Standard Error	0.117325	0.015918259	0.109497784
Median	0.1602	0.01365	1.12145
Standard Deviation	0.550302	0.074663253	0.513590131
Sample Variance	0.302833	0.005574601	0.263774823
Kurtosis	4.16515	10.12171068	14.22036801
Skewness	1.826786	2.236189997	3.413604966
Range	2.5203	0.4374	2.7619
Minimum	-0.3965	-0.1288	0.5946
Maximum	2.1238	0.3086	3.3565
Sum	8.2323	0.6695	27.8026
Count	22	22	22
p value	0.24399	0.033103832	0.227713106

We may observe that firm's ability to generate return on capital employed is quite disparate and p value is significant. However in line with previous conclusion that firms have similar debt equity ratios in the financing mix, return on equity for these firms is identical. This is also reflected in Operational self sufficiency where p value is not significant.

3. Revenue

Financial Revenue Ratio (%)		*Profit Margin (%)*
Mean	0.210004545	0.132827273
Standard Error	0.015118144	0.051919914
Median	0.2031	0.10815
Standard Deviation	0.070910383	0.243525984
Sample Variance	0.005028282	0.059304905
Kurtosis	4.502284585	6.49830832
Skewness	1.41416545	-1.197926577
Range	0.3505	1.3839
Minimum	0.089	-0.6818
Maximum	0.4395	0.7021
Sum	4.6201	2.9222
Count	22	22
p value	0.031439902	0.107973372

We saw no significant 'p' value in case of return on equity and the same conclusion is visible here also in profit margin. However in terms of revenue there is significant difference between the firms that are star performers and it may be deduced that they are following unique business models in India.

4. Expenses

Total Expense Ratio (%)		*Financial Expense Ratio (%)*	*Loan Loss Provision Expense Ratio (%)*
Mean	0.177114	0.077122727	0.007381818
Standard Error	0.015047	0.004708654	0.001991417
Median	0.17115	0.07515	0.0047
Standard Deviation	0.070577	0.022085546	0.009340574
Sample Variance	0.004981	0.000487771	8.72463E-05
Kurtosis	8.249143	1.11892267	3.733310227
Skewness	2.245887	-0.148382072	1.985314409
Range	0.37	0.1042	0.0354
Minimum	0.0641	0.0236	0
Maximum	0.4341	0.1278	0.0354
Sum	3.8965	1.6967	0.1624
Count	22	22	22
p value	0.031292	0.009792183	0.004141378

The p values are significant in case of expenses either financial or overall. However especially in case of financial expenses the firms seem to be incurring different costs on debt funds for reasons discussed before.

5. Efficiency

Operating Expense/Loan Portfolio (%)		*Cost per borrower*
Mean	0.111790909	16.74090909
Standard Error	0.014380357	3.120471847
Median	0.1023	13.85
Standard Deviation	0.067449854	14.63631033
Sample Variance	0.004549483	214.2215801
Kurtosis	7.2516219	13.03831637
Skewness	2.25050442	3.322561668
Range	0.3183	70.6
Minimum	0.0342	4.8
Maximum	0.3525	75.4
Sum	2.4594	368.3
Count	22	22
p value	0.02990559	6.489376432

On these efficiency parameters we may see that p value is significant in case of operating expenses as a percentage of loan portfolios. This is mainly due to the fact that most of the companies are following unique business models. However p is not significant in case of cost per borrower especially due to the fact that the size of loan per borrower differs widely in case of borrower to borrower in different companies. This is reflected in standard deviation also.

7. Productivity

Borrowers per Staff member		*Savers per Staff member*
Mean	259.2273	58.77272727
Standard Error	24.01063	58.77272727
Median	246.5	0
Standard Deviation	112.6199	275.6685262
Sample Variance	12683.23	75993.13636
Kurtosis	0.22259	22
Skewness	0.26415	4.69041576
Range	461	1293
Minimum	50	0
Maximum	511	1293
Sum	5703	1293
Count	22	22
p value	49.93285	122.2245769

As expected p value is highly insignificant in both these parameters of productivity. We may observe that this reflects similar managerial capability across different MFIs. The fuller utilization of available manpower is not very apparent in most of the cases.

8. Risk Management

Portfolio at Risk > 30 days Ratio (%)		***Loan Loss Reserve Ratio (%)***	***Risk Coverage Ratio (%)***	***Write Off Ratio (%)***
Mean	0.02085	0.009859091	27.76455	0.003345455
Standard Error	0.010437552	0.002193947	24.34979463	0.001497006
Median	0.0015	0.0066	0.8719	0
Mode	0	0	0	0
Standard Deviation	0.04895646	0.010290525	114.2106605	0.007021581
Sample Variance	0.002396735	0.000105895	13044.07496	4.93026E-05
Kurtosis	11.14635316	0.878973928	21.89541705	8.688322618
Skewness	3.250314834	1.261474572	4.674622803	2.897815878
Range	0.2093	0.0359	538.5818	0.0288
Minimum	0	0	0	0
Maximum	0.2093	0.0359	538.5818	0.0288
Sum	0.4587	0.2169	610.8201	0.0736
Count	22	22	22	22
p value	0.021706078	0.004562563	50.63816984	0.003113195

The p value is significant in case of potential future bad debts, provision for bad debts and write-off ratio. It appears that the firms are operating with differing levels of risk appetite. However in case of institutionalized risk management procedures and covering the risk through various measures there exists lot of similarity between firms. This means that the risk avoidance is different but not loss prevention.

Conclusion

We may conclude that most of the best performing firms are following different business models in India. This is reflected in 13 out of 22 parameters studied. However in other areas especially in risk coverage, debt equity ratio, productivity, cost per borrower, operational self sufficiency etc there exist a similarity between the firms performance. However the similitude in performance is not due to a chance factor but a deliberate business model that emanates from group lending and rural focus of MFIs operating in the Asian subcontinent.

They seem to be following a time tested way of doing business which has sustained itself over the years.

However the managerial capability as reflected in productivity parameters etc is different as it is possible that management of different MFIs are at different stages of the learning curve.

Limitations

The study has been conducted on the 5-star rated performers of Mix-market database. This is possible that the similarities observed in various parameters emanates from their belonging to the elite group of firms with strong ethics of disclosure. If the study is conducted with a broader sample (however there is a dilemma here, if we want to include more firms here to broaden the database the data needed would not be available since many firms are not disclosing their financial data) the results may be different. Also the data analyzed has been taken from 2008 statements to reflect the most up to date position. Again an average of past two to three years if taken might throw more insights to the study.

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