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Microfinance Products & the Role of Securities Markets

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Microfinance Products
&
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Abstract

In most developed countries and in several developing countries, even low-income people have bank accounts. However, microfinance institutions (MFIs) in India offer only microcredit products; savings is hardly offered due to regulatory hurdles. Microfinance has successfully permeated into the rural sector in India, primarily through the indigenous self-help group model. Our research shows that with the regulatory impediments on interest rate and margin, MFIs need to have the freedom to offer the breadth of products; else, sourcing capital will be a problem. Almost all the MFIs primarily rely on bank funds for capital; banks relent due to the stipulation of priority sector lending. In order to free this sector from costly debt capital and allow them to source their capital from the securities market, the MFI Bill 2012 would need to be passed at the earliest.

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Executive Summary

Microfinance (MF) is not new to India and has successfully permeated into the rural sector primarily through the indigenous self-help group (SHG) model pioneered by the National Bank for Agriculture and Rural Development (NABARD) in the seventies. However, the basic model addressed only microcredit, a small subset of microfinance, which is a big universe of financial services that can be tapped to bring about financial inclusion for low-income households. Until regulation addresses and allows MF institutions to offer savings products—the first step towards financial inclusion—the necessary change will not come about. This is because all efforts to introduce policy changes in commercial banks to bring about financial inclusion will be worthless, as commercial banks by definition are elitist in their products. They seem to offer financial inclusion products more for compliance and out of the need for conformity, and not out of choice.

In this research project, we first study the literature from other countries regarding the products they offer and the role of their securities market. In most developed countries, even low-income people have bank accounts; however, in developing countries, the scenario is rather different. In Latin America, Africa, Mexico, and Bangladesh—where MF is extensive—these MF institutions (MFIs) have mobilized savings accounts, which provided their basic source of funds for lending. In fact, of late, in the case of SafeSave in Bangladesh, their savings have exceeded their microcredit. We also find that globally, while microinsurance has been successful, life insurance and accident insurance products seem to have more takers. Competition and risk mitigation features are seen in microinsurance products in Bangladesh and Indonesia.

We categorize the institutions that offer MF in India into four tiers. A Tier 1 institution is also known as an NBFC-MFI. As of now, none of the non-banking financial companies (NBFCs) we analyzed have received this status. Tier 2 institutions are for-profit NBFCs, while Tier 3 institutions are non-profit MF Section 25 companies and Tier 4 institutions are non-profit trusts and/or societies working for local community development, with MF as one of their activities.

All MF institutions in India offer only microcredit products; savings is hardly offered due to regulatory hurdles. Currently, both insurance as well as pension products are offered, but is more common in Tier 2 institutions as compared to Tier 3 and 4 institutions. The NPS Lite product is still facing teething trouble. With regulatory impediments on interest rate and margin, it becomes very urgent that MFIs have the freedom to offer the breadth of products; else, sourcing expensive capital would be a problem. Even now, almost all of these institutions rely on bank funds for capital. Banks relent due to the stipulation of priority sector lending. Isn’t it time to free this sector from costly debt capital and let them source their capital from the securities market? The immediate need is to pass the MFI Bill 2012, which will be the beginning of a new era of sourcing of cheap funds for the MF institutions as well an outlet for investment for the clients.

Microfinance Products and the Role of Securities Markets

1. Introduction

To get the poor to save in formal financial institutions in India has been a difficult proposition since independence in 1947, despite several efforts. This, however, does not mean that the poor do not save. In a bid to make banking accessible to low-income users in India, the central bank, i.e., the Reserve Bank of India (RBI), made it mandatory for commercial banks to offer "no-frills accounts". The low usage (about 11%) of these accounts does not necessarily imply low demand for savings or banking by the poor in India. It could just mean that the products offered by the banks are unappealing to them and are custom-made for the elite. Without doubt, there is volatility in the income of the poor; however, their potential to save has been demonstrated empirically based on data from three countries (including India) in the recording of the financial diaries as well as in the studies by the International Food Policy Research Institute.

Offering simple financial products such as savings accounts, insurance, and so on is the first task of a microfinance institution (MFI) and is probably a challenging one too in a country like India with both geographic as well as socio-economic diversities. There are still many issues that remain unaddressed or unresolved in this context. The proposed Microfinance Institutions (Development and Regulation) Bill, 2012 in its current form addresses these issues adequately, but is yet to be passed. "The bill, without overtly saying so, hints at the possibility that MFIs will be permitted to mobilize thrift (small illiquid savings). If the regulations are introduced for this and MFIs permitted to mobilize thrift it would be an exciting development as it makes meaningful financial inclusion possible. The tough task of ensuring depositor protection remains unexplained" (Srinivasan, 2011, p. 96).

This research aims to understand the status of microfinance (MF) products in Tamil Nadu (TN). MF has penetrated in the rural areas of TN through the self-help group (SHG) movement thanks to the National Bank for Agriculture and Rural Development (NABARD). It is only of late that urban microfinance has picked up through the joint liability group (JLG) model. This study traces the historical evolution of the growth of MF products in TN as well as the growth of the various models in the different districts of TN. It also looks at how the securities market can play a more efficient role in the same.

The rest of the paper is organized as follows. Section 2 defines the topic of research, while Section 3 introduces the literature on the evolution of microfinance products around the world and in India with reference to the securities market. Section 4 then brings out the objectives of the study in light of the literature review. Section 5 provides a framework for the analysis and discusses the evolution of the questionnaire. Section 6 analyses the results of the meeting with various MFIs in Tamil Nadu and Section 7 concludes the paper with a few suggestions.

2. Microfinance Products and the Securities Markets

Microcredit, microsavings, and microinsurance cover the main products offered by microfinance institutions. Pension and remittances are also offered but are not used a lot. The term **microfinance** includes all the above efforts as well as the collection of savings from low-income households, the provision of insurance, and in some cases such as the Bangladesh Rural Advancement Committee (now known as the BRAC) in Bangladesh, the assistance in distributing and marketing clients' output (Armendariz and Murdoch, 2005).

