Microfinance Institutions: Sustainability and Outreach

Saundarjya Borbora* & Gopal Kumar Sarma**

I. Introduction:

Microfinance has been accepted as a tool for poverty alleviation and financial inclusion in most of the countries. Understanding the need to bridge the gap in accessing credit facilities for the excluded sections of people, microfinance has emerged in late 1970s in Bangladesh. Enthused by the success of Grameen Bank, over hundreds of replication has germinated worldwide over the period of three decades. The program has reached more than 133 millions of poor people from 3316 MFIs worldwide as of December 2006, out of which 69.85% were among the poorest and 85.2 percent were women (Haris, 2007).

In view of burgeoning outreach of MFI model, the present concern is centered on the sustainability of the program. Sustainability and outreach is a widely discussed issue in the field of microfinance and two strands of thought emerge in this connection- The Poverty Camp and The Sustainability Camp (Morduch, 2000). Although it is viewed that sustainability and outreach are competitive, some authors indicates its complementary nature (Rhyne, 1998). It implies that sustainability is the means to achieve outreach and it indicates permanency in realizing the intended goal of the program. A financially self-sufficient MFI would earn so much profit that when donors leave it will not shrink in real terms nor will it reduce the size or coverage of its service to the poor in future (Schreiner, 1997). Importantly, repayment also spins on the sustainability and permanence of a MFI and also helps in further outreach.

Field or track of Research: Finance

Keywords: Microfinance Sustainability, Outreach, Self-Sufficiency, Subsidies

*Professor (Economics)
Department of Humanities and Social Sciences
Indian Institute of Technology Guwahati, Guwahati -39
Email: sborbora@iitg.ernet.in / sborbora@gmail.com
Phone: +91 361 2582562(o)
Mobile:+91-94351 16299

**Research Scholar (Economics)
Department of Humanities and Social Sciences
Indian Institute of Technology Guwahati, Guwahati -39
E-mail: g.sarma@iitg.ernet.in / gopalkumarsarma@hotmail.com
In India, microfinance has operated under two broad models – SHG-Bank Linkage model and Microfinance Institutions (MFIs) model. The MFI model has also been operating in Assam for a period of over one decade and recently a large number of players in the field have come out to provide microfinance. The rationality behind the emergence of the state as a lucrative microfinance market can be inferred from socio-economic position. Census of India reported in 2001 that 87.1% of the total population live in rural areas of the state. Besides during 1999-2000, 36.09% people are below the poverty line where rural poverty constitutes 97.48% (indiastat.com). Besides, the All India Debt and Investment Survey reported that institutional credit access constitutes 57.9% of total credit availability, of which commercial bank and Government credit share 66.5%. On the other hand non-institutional sources of credit still constitute 42.1% (NSSO, 2003), which imply that there is a need for more institutional credit arrangement.

Rashtriya Gramin Vikash Nidhi (RGVN) is the one of the pioneer and older MFI in the state. In addition, a number of MFIs such as ASOMI, Bandhan, IIRM, Prochesta, etc. also provide microfinance in the state although outreach is limited but gaining impetus. But at the same time trade-off between outreach and sustainability seems to be a matter of concern. Financial viability in the long run is an important aspect for these MFIs. The balance sheet of the MFIs reveals that they are profitable and their repayment rates are high. But an in-depth analysis through various financial performance indicators such Operational Self Sufficiency (OSS), Financial Self Sufficiency (FSS) and Subsidy Dependence Index (SDI) will tell more about the financial health of the MFIs apart from the repayment rate. Thus for analyzing the financial sustainability, careful analysis of performance indicators are necessary to know whether MFIs are financially more sufficient as time passes out or not.

With this backdrop, an attempt has been made to examine the trade-off between outreach and sustainability of the MFIs model of microfinance in the state. For analysis, a case study of one mature MFI namely, Credit and Savings Program-Rashtriya Gramin Vikash Nidhi (hereafter CSP-RGVN) is considered. The rationality behind the selection of CSP-RGVN is based on the argument that as operational year's increases with a growing outreach of the program, the MFI can become sustainable in the long run.

The paper is organized in five sections. Apart from the introduction and methodology in section I, section II discusses on the issue of sustainability and outreach from the review of literatures. Section III describes lending methodology of RGVN-CSP, which is followed by results and analysis on the issue of outreach and sustainability of the MFI in section IV. Finally section V concludes the paper.