Microcredit is the extension of very small loans (microloans) to impoverished borrowers who typically lack collateral, steady employment, and a verifiable credit history. It is designed not only to support entrepreneurship and alleviate poverty, but also in many cases to empower women and uplift entire communities by extension. In many communities worldwide, in developed and developing nations alike, women lack the highly stable employment histories that traditional lenders tend to require. As of 2009, an estimated 74 million men and women held microloans that totaled USD 38 billion. Grameen Bank reports that repayment success rates are between 95 and 98%. As of 2012, microcredit is widely used in developing countries and is presented as having "enormous potential as a tool for poverty alleviation". (Grameen Bank)

Microsavings consists of a small deposit account offered to lower-income families or individuals as an incentive to store funds for future use. Microsavings accounts work similar to a normal savings account; however, they are designed around smaller amounts of money. The minimum balance requirements are often waived or very low, allowing users to save small amounts of money without being charged for the service. Microsavings plans are usually offered in developing countries as a way to encourage saving for education or other future investments. People who invest in these plans are better prepared to cope with any unforeseen expenses, which would usually harm lower-income individuals (Rutherford, 2000).

Microinsurance is the “protection of low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved” (Churchill, 2006). Similar to regular insurance, microinsurance serves as an instrument to isolate fluctuations in consumption from fluctuations in income and wealth (consumption smoothing). Traditional microfinance schemes do not address such vulnerabilities and the necessity of risk reduction for the ultra poor. Microinsurance, like regular insurance, may be offered for a wide variety of risks. These include health risks (illness, injury, or death) and property risks (damage or loss). A wide variety of microinsurance products exist to address these risks, including crop insurance, livestock/cattle insurance, insurance against theft or fire, health insurance, term life insurance, death insurance, disability insurance, insurance against natural disasters, and so on.

The mobilization of savings from surplus savers to deficit savers is most efficiently carried out by the **securities market** through a range of complex products called “securities”. The definition of securities as per the Securities Contract (Regulations) Act, 1956 includes shares, bonds, scrips, stocks, or other marketable securities of similar nature in or of any incorporate company or body corporate, government securities, derivatives of securities, units of collective investment scheme, interest and rights in securities, security receipt, or any other instruments so declared by the central government. The securities market has essentially three categories of participants, namely, the issuer of the securities, the investors in the securities, and the intermediaries. Issuers are the borrowers or deficit savers who issue securities to raise funds. Investors, who are surplus savers, deploy their savings by subscribing to these securities. Intermediaries are the agents who match the needs of the users and the suppliers of funds for a commission. These intermediaries pack and unpack securities to help both the issuers as well as the investors to achieve their respective goals. There are a large variety and number of intermediaries providing various services in the Indian securities market.

In recent years, international capital markets have begun investing in microfinance. Collateralized debt obligations (CDOs), private placements, and direct securitizations of microloans have raised approximately USD 500 million (2006). Private sector debt and equity microfinance funds controlled more than USD 2 billion in 2006. Although traditional microfinance funders are behind most of these investments, private sector institutional investors are increasingly seeking full market returns. These mainstream commercial investors are driving the opening up of capital markets to microfinance (Swanson, 2007).

3. Literature Review

Microfinance institutions (MFIs) provide a gamut of financial services to low-income households and play an important role in financial inclusion (Sane and Thomas, 2011). World over Microfinance Institutions (MFIs) seems to have started off as NGOs offering microcredit products to the poor in order to enable them to enhance their livelihood. Currently, the microfinance industry designs microcredit products such that interest rates are decided based on the risk profile of individuals. The income cycles of the clients are reflected in the repayment schedules. Stepped lending is used to increase loan sizes for clients who are regular in their repayment. In some cases, interest has been partially rebated (Charitonenko and Campion, 2003).

In European countries such as Albania, MFIs had a formal banking or financial institution license from the outset; most of them offer or at least aim to offer complete banking services. Besides micro- and small-business loans and time and savings deposits in local as well as foreign currencies, these institutions offer payment services and some also issue letters of credit or traveler’s cheques. (World Bank, 2008)

More than 40% of households in India do not have access to financial services from formal channels (Roy, 2011). Globally, MFIs seem to have started off as non-governmental organizations (NGOs) offering microcredit products to the poor in order to enable them to enhance their livelihood. With time, MFIs moved on from being NGOs; as they grew in size, their funding needs could not be met by grants alone (which is the case in India also). As their funding needs grew, they had to look at different sources of funding. This led to the need for getting savings from the poor as a source of financing. While we understand that it would be systemically unsafe to allow all MFIs to operate like banks (in terms of savings products), we still think that some MFIs are suited to move up to this status. If this avenue proves insufficient to meet their funding needs, MFIs approach the securities market for funding.

NGOs in India perform a range of developmental activities and microfinance is usually a sub-component. Some of these NGOs organize groups and link them to an existing provider of financial services. In some cases, NGOs have a "revolving fund" that is used for lending. An example is the Aga Khan Rural Support Programme, India (AKRSP-I). For AKRSP-I, the microfinance component is secondary to its work in natural resource management.

In most developed economies, more than 90% of households use bank accounts to save and to make payments. The ubiquity of such services speaks volumes about their critical role in daily life. Where they are not available, as in many poorer countries around the world, individuals are denied a basic service and are forced to rely on informal savings and payment techniques that may be of inferior security, liquidity, and returns. Moreover, many poor and low-income households lack access to formal or semi-formal credit for consumption smoothing; they also lack access to other services such as savings, money transfers, and insurance. The excess demand for deposit services is evident in the common practice among the poor of paying someone to hold lump sums of money for them (Aryeetey and Steel, 1995).

Despite the many challenges, there are promising signs that the poor can profitably be offered savings and payment services in large numbers. As a separate regulated type of institution, MFIs hold only about 1% of deposits, most of which are concentrated in developing countries. When MFIs are allowed to accept deposits, they can become significant players. Microfinance institutions have begun to recognize the benefits of savings mobilization for the clients—rural poor can and do save—and for the MFI—in terms of providing it with a potentially large, stable source of funds. While designing savings products, MFIs take into account the client's preference for security, liquidity, and returns. MFIs use whatever infrastructure is available to reduce transaction costs. Technology also plays a part in providing savings products (PDAs, ATMs, etc.) (Charitonenko and Campion, 2003).

In Bangladesh, in response to competitive pressure related to flexibility, BURO-Tangail (BT), which was established in 1990, increased its savings services to three and made each type voluntary (independent of any outstanding microloan) and completely liquid. The results were very positive—the deposits and net savings increased substantially and they became a major source of funds. Subsequently, BT increased the number of its microcredit products to nine and it remains committed to providing high quality, flexible financial services that are adapted to the needs of the poor.

SafeSave offers convenient savings and loan services to the slum dwellers of Dhaka, the capital of Bangladesh. The interim results of their random-trial evaluations of microfinance show that savings may have more power to alleviate poverty than loans do (SafeSave, 2012). The report also suggests that financial service for people must help their users deal with the full range of daily financial needs, and not just a narrow range of uses such as micro-enterprise financing. These are the ideas at the heart of SafeSave. The following indicate the growth of SafeSave:

- The general savings portfolio grew very strongly, outpacing growth in the loan portfolio by a wide margin.
- When savings collected in the increasingly popular long-term savings product is added, the ratio of savings held to loans outstanding was 127%.
- The proportion of clients who borrow has fallen steadily, and now stands at just 53%. At the same time, savings have grown rapidly. This indicates that client trust in SafeSave continues to grow, and that clients increasingly see saving as a welcome alternative to borrowing as they seek to build the sums they need in their lives.

In El Salvador, Financiera Calpiá's rural microfinance methodology has the following attributes (WSBI, 2009):

- Calpiá communicates to clients its desire to create a long-term relationship, offering a stream of financial services at improving terms and conditions.
- Loans are tailored to individual demand, which allows clients to take advantage of a wider set of productive opportunities and offers the organization opportunity to maximize income from each borrower.

- Non-traditional assets (with high incentive value but low resale value) and traditional assets (such as mortgages on houses) are accepted as collateral.
- Calpiá conducts in-depth analysis and monitoring of the client's use of loan funds to gauge their repayment capacity and to detect changes in risk profiles.
- Calpiá understands that clients perceive changes in their productive opportunities better than anybody else and encourages them to adjust their decisions to these changes in the environment.
- Calpiá is instrumental in keeping arrears at very low levels, for example, even during the El Niño flooding.

Such experiences where savings is found to be increasing as compared to borrowing (in Bangladesh, for instance) and the acceptance of non-traditional assets as collateral by MF institutions such as Financiera Calpiá in El Salvador establish the fact that building a long-term relationship with clients is very important for understanding their financial requirements and developing products suited to them.

In the Dominican Republic, Banco ADEMI launched a debit card in 1998 in conjunction with a new loan product, "Préstamo con ahorro" (loan with savings). When a customer applies for a loan up to DOP 200,000 (USD 12,500), she/he agrees to deposit 10% of the loan value into a Banco ADEMI savings account and to allow the bank to automatically withdraw future loan payments from that account. In exchange for this agreement, Banco ADEMI authorizes loan amounts 10% higher than it would otherwise authorize. The additional loan funds are then placed in savings at the time of the loan disbursement (WSBI, 2009).

Freedom from Hunger started working with two commercial microfinance credit unions in Mali—Nyèsigiso in 1996 and Kafo Jiginew in 1997—to target rural women through its Credit with Education group lending program. The result of participation in such microfinance programs is that the access to credit enables women to expand and diversify their enterprises and often replaces more costly sources of funding (Charitonenko and Campion, 2003).

In Latin America, the World Savings Banks Institute (WSBI) microfinance providers offer microcredit and microsavings products primarily as licensed institutions. All WSBI members are authorized to collect savings. One of them, Banco del Ahorro Nacional y Servicios Financieros (BANSEFI) in Mexico is a savings-only institution that is also allowed to process payments—mostly national and international remittances and payments of social programs (WSBI, 2009).

BANSEFI is also a large mobilizer of savings in Mexico. As of June 2006, it registered 3.3 million accounts with an overall balance of USD 455 million. The entire organization of BancoEstado mobilizes 88% of the savings retail market in Chile, with a total of 10.5 million passbooks savings accounts totaling USD 3.4 billion in deposits. FEDECREDITO in El Salvador has experienced rapid expansion since 2004. Savings collected grew from USD 56 million in 2004 to more than USD 138 million in 2007 (WSBI, 2009). According to the Superintendencia de Banca, Seguros y AFP (SBS) del Peru, which is the Peruvian banking supervisor, the municipal credit unions—Cajas Municipales de Ahorro y Credito, known as CMACs—in Peru have reached leadership positions as savings mobilizers, ranking ahead of most other financial institutions in their regions (WSBI, 2009).

In terms of remittances, BANSEFI (Mexico), BANRURAL (Guatemala), Cajas de Crédito affiliated with FEDECREDITO (El Salvador), and the CMACs (Peru) are the main institutions providing services on a large scale in the U.S.-Latin American corridor. Banco BCSC (Colombia) also processes remittance payments via agreements with the Spanish Savings Banks Confederation (CECA) and La Caixa (Spain). In Central America, the FEDECREDITO System has become an important remittances service provider in El Salvador (WSBI, 2009).

In terms of insurance offered to the micro-entrepreneur and the low-income market, the active WSBI members are BancoEstado (Chile), Banco BCSC (Colombia), and BANRURAL (Guatemala). Insurance policies are usually distributed to microcredit clients and cover mainly life, disability, and accidents leading to injury in microbusinesses (WSBI, 2009).

BancoEstado is the national market leader in Chile, with more than 1.3 million insurance customers. It has designed low-cost insurance policies such as the Incredible Insurance product, which covers the risk of accidental death at a cost of only USD 7.8 per year—about 60 cents per month (WSBI, 2009).

Microinsurance is rapidly expanding in Bangladesh. Microinsurance products are becoming more competitive, and there are several risk mitigation options available to the low-income market (Ziaulhaq, 2007). The Association for Social Advancement (ASA) offers a Credit with Endowment Life Insurance product; in addition to covering the life of the borrower, the product also insures the outstanding loan balance in case of the death of the husband/guardian of the borrower. Grameen Bank (GB) offers a Credit plus Livestock Insurance product that benefits both parties—it guarantees the collection of at least half of the unpaid loan for GB, while it relieves the client from having to pay the full outstanding amount (Khalily et al., 2009).

In Indonesia, there is strong demand for insurance products that cover the risks that people are least prepared for and have insufficient means to manage. Such risks include serious illness, poor harvest, death in the family, and social obligations. An array of products are offered by member-owned insurers such as Bumiputera, the internationally-regulated insurance company American International Group (AIG), and BRIngin Life, the company created by the state-owned Bank Rakyat Indonesia. Additionally, microinsurance is often seen in informal risk-pooling mechanisms such as the arisan, which is a form of rotating savings and credit association (Allianz AG, GTZ and UNDP Public Private Partnership, 2006).