The study is based on secondary data collected from various sources like publications such as Reserve Bank of India (RBI) Bulletin and Annual Report, Statistical Handbook of Assam and Annual reports of RGVN. Besides a number of websites are consulted to gain access of information and in-depth understanding and analysis. For analysis of
sustainability indicators such as OSS, FSS, SDI and SDR have been calculated, based on the audited financial statement of CSP-RGVN.

II. Outreach and Sustainability: A Review of Literatures

MFIs outreach is a perceived goal from social and business point of view. When question of sustainability of MFIs come, it is observed that only few percent of the MFIs are sustainable to run operation without subsidies (Hulme and Mosley, 1996). Outreach and impact are complementary in nature in achieving microfinance sustainability. The concept cannot apply in general since in some cases outreach and sustainability are competitive and sustainability pre-conditioned on the reduction or removal of subsidy on microfinance. Sustainability of microfinance is hence becoming more complex and debatable issue from different angles and is among the one of the important key principles of Consultative Group to Assist Poor (CGAP).

Generally sustainability of microfinance indicates permanency of the program. Within microfinance, sustainability can be viewed at several levels- institutional (group and individual) and can relate to organizational, managerial and financial aspects. However, financial sustainability of microfinance institutions has become the critical point of focus in microfinance analysis. In defining sustainability of microfinance, Woller et al (1999) used the definition offered by Brinkerhoff, which stated sustainability could as the “ability of a program to produce outputs that are valued sufficiently by beneficiaries and other stakeholders that the program receives enough resources and inputs to continue production.” Pollinger et al (2007) defined sustainability as the ability to cover annual budgets including grants, donations, and other fundraising. Acharya and Acharya (2006) considered view of Sharma and Nepal (1997) where sustainability indicates excess of operating income over operating cost. The concept is from the banker’s perspective and it includes both financial viability and institutional viability of MFIs. On the whole sustainability is not an end in itself. It is just a means to the end of improving the lot of the poor (Schreiner, 1997:63-64).

Although, sustainability of microfinance indicates different levels of sustainability, it is financial sustainability of the MFIs that considered for this paper. Financial sustainability indicates that income from the microfinance services should be greater than the cost of providing services. Therefore, self-sufficiency is an indication for the financial sustainability of the MFIs. As the microfinance industry matures, the definition of the self-sufficiency has commenced to slender (Ledgerwood, 1999, pp. 216-17) and currently sustainability refers only two levels of sustainability by the most of the people associated with this industry. These are Operational Self Sufficiency (OSS) and Financial Self Sufficiency (FSS).

OSS indicates whether enough revenue has been earned to cover the MFI’s direct costs, excluding the cost of capital but including actual financing costs. Thus formula for calculating OSS is: [Operating Income/ (Operating Expenses + provision for loan losses)]. FSS on the other hand portray the actual financial health of MFIs. Thus, FSS includes cost of capital (adjusted) apart from the components in OSS. On the other
hand Pollinger et al (2007) refers self-sufficiency as to organizations that can survive and add to their asset base wholly on the basis of income derived from their lending and related operations.

Subsidy is a crucial factor in analysing sustainability of microfinance in general and MFIs in particular. Even front line institution like Grameen Bank of Bangladesh may experience a high repayment rate, but has also depends on subsidies due to higher value towards social sector (Morduch, 1999). It is also learned from the Philippines that replication of Grameen-type MFIs can be sustainable and can substantially increase their outreach, but not by fully subsidy independent (Seibel and Torres, 1999). Subsidy syndrome thus considered attention from very beginning by researchers like Yaron, Hulme and Mosely, Khandker, etc. who constructed index to examine the subsidy dependence of the MFIs. The rationality of this index is to examine the social cost associated with such subsidies and to highlight the harmful effects of subsidies to credit (Yaron, 1992).

Subsidy Dependence Index (SDI), first developed by Yaron assesses and quantifies subsidy dependence and measures the extent to which the lending interest rate would have to be raised in order to cover all operating costs if any subsidies the MFIs receive were to be uncovered (Hulme and Mosley, 1996:43). SDI as calculated by Yaron is a fraction of (Subsidy/ Loan Portfolio* lending interest rate). A modified version of the formula was devised by Hulme and Mosley (1996). SDI shows subsidy dependence of an MFI and in calculating the index from the earning point of view only income from loan portfolio is considered.