In India, financial inclusion of the poor by providing them with access to savings, credit, and insurance forms an integral part of the package of livelihood promotion services that the poor require. While a diverse set of both formal and informal institutions have evolved to cater to the savings and credit needs of the poor, there is still a huge gap with respect to insurance services available for the poor. The penetration of the formal insurance sector is very low today. According to estimates, less than 15% of the country's population is insured (Ghate et al., 2007). The challenge in providing a whole of range of insurance products to cover the risks related to both the life as well as the livelihood-generating assets of the poor is huge. It is imperative for microfinance institutions to seize the moment by actively providing microinsurance services for the poor, and thereby, contribute to achieving comprehensive financial inclusion of the poor.

The rapid growth of the microcredit movement in terms of scale has tempted many to expect a similar growth in microinsurance. A large chunk of microinsurance includes credit life insurance, which is automatically bundled with microcredit. However, providing insurance as a standalone product for the poor has not been as easy. The reason for this contrast is that microcredit is largely a pull product (demand-driven), whereas micro insurance (or any insurance for that matter) is a push product that requires significant marketing and sales efforts to enroll customers. The transition from selling a pull product to a push product has not been easy for microcredit institutions. Another issue that has to be addressed to promote microinsurance is the sustainability of such programs.

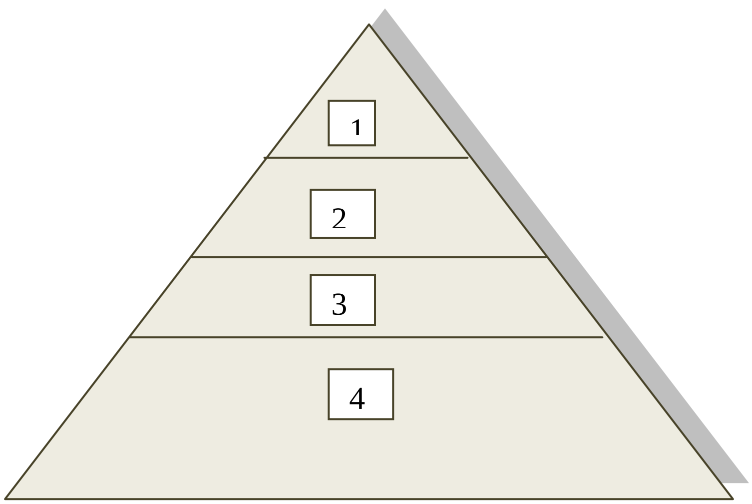
A comparison of the MFI products offered by various countries shows marked differences in the products. For instance, consider the depository services of international and domestic MFIs. Bank Rakyat Indonesia, one of the more successful international MFIs, had 26 million savings accounts in 2004 that provided some lending capital. However, in India, regulations prevent MFIs from offering savings products. These differences between India and the rest of the world highlight the need for scrutinizing the various products offered by MFIs in India. Based on the literature review and the framework defined in the subsequent section, we describe our objectives and discuss our analysis based on discussions with institutions that offer MF services in TN.

4. Objectives/Research Questions

1. What is the model-wise evolution of MF products in Tamil Nadu?
2. What are the current proposals in the MFI Bill 2012 regarding MF products in India?
3. How can the securities market play a more efficient role in integrating these MF products?

5. Framework for Analysis

The microfinance industry is rapidly transforming, particularly among institutions serving poor customers. A growing divide is emerging between smaller, NGO-managed MFIs and larger, more commercially-oriented specialized microfinance institutions, many of whom are or intend to become regulated financial intermediaries. The various products offered by MFIs will be analyzed by segmenting them into four tiers as proposed in Meehan (2004). The products offered by MFIs in different tiers may differ drastically. Figure 1 illustrates the magnitude of the divide segmenting the sector into four tiers.



Tier 1: Mature and best-known MFIs with strong financial and operational track record. Most are regulated. At most, 2% of all MFIs; the Top 50 or 100.

Tier 2: Successful but smaller, younger, or simply less well-known MFIs. At or near profitability. Mostly NGOs; consider conversion. Majority will progress up. 8% of all MFIs.

Tier 3: MFIs approaching profitability. Understandable shortcomings due to young organization, lack of capital, weak MIS, or other needs. Nearly all NGOs. Some will progress up. 20% of all MFIs.

Tier 4: Mix of unprofitable MFIs: start-ups, post-conflict settings, weak institutions, or those for which microfinance is not the focus. Some will progress up. 70% of all MFIs.

Figure 1: Segmentation of MFIs
(Source: Meehan, 2004)

A microfinance institution (MFI) in India can lend without registration at present, though the proposed MFI Bill suggests mandatory registration for lending. Each legal structure has different requirements and privileges. MFIs in India are generally classified as follows:

- **Tier 4**: Non-governmental organizations (NGOs) engaged in microfinance (NGO-MFIs), comprising Societies and Trusts generally at the grassroots level.
- Cooperatives registered under the conventional state-level Cooperative Acts, the national-level Multi-State Cooperative Legislation Act (MSCA 2002), or under the new state-level Mutually Aided Cooperative Act (MACS Act). (This category will not be considered in this study.)

- **Tier 3**: Section 25 Companies, which are generally defined as not-for-profit organizations.
- **Tier 2**: For-profit non-banking financial companies (NBFCs).
- **Tier 1**: NBFC-MFIs.

If we try to map the framework of Figure 1 to the legal structure in India, we can get such a mapping based on the organization's corporate structure. Does an organization's structure determine its ability to provide various products to its clients or leverage such ability? Similarly, does its structure restrict or increase its ability to source capital from various sources, particularly from the capital markets? These questions, the literature review, and the MFI Bill 2011 formed the basis for the formulation of the questionnaire (Appendix 1), which is classified into three broad sections.

1. **Products offered:** This section of the questionnaire discusses the different types of products offered by the various MFIs and the obstacles faced by them.
2. **Sources and cost of funding:** This section elaborates on the source of an MFI's fund and their respective costs.
3. **Securities market:** The final section discusses how MFIs view the securities market in relation to issuing securities as well as investing in securities by them and by their clients.

6. Analysis of Results

Studying the MFI Bill 2012 that is waiting to be passed in Parliament will offer a good understanding of how the Indian government perceives the sector will progress in the near future; this will assist in the evaluation of the results of our discussion with institutions that offer MFI services. The MFI Bill 2012 starts off with the following statement: "… to provide for development and regulation of the micro finance institutions for the purpose of facilitating access to credit, thrift and other micro finance services to the rural and urban poor and certain disadvantaged sections of the people and promoting financial inclusion through such institutions and for matters connected therewith or incidental thereto."

Enormous changes in the legal structure of the MFIs are required if these institutions are to access the poor's thrift or savings. This is because MFIs in India are currently not allowed to offer savings products. Globally, MFIs have been successful in reaching the poor by bringing about financial inclusion through their savings products. What hinders India? The analysis below is based on discussions with the various institutions in Tamil Nadu (Appendix 2) regarding the products they offer to low-income families, the source of their funds, and how well they tapped the securities market for their funds.

The unit of analysis was the MFI. One of the main reasons for this was to understand the various products they offer to their clients. Moreover, we wanted to understand if these products varied depending on the classification of the institution and the reasons why they did or did not offer certain products. With the list of MFIs available from the National Bank for Agriculture and Rural Development (NABARD), we could only do convenience sampling as several MFIs were either unavailable or their contact details were not reachable. As our analysis involves only simple averages, we feel that the present sample of 49 institutions is representative of the population.

We found no institutions in the Tier 1 category (NBFC-MFIs) among the institutions we analyzed. Many institutions in the Tier 2 category indicated that they were waiting to move up to the Tier 1 category but were waiting for the MFI Bill to be passed. The responses to the key questions in the questionnaire are analyzed below.

6.1 Microfinance products

The distribution of the MF products offered by the various institutions that we spoke to is presented in Table 1.

Table 1: MF Products offered by various institutions

	Microloans	Savings	Insurance	Others (Pension, Remittances, etc.)	Non-financial products/services
Tier 2	100%	0%	98% Life Insurance 70% General Insurance	15% Pension 8% Remittance	23% (Providing KYC to clients to enable them to buy Gold Coins from ICICI)
Tier 3	100%	0%	28% Life Insurance 0% General Insurance	0% Pension 0% Remittance	
Tier 4	100%	10%	14% Life Insurance 4% General Insurance	4% Pension (if associated for over 5 years) 0% Remittance	

Regardless of the legal structure in India, **microloans** were offered by MFIs; these were the primary product. Almost all institutions offered progressive loans to groups, which could be a self-help group (SHG) or a joint liability group (JLG), varying in the number of women per group. **Savings** products were not offered due to regulatory barriers. Only MFIs operating as Credit Cooperatives offered savings products.

Among **insurance** products, life insurance was a very common product regardless of the legal structure. The reasons for insurance were more to protect the loan taken and the family in case of sudden death. However, general insurance was offered the most by Tier 2 MFIs (50%) as compared to Tier 3 and 4 MFIs. General insurance constituted medical insurance, cattle insurance, livestock insurance, etc. MFIs that offered general insurance did so due to a strong financial literacy program that they had in place, which they used to educate their clients about financial management. In fact, the MFIs did not incur any cost on account of the insurance products as the clients were directly tied to the insurance companies. The MFIs acted as middlemen only, giving advice. However, the MFIs that did not offer these products feigned discomfort at these products and were unwilling to offer products to their clients that they were not sure about. They claimed to have had several difficult and bad experiences with insurance products as companies were not upfront about what they had to offer. Hence, these MFIs did not want to collect premium from their low-income clients for whom every rupee is precious.

About 16% of the Tier 2 companies offered **pension** products such as the National Pension Scheme-Lite (NPS Lite) and 8% offered a remittance product through Western Union. Additionally, a couple of Tier 4 MFIs offered pension products to their older clients. The NPS-Lite model is designed to ensure very low administrative and transactional costs, so as to make such small investments viable. NPS Lite works on a group model. It also aims at harnessing the outreach and capacity of the government-operated schemes, NGOs, MFIs, NBFCs, etc. in targeting and servicing the old-age savings needs of low-income workers. Each eligible group or "aggregator" in the NPS-Lite model will be responsible for grassroots-level enrolments, ongoing collection, and reconciliation and transfer of individual contributions, as well as for ongoing services and information delivery.

All the MFIs that we visited were quizzed about why there was low offtake of the NPS Lite when there was no financial burden to them and it seemed a good savings product for their clients. Most MFIs claimed to be unaware of the same, the commission was too low, or their clients were not convinced about monthly contributions towards a distant tomorrow as the scheme still seemed hazy. Additionally, several MFIs were very apprehensive from the client's perspective as this looked like an individual pension product and not a family pension scheme. We felt that this product can be marketed as a savings product through MFIs only through financial literacy programs. The reason for the poor offtake of Western Union was also lack of awareness. The scheme appears to be well regarded but it has not taken off because of lack of incentives for the points of presence and their poor marketing strategies. This is discussed by Stelten (2011).

Ananth et al. (2012) describe the quest for complete financial inclusion in India through the Kshetriya Gramin Financial Services (KGFS) model. The three characteristics of the model are: (a) complete coverage of the population in a location; (b) tailored client wealth management services; and (c) a wide range of products. A deeper understanding of their model might provide better answers for developing a policy for village development as compared to top-down policies.

6.2 Obstacles to implementation of MF products

6.2.1 Savings

The only major obstacle to savings products according to the MFIs was regulation. If this were true, why did they not offer the NPS Lite? Further questions revealed that the obstacles were the poor incentives structure, the lack of awareness, and the poor marketing of the product. The pension schemes of some MFIs did better than NPS Lite among clients, both in terms of offtake as well as trust. The presence of rotating savings and credit associations (ROSCAs) in villages could be a major reason for this. Once the MFI Bill is passed, short-term savings products can be expected to have more takers from the low-income group. However, we feel that these NBFCs should not be allowed to offer savings products without deposit insurance because this could cause systemic problems. Since the clients are from low-income households, they need protection. Given that savings account holders in commercial banks have a deposit insurance of up to INR 1 lakh, we feel that MFIs offering savings products should also offer deposit insurance to their clients. The other option would be to systemically divide the institutions into important and unimportant institutions based on their size and/or operations, and grant them licenses to offer savings products with deposit insurance.

6.2.2 Insurance

With insurance products—medical (Rashtriya Swasthya Bima Yojana or private), cattle, livestock, and weather insurance products—most clients and/or MFIs were either unaware or felt that the premium was not worth it. They felt life policies were worth the premium paid as they got a lump sum at the end of the period whereas they saw other policies as a burden. Somehow, they could not relate to the idea of purchasing a policy to insure against the possible risks they faced. This is due to their low income and lack of financial literacy. Hence, most MFIs do not offer these products.

Box 1 illustrates the various general insurance products that have been developed by the Kshetriya Gramin Financial Services (KGFS) according to the needs of the clients of a particular geographic area.