But as it is observed that source of earning of an MFI also comprises earning on investment and others apart from loan portfolio. In addition, since cost component involves in case of all these segments of earning, thus SDI seems to be narrow in calculating subsidies. Khandker proposes Subsidy Dependence Ratio to have a better understanding on the financial health of the institution. The basic rationality for taking this ratio is based on the argument of Kahndakar and Khalily (1996), which stated that as the SDI compares subsidy only with revenue from lending even though DFIs also get revenue from investments in non-loan assets such as treasury bills. In principle, a DFI could decrease its subsidy dependence through increased revenues either from loans or from investments. Thus the SDR suggests that subsidy be compared with revenue both from loans and from investments (Schreiner and Yaron, 1999).

Numbers of empirical works in different settings has strengthened the literature base on sustainability and self-sufficiency of microfinance. Brewer et al.’s (1996) researched into the performance of Small Business Investment Companies (SBICs) between 1958 and 1996 and highlighted the potential dangers of subsidized funding. Vinelli (2002) suggests that mission drift can occur when a lender seeks profit not by working harder to make better and less expensive products but rather by searching for borrowers who are easier and cheaper to serve. Regarding pricing and self-sufficiency, Gulli (1998) suggests that institutions must charge sufficient interest rates to cover their costs. Tang, Painter and Bhatt (2002) suggest that one reason for continued dependence on
subsidies is unwillingness to charge the maximum legally allowable interest rates and fees that would allow programs to cover as much expense and risk cost as possible from operations. Acharya and Acharya (2006) in their study in Nepal found that clients did not think about institutional sustainability, rather think of individual sustainability and this resulted in ‘trickle-up’ of microfinance institution to be institutionally sustainable. Adongo and Stork (2005) in Namibia found that microfinance is instrumental in promoting the sustainability of micro enterprises, to the extent that it creates an improvement in the management of their financial activities. But as far as the subsidised funding is concerned it was found no microfinance institution in Namibia is currently, independently financially sustainable. This finding implies that if the cost of providing non-financial services is managed and separated from that of providing financial services, financial sustainability should improve for this category.

III. CSP-RGVN: Context and Credit Delivery Methodology:

The Credit and Savings Programme (CSP) was initially started as an action research program in 1995 by Rashtriya Gramin Vikaskh Nidhi (RGVN) to try out the aptness of micro-credit intervention in the North-eastern region. CSP-RGVN is under the legal form of Section 25 Company, which is going to be converted to NBFC shortly. The main objectives of CSP are to channelize credit to the poor, eliminating the exploitation of moneylenders and creating opportunities for self-employment. The intended client for the program is basically those sections of people who cannot access credit from formal financial sector. The Credit and Savings Program operates through its large network of unit and area officers.

III.1 Credit Delivery Modes of CSP:

CSP delivers credit via two broad delivery modes, such as Group Lending Model and Individual Lending Model. Under Group Lending Model, poor women & men are provided credit through Self Help Groups (SHGs) and Joint Liability Groups (JLGs). On the other hand Entrepreneurship Development Loan (EDL) comes under Individual Lending Model.

III.2 CSP’s Process of Intervention:

CSP conducts area survey to have a better understanding on the operational potentiality in the intended area. The next step is to form suitable group for disbursement of credit. Following steps are carefully conducted in selecting client’s group:

- Group selection is helped by the field supervisor or credit officers.
- In case of SHGs, weekly group meetings are held for three months when the group begins the process of saving a minimum of Rs 10/- per member per week. For another three months, SHG are encouraged to revolve the savings within members at a rate of interest decided by them. This is done to self and credit discipline and on system development.
- Credit to SHGs begins after this phase of six months.
In case of JLGs, credit begins as soon as the group is formed. Besides the MFI also provides training for groups on group cohesiveness, bookkeeping and credit discipline.

IV. Results, Analysis and Discussion:

IV.1. Outreach and Operational Performance during 2001-02 to 2006-07:

Credit and Savings Program has completed 13 years of operation in May 2008. It is worthwhile to have a glimpse on the operational performance, which also includes outreach of the program. The program initially operated only with 4 field offices in 4 districts of Assam in March 1996, which has spread to over 32 field offices across 12 districts as on March 2008. Thus it is reflected that area coverage has increased by 240% and client outreach in terms of active borrower by 158% from 28174 in March 2002 to 44722 in 2008, which reveals a growth of 22.68% CAGR for the period of 2001-02 to 2007-08. It is also reported by the head office that about 90% among the borrowers are women.
Table 1: Year wise Operational Highlights of CSP-RGVN