Box 1

Insurance products to mitigate risk at KGFS

For the poor, insurance is more of a mechanism to cope with catastrophic events. Savings is seen as a vehicle to smooth consumption; however, insurance is a hedge during uncertainties to protect their savings. At Kshetriya Gramin Financial Services (KGFS), insurance is provided to cover human capital, livestock, and shops.

To protect human capital, KGFS offers life insurance schemes. This is to ensure that on the death of the earning member of the family, the rest of the family does not suffer due to a break in the continued flow of income. Young children who are studying need not leave school to support the family if the income-earning parent has his/her life insured. This enables the family to have the present steady income and secure a better future as the children have the opportunity to continue studying.

Livestock insurance is offered to guarantee continuous income to families who rely on selling milk to earn a living. The insurance is meant to enable the purchase of new animals in case the cattle die due to disease. This insurance product is combined with the loan product using which the client buys the cattle. This is done to ensure that the customers are not hampered in repaying the loans while they earn a steady income.

Shop insurance is given to guard against unanticipated catastrophes in the client's shop that is the main source of income for the client. The "insurable interest" of the client is considered while offering the product. This ensures that they are adequately compensated for their losses. This product does not cover shops that are prone to catastrophes by nature of their construction, such as shops with a thatched roof.

http://www.ifmr.co.in/blog/

6.2.3 Pension

Acting on the Project OASIS Report of 2001 on pension reforms, the Government of India started the defined contribution-based New Pension Scheme (NPS). Under this scheme, one can invest between INR 1000 and INR 12,000 a year. The fund is then invested in market instruments by seven pension fund providers. At maturity, 40% of the realized amount has to be compulsorily invested in a pension annuity, 80% or more if withdrawn any time before, depending on how a 1000-rupees-per-month pension payout can be ensured. Its ultra-low-cost version, the NPS Lite, was recently introduced for unorganized workers, but it has had a lukewarm response. Only 17,306 had registered as of January 2011, which is an improvement from 1,476 in November 2010. This increase in numbers is thanks to the co-contribution Swavalambam scheme offer from the government (INR 1000 for the next three years), better incentives to aggregators of the product, and other goodies. The low registration is due to low awareness among clients and MFIs, poor incentives for the offtake of NPS Lite, as well as a prevailing sense of uncertainty about the product. Clarity in all these aspects could potentially make this a good product as the fund is invested in market instruments. With about a third of the population as potential clients, this could mean security in the long run for them as well as a risk spread from tapping the market over a period of time. This would also ensure the continuous flow of funds from the household sector to the markets.

6.3 Reasons for not entering the securities market

MF institutions gave the following as the top reasons for not entering the securities market:

- The failure of SKS Microfinance: 61%
- Capital requirements: 28%
- Lack of knowledge about the securities market: 17%

The crisis in Andhra Pradesh that led to the failure of SKS Microfinance reduced the confidence MF institutions have in the securities market. This, coupled with the capital requirements needed to enter the market, forced the MFIs to look for other sources of funding. To add on to this, many MFIs are unaware of the securities market as a whole and the opportunities available to get funds for their operations. Other reasons given by MFIs were that they could not enter the market due their legal structure (namely, that they were a trust), that private equity wanted to control investments in their MFI, and they felt that the market conditions were too poor to enter the market.

6.4 Source of funds

Table 2 presents the various sources of funds of the MFIs that we studied.

Table 2: Source of funds of MFIs

Category	Bank Loan	Private Placement/Equity	Grants	Securitization	Debentures
Tier 2	45–60%	25–30%	5%	20–30%	5%
Tier 3	50–60%	0%	35–45%	0%	0%
Tier 4	50–70%	5–10%	25–30%	0%	0%

The legal structure of the MFI was a major determinant of its source of funding. While banks loans constituted the largest part of the source of capital for both Tier 3 and Tier 4 MFIs, grants played an active role in Section 25 companies (Tier 3 MFIs). This was the main reason they were restricted in their activities and could not securitize their portfolio. Only Tier 2 MFIs sourced capital from the market by securitization of their portfolio. This was possible only because of equity participation (private placement) in their capital structure. IFMR Capital seems to be the only institution that is successfully involved in securitization of MFI portfolios (since 2008). Anand and Fernandes (2012) describe multi-originator securitization in microfinance. They describe how IFMR Capital helps MFIs access capital through securitization to investors such as mutual funds, high networth individuals, private banks, and other financial institutions. Box 2 describes the listing of the first securitized debt at the Bombay Stock Exchange (BSE) in 2013.

Box 2

Financial inclusion through securitization: IFMR Capital

For the first time, the Bombay Stock Exchange (BSE) saw the listing of senior securities of IFMR Capital Mosec™ XXII. This marks the listing of securitized debt for the first time in India. How does this bring about financial inclusion as well as greater transparency and accountability to the MF sector? A close look at the originators of the debt capital could indicate how this could probably pave the way for the evolution of more products.

The MF originators who participated in this transaction are Asirvad Microfinance Private Limited, Chaitanya India Fin Credit Private Limited, Disha Microfin Private Limited, Fusion Microfinance Private Limited, Grama Vidiyal Microfinance Limited, Sonata Finance Private Limited, Suryoday Micro Finance Private Limited, and Utkarsh Micro Finance Private Limited. Together, these entities have portfolios diversified across 11 states—Tamil Nadu, Karnataka, Gujarat, Uttar Pradesh, Uttarakhand, Madhya Pradesh, the National Capital Region, Haryana, Orissa, Bihar, and Maharashtra. The Mosec™ XXII pool is diversified across 10 states and 94 districts across India. CRISIL has assigned a rating of A+ (SO) to the senior subsidy dependence indexes (SDIs) of IFMR Capital Mosec™ XXII, while the junior tranche received a rating of BB- (SO). Axis Bank subscribed to the senior SDIs.

In a Mosec™ (multi-originator securitization) transaction, loan pools of multiple originators are combined and securities that are backed by these pools are issued. This structure allows smaller originators to tap into the capital markets, while at the same time providing investors the benefit of diversification and credit enhancement.

http://capital.ifmr.co.in/

As an MFI moves up the learning path from being just a debt-based institution (with bank loans or grants) to a portfolio-based (debt + equity-based) institution, it also seems to change in legal structure. Most often, the goals of the MFIs lead them to change their legal status. However, if they decide to remain in just a single geography, they often remain Tier 3 or 4 institutions, sourcing capital from banks and grants only.

There are many microfinance institutions in the country that are potential enablers of access to finance for the poor. However, not many of them have been able to raise adequate funds. This could be due to multiple reasons—the structure of the MFIs may not be conducive to attracting growth capital, or the promoter may have exhausted his/her sources to provide equity and is unable to attract further funds, or it could be a combination of these factors.

As the promoter tries to bring in outside investors to expand equity capital, the dilution of stake is inevitable. Such dilution at an early stage might lead to a situation where the MFI is forced to adopt a strategy that maximizes returns for investors, which could possibly not enable real access to finance. On the other hand, the absence of capital severely affects the growth of the MFIs, since limited equity caps the leverage potential of the MFI.

IFMR Mezzanine Finance (IFMR MF) believes that enabling small and medium microfinance institutions to access finance would allow a large number of individuals (who are currently excluded from this access) to benefit from it. IFMR MF aims to achieve this by providing long-term loans to MFIs to serve as growth capital in lieu of equity.

The objective of IFMR MF is to enable deserving MFIs to gain access to long-term funds without having to dilute their stake. They provide innovative debt funding through mezzanine products that help MFIs overcome some of the issues imposed by traditional debt funding. This innovative structuring allows the debt to be classified as Tier 2 capital. IFMR MF looks to work with MFIs operating under different legal structures, including trusts, societies, Section 25 companies, and NBFCs. Based on the needs of the MFIs and based on its evaluations of such needs, IFMR MF recommends different product structures.

The funds from IFMR MF can be used to build systems and strengthen the organization, to leverage with banks, and to meet regulatory norms.

6.5 Investment options for clients

For clients of MFIs, the most popular modes of investing the money earned using loans are: income-generating asserts such as cattle (61%); gold (90%); and fixed deposits (9%).

The clients of MFIs use their loans and the income earned by doing business to invest in assets that can help them earn more, such as cattle (61%). However, a majority of them invested in gold (90%), which they felt was the best investment option in times of need. Fixed deposits were rare, mainly because of lack of knowledge and financial illiteracy. The returns from FDs are higher on an average compared to the returns on gold, in the short term at least; and yet, they prefer gold for several reasons (Kumar, Mukhopadhayay, 2012). One way to get out of this situation would be to pass the MFI Bill 2011 pending in Parliament, which includes provisions for saving (thrift). This way MFIs can think of offering savings products.

Box 3 describes the unique case of an MFI, the Integrated Village Development Project (IVDP) led by Kulandei Francis, which has brought about development in the districts of Krishnagiri, Dharmapuri, and parts of Vellore. This point to a case where conditions for livelihood were created before the SHG movement was initiated. It also shows how the zeal of a single individual brought about change without any external aid.

Box 3

Building the economic power of women: The IVDP way

It is often debated whether MF institutions really lend to the real bottom of the pyramid as they might not have the capacity to repay. The case of the Integrated Village Development Project (IVDP) stands out as an instance where entire districts have developed without external assistance but with only the zeal and vision of a man, 2012 Magsaysay Award winner Kulandei Francis. In 1979, he started the IVDP as he was upset on seeing suffering and poverty in Natrampalayam village in Krishnagiri district of Tamil Nadu. The first step was to build the micro-watershed program to benefit the community, which was suffering without water for several years. Following its success, he started the SHG movement in a small way to help families to move away from the shackles of moneylenders. There was stiff resistance in several villages as the moneylenders and landlords were in control. However, he was able to convince the poor women with the support of their husbands, and he got most of these women to be disciplined and to form SHG groups. On seeing the creation of livelihood in the region, there were several positive spin-offs—several migrants returned and IVDP's SHG movement became very popular. Groups formed clusters and clusters led to federations.

The uniqueness of IVDP lies in its holistic development of the village rather than the development of wealth, which has a productive return. Development of social capital in underdeveloped places is needed before the SHG movement begins because the poor cannot think of doing business without basic infrastructure. According to Francis, he did not wait or blame the government but was proactive in his vision. All he asks is for the government not to interfere!

http://www.ivdpkrishnagiri.org/

7. Conclusions and Suggestions

The MFI Bill 2012, which has been modified from its previous form, is waiting to be passed in Parliament; it envisages gigantic strides both in legal terms as well as the range of products to be offered by MF institutions in India. Studies have shown that low-income families have benefitted by savings products offered by these institutions in Latin America, Africa, and Bangladesh. These institutions have benefitted from these small savings as a source of funds for lending. The situation would be even better when the NBFC-MFI is created—the new class that will focus only on this sector.

Almost all MF institutions in India offered only microcredit products; savings was hardly offered due to regulatory hurdles. Presently, insurance and pension products are offered, but these are predominant in Tier 2 institutions as compared to Tier 3 and 4 institutions. The NPS Lite is still facing teething problems. With regulatory impediments on interest rate and margin, these institutions urgently need the freedom to offer the breadth of products or else sourcing expensive capital becomes a problem. Even now, almost all of these institutions rely on bank funds for capital. Banks in turn relent due to the stipulation of priority sector lending. The legal structure of the Tier 2 institutions helped them securitize their portfolio and source capital from the capital markets, which again is largely an offshoot of private banks trying to meet the priority sector lending stipulation.

It is time to free this sector from costly debt capital and to allow them to source capital from the securities market. A quiet beginning has been made by the listing of securitized debt at the BSE in 2013 by IFMR Capital. The hope is that this product is emulated and we can see financial inclusion through the securities market in a fair and transparent manner.

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Appendix 1
Questionnaire: Microfinance products and role of securities market

1. Profile of the institution

- Name :
- Contact details :
- Legal status :
- Area of operation (rural or urban) :
- % Rural & % Urban :
- Year and place of inception :
- Eligibility (age/income/education) :
- Gender of your client :
- Head office :
- Number of clients :
- Number of branches :
- Number of states :
- In TN, how many districts :
- Have they offered savings? :

2. Do you offer the following products?
   a) Microcredit product/loan product
      (Consumption/productive/emergency/housing/agri/education/individual/water&sanitation/solar energy/infrastructure/gold/debt/education/others ______________________)
   b) Savings product/deposit product
      (Periodic compulsory saving/voluntary saving/daily saving/any others___________)
   c) Life insurance product
      (Endowment/whole life/both/others____)
      (Provided by own institution/any other institutions/any other intermediary_______)
   d) General insurance product
      (Health/any other_______________________________)
      (Provided by own institution/any other institutions/any other intermediary_______)
   e) Pension product
      (NPS Lite____)
   f) Remittance product
      (Western Union/MoneyGram/any others___________________________________)
   g) Non-financial products and services____
   h) If any other, please mention____
3. What are the obstacles you face in offering the following products?
   a) Savings:
   b) Insurance:

c) Pension (NPS Lite):

4. What is your reaction to the securities market in relation to microfinance?

5. Which of the following are issued by your institutions?
   a) Equity in private placement
   b) Debt in private placement
   c) IPO
   d) Bond
   e) Securitization for given microloans
   f) Others
   g) None of the above
6. What do you think is the most important reason for not entering into the securities market by most microfinance institutions?
   a) Failure of SKS Microfinance
   b) Limited control over the institution
   c) To become accountable to stockholders
   d) Lack of knowledge
   e) Capital
   f) Management
   g) Riskiness
   h) Regulations
   i) Others
7. What are your sources of funding, cost, and percentage?