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>No of area offices</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>6</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>No of field offices</td>
<td>10</td>
<td>10</td>
<td>9</td>
<td>13</td>
<td>22</td>
<td>32</td>
<td>32</td>
</tr>
<tr>
<td>No of Field Staff</td>
<td>55</td>
<td>53</td>
<td>54</td>
<td>50</td>
<td>70</td>
<td>120</td>
<td>161</td>
</tr>
<tr>
<td>No of Districts covered</td>
<td>5</td>
<td>5</td>
<td>8</td>
<td>8</td>
<td>9</td>
<td>10</td>
<td>12</td>
</tr>
<tr>
<td>No of active groups</td>
<td>2493</td>
<td>2291</td>
<td>2353</td>
<td>979</td>
<td>1557</td>
<td>3227</td>
<td>7952</td>
</tr>
<tr>
<td>No of active members (1st cycle)</td>
<td>28174</td>
<td>30089</td>
<td>30939</td>
<td>31674</td>
<td>30578</td>
<td>44279</td>
<td>62849</td>
</tr>
<tr>
<td>No of Active borrowers</td>
<td>28174</td>
<td>30089</td>
<td>30939</td>
<td>13526</td>
<td>15859</td>
<td>24147</td>
<td>44722</td>
</tr>
<tr>
<td>Outstanding portfolio ( Rs in Lakh)</td>
<td>396.83</td>
<td>434.25</td>
<td>374.68</td>
<td>406.6</td>
<td>615.24</td>
<td>1322.34</td>
<td>2695.38</td>
</tr>
<tr>
<td>Average loan size on Outstanding portfolio (Rs)</td>
<td>1408.49</td>
<td>1443.21</td>
<td>1211.03</td>
<td>3006</td>
<td>3879</td>
<td>5476.2</td>
<td>6026.97</td>
</tr>
<tr>
<td>Total no of loans</td>
<td>42055</td>
<td>43970</td>
<td>44820</td>
<td>62233</td>
<td>70091</td>
<td>85935</td>
<td>117854</td>
</tr>
<tr>
<td>Cumm. Amt loan disbursed ( Rs in Lakh)</td>
<td>1756.22</td>
<td>2309.59</td>
<td>2821.79</td>
<td>3246.07</td>
<td>3928.52</td>
<td>5721.07</td>
<td>9461.1</td>
</tr>
<tr>
<td>Avg loan size on Disbursement</td>
<td>4176.01</td>
<td>5252.65</td>
<td>6295.83</td>
<td>5215.9</td>
<td>5604.89</td>
<td>6657.43</td>
<td>8027.82</td>
</tr>
</tbody>
</table>

Source: Head Office, Credit and Savings Program - RGVN, Guwahati

Although the growth rate is inspiring, the trend for the period is not smooth and uniform. The annual growth rate declined from 22.3% in 2001-02 to 6.8% in 2002-03 and showed a negative growth of 56.3% in 2004-05. However the trend recovered in the subsequent period continuously. There may be a number of reasons for this negative growth rate. One possible explanation that can be envisaged is client drop out, completion of the repayment term and up gradation of client for higher loan size under JLG and EDP.

IV.2. Financial Performance and Sustainability of the Program:

It is clear from above table that the program has a large outreach of client for the reference period and cumulative loan disbursement amount has grown at 77.0% CAGR while loan outstanding amount shows a growth of 97.0% CAGR for the period. The growth of the loan portfolio indicates profitability of the program for the period. But, it is confirmed from the audited financial statement for various years that the MFI has made a profit in 2003-04, 2005-06 and 2006-07 fiscal years. It is important to examine
whether this profit are accrued either from business of the program or from subsidy component. The importance of the issue is lies in the fact that if an MFI like CSP-RGVN, which has operated for a period of more than 13 years could not reach clients profitably, then avowed win-win proposition may be questioned. Therefore to understand the financial health of the MFI, OSS and FSS for financial matter and SDI and SDR to analyse sustainability of the program have been adapted.

### Table 2: Calculated Indicators of MFI for the period 2001-02 to 2006-07
(Figures are in percentage)

<table>
<thead>
<tr>
<th>Financial Year</th>
<th>OSS</th>
<th>FSS</th>
<th>SDI</th>
<th>SDR</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>129.22</td>
<td>82.32</td>
<td>46.77</td>
<td>0.78</td>
</tr>
<tr>
<td>2002-03</td>
<td>165.55</td>
<td>98.40</td>
<td>15.20</td>
<td>0.62</td>
</tr>
<tr>
<td>2003-04</td>
<td>169.19</td>
<td>105.70</td>
<td>-12.71</td>
<td>0.70</td>
</tr>
<tr>
<td>2004-05</td>
<td>121.87</td>
<td>81.77</td>
<td>43.31</td>
<td>0.86</td>
</tr>
<tr>
<td>2005-06</td>
<td>121.80</td>
<td>87.14</td>
<td>47.75</td>
<td>0.67</td>
</tr>
<tr>
<td>2006-07</td>
<td>153.39</td>
<td>106.66</td>
<td>31.40</td>
<td>0.18</td>
</tr>
</tbody>
</table>