Sources of fund	**Tick them**	**%**	**Cost %**
a) Savings from members/collection of thrift			
b) Interest income on loans			
c) Loans from local banks and consortium at market rates			
d) Entrance fee			
e) Service costs			
f) Grants from government			
g) Venture capital			
h) Equity			

i) Debentures			
j) Bonds			
k) Foreign borrowings			
l) Philanthropic agencies			
m) Others			

8. Did these sources of funds fulfill your requirements?
   a) Yes b) No
9. If no, what did you do when you ran short of money?
10. Do you assist your clients in buying assets from the market? If yes, how do you facilitate this process?
    - Financial
    - Non-financial
11. In which of the following assets have your clients invested?
    a) Shares
    b) Bonds
    c) Fixed deposits in bank
    d) Fixed deposits in your institution
    e) Post office products
    f) Money market mutual fund
    g) Land
    h) Cattle
    i) Gold/silver from your institution
    j) Gold from commodity market
    k) Silver from commodity market
    l) Other commodities, if any
    m) Others
12. What could be the barriers preventing MF institutions from facilitating their clients to invest?
    a) Investment fee
    b) Lack of transparency
    c) Liquidity
    d) Financial literacy
    e) Regulation
    f) Technological
    g) Others

Appendix 2

List of institutions related to MF activities in TN that were studied

Sl. No.	List of Institutions	Status
1	Arasan Rural Development Society (ARDS)	Society
2	Asirvad	NBFC
3	Association for Rural Community Development (ARCOD)	Society
4	Activist for Social Alternatives (ASA)	Trust
5	Bullock-cart Workers Development Association (BWDA)	Society
6	BWDA Finance Limited (BFL)	NBFC
7	Community Action for Rural Development (CARD)	Society
8	Community Development Centre	Trust
9	Community Service Trust	Society
10	Ecumenical Church Loan Fund of India (ECLOF)	Section 25 Company
11	Equitas Microfinance India Private Limited	NBFC
12	Guidance Society for Labour Orphans & Women (GLOW)	Society
13	Grama Vidiyal Microfinance Limited (GVML)	NBFC
14	Growing Opportunity Finance	NBFC
15	Hand in Hand	Trust
16	Impact (World Vision)	Section 25 Company
17	Indian Association for Saving & Credit (IASC)	Section 25
18	Integrated Village Development Project (IVDP)	Society
19	Kalanjiam Development Financial Services (KDFS)	Section 25 Company
20	Kalrayan Hills ADP (KHADP)	Society
21	League for Education & Development (LEAD)	Society
22	Madura Microfinance Limited	NBFC
23	Mahalir Association for Literacy, Awareness and Rights (MALAR)	Society
24	Mahasemam Trust	Trust
25	Micro-finance Consulting Group (MCG)	NBFC
26	Manidham Grameen Savings & Credit Services (MGSCS)	Section 25 Company
27	Nanayasurabhi Development Financial Services (NDFS)	Society
28	NEW LIFE	Society
29	The Society for Development of Human Abilities and Environment (OAZOANE)	Society
30	Omalur Block Women Welfare Uplift Organisation (OBWWUO)	Trust
31	Pioneer Trad	Society
32	PREPARE	Society
33	People’s Action for Transformation	Trust
34	People’s Action for Development and Credit Union (PADACU)	Trust
35	People’s Voluntary Integral Service Organization	Section 25 Company
36	Pudhuaaru Khasthriya Gramin Financial Services	NBFC

37	Rural Education & Action Development (READ)	Society
38	Rural Organization For Action and Development (ROAD)	Trust
39	SEARCH-KOPSA	Section 25 Company
40	Sarvodaya Nano Finance Ltd (SNF)	NBFC
41	Senam Micro Finance Investment Literacy & Empowerment Ltd. (SMILE)	NBFC
42	Serva Jana Seva Kosh Ltd. (SJSK)	NBFC
43	Sangamam Women's Multipurpose Thrift and Credit Co-operative Society Ltd	Society
44	Shalom Trust	NBFC
45	Suryodaya	NBFC
46	Thirumalai Charity Trust (TCT)	Trust
47	Welfare Organization for Multipurpose Mass Awareness Network (WOMAN)	Society
48	Working Women's Forum (WWF)	Society

About Institute for Financial Management and Research

The Institute for Financial Management and Research (IFMR), Chennai, is one of India's most prestigious business schools and academic institutions. Established in 1970, it has been recognized as an Institution of National Importance by the Ministry of Finance. Since its inception, IFMR's mission has been to contribute to the growth and development efforts in India with an emphasis on finance and research. The IFMR also has several key partnerships with some of the leading academic institutions worldwide and offers a stimulating and world-class environment to faculty and students alike.

About National Stock Exchange

The National Stock Exchange (NSE) is India's leading stock exchange covering various cities and towns across the country. The NSE was set up by leading institutions to provide a modern, fully-automated, screen-based trading system with national reach. The Exchange has brought about unparalleled transparency, speed and efficiency, safety, and market integrity. It has set up facilities that serve as a model for the securities industry in terms of systems, practices, and procedures. The NSE has played a catalytic role in reforming the Indian securities market in terms of microstructure, market practices, and trading volumes. The market today uses state-of-the-art information technology to provide an efficient and transparent trading, clearing, and settlement mechanism, and has witnessed several innovations in products and services, namely, the demutualization of stock exchange governance, the use of screen-based trading, the compression of settlement cycles, the dematerialization and electronic transfer of securities, securities lending and borrowing, the professionalization of trading members, the use of fine-tuned risk management systems, the emergence of clearing corporations to assume counterparty risks, the marketing of debt and derivative instruments, and the intensive use of information technology.