Source: Authors calculation from the audited financial statement for various years

Table 2 shows that throughout the period, OSS is more than 100%, which indicate that the MFI can compensate its operational cost from the operational income allowing provision for loan loss. But a close look on FSS, which includes adjusted cost of capital, can portray a precise picture about the financial sustainability of the MFI. As depicted in table 2, the MFI was financially self sustainable only for two fiscal years (2003-04 and 2006-07). This indicates that MFI has much more to do to become financially self sustainable.

Whatsoever the implication of these ratios, it still lacks in portraying a real picture of economic sustainability which require to examine SDI and SDR. It is clear from table 2 that throughout the period, the MFI is less dependent on subsidy. The dependency ratio does not cross 50%, which implied that the MFI could be sustainable in the long run. The trend for the period indicates that subsidy dependence was negative in 2003-04, which implies that the MFI could compensate its social cost in future.

As an alternative to SDI, SDR is calculated to examine dependency of MFIs on subsidies, calculating income from loan, investment and others. In the analysis, it is found that SDR indicate more subsidy dependency than SDI for the period. Moreover dependency is not uniformly decreasing for the period. For example, with a dependency of 0.78 in 2001-02, the ratio has declined to 0.62 in next year and increased to a maximum of .86 in 2004-05 and declined in the subsequent period. Although, ratio indicates that the MFI is not fully subsidised, yet it is subsidy dependent. But trend since 2004-05 indicates a continuous less dependence on subsidy.

The controversial debate regarding trade-off between outreach and sustainability implies that as outreach increases subsidy dependence increases. In the analysis, it is
observed that active borrowers for this period are also increasing. But indicators of subsidy dependence show an opposite picture in our analysis and thus to examine the inference Pearson correlation coefficient is calculated which is depicted in table 3.

<table>
<thead>
<tr>
<th></th>
<th>Outreach</th>
<th>FSS  (0.77)</th>
<th>OSS  (.015)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SDI</td>
<td>-.681 (.136)</td>
<td>-.763</td>
<td>-.897</td>
</tr>
<tr>
<td>SDR</td>
<td>-.202 (.701)</td>
<td>-.719 (.107)</td>
<td>-.421(.406)</td>
</tr>
</tbody>
</table>

* Correlation is significant at the 0.05 level (2-tailed)
Source: Author’s calculation

It is observed from table 3 that for the sample MFI, only SDI has significant negative relation with OSS. It reveals that as SDI increases, OSS decreases and alternately it supports the argument that when OSS increases, dependence of the MFI on subsidy decreases. Although FSS is also related in the same way to SDI and SDR, they are not significant. Table 3 indicates a negative relationship of outreach with SDI and SDR, and SDR correlation between SDR and outreach is high although both are statistically insignificant. Thus the relationship cannot be confirmed and it can be inferred that there may be trade-off between outreach and sustainability of the program.

V. Conclusion:

It can be inferred from the analysis that although concerned MFI increased outreach since its inception, the MFI is yet to be self-sufficient. Although operationally MFI is self sufficient, to achieve financial self-sustainability is a crucial area of consideration. It is pertinent to note that the MFI is operationally self-sufficient but still depends on subsidies, which is reflected in the SDI and SDR. This may be tackled either by lowering the operating cost or by increasing the interest rate earnings, but these need further research. Another area of possibility to make the MFI self sustainable is the introduction of equity funding which need further research and necessary regulations.

References:


Hulme, D. and Mosley, P. 1996 “*Finance Against Poverty*” *Vol. 1*, Routledge, New York, pp.16-17


NSSO, 2003 “All India Debt and Investment Survey: NSS 59th Round”, Government of India

Rhyne, E., 1998 “The Yin and Yang of Microfinance: Reaching the Poor and Sustainability”, *Micro Banking Bulletin*


Sa-Dhan Microfinance Resource Centre, 2003 “Sustainability of Microfinance Interventions”, Perspective Paper No. 4, pp. 1-20


Sharma, S.R. and Nepal, V., 1997 *Strengthening of Credit Institutions /Programs for Rural Poverty Alleviation in Nepal*, United Nations, Economic and Social Council (ECOSOC) for Asia and Pacific, Bangkok, Thailand


www.indiastat.com