A COMPARATIVE ANALYSIS OF THE FINANCIAL PERFORMANCE OF MICROFINANCE INSTITUTIONS OF INDIA AND BANGLADESH

Thesis submitted in fulfillment for the requirement of the Degree of

Doctor of Philosophy

by

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DECLARATION BY THE SCHOLAR

I hereby declare that the work reported in the Ph.D. thesis entitled **“A Comparative Analysis of the Financial Performance of Microfinance Institutions of India and Bangladesh”** submitted at **Jaypee Institute of Information Technology University, Noida, India, is** an authentic record of my work carried out under the supervision of Dr**. Moonis Shakeel (Internal supervisor) and Dr. Kanwal Anil (External supervisor)**. I have not submitted this work elsewhere for any other degree or diploma.

(Signature of the Scholar)
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July 23, 2012

SUPERVISOR'S CERTIFICATE

This is to certify that the work reported in the Ph.D. thesis entitled "**A Comparative Analysis of the Financial Performance of Microfinance Institutions of India and Bangladesh**", submitted by **Anand Kumar Rai** at **Jaypee Institute of Information Technology University, Noida**, **India,** is a bonafide record of his original work carried out under my supervision. This work has not been submitted elsewhere for any other degree or diploma.

(Signature of Supervisor)
(Dr. Moonis Shakeel)
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July 23, 2012

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ABSTRACT

India and Bangladesh are two developing countries in the world. Poverty is the major problem in these countries. In these economies, it is argued that among others absence of access to credit is presumed to be the cause for the failure of the poor to come out of poverty. Lending to the poor involves high transaction cost and risks associated with information asymmetries and moral hazards. Microfinance is one of the ways of building the capacities of the poor who are largely ignored by commercial banks and other lending institutions and graduating them to sustainable self-employment activities by providing them financial services like credit, savings and insurance.

To provide microfinance and other support services, Microfinance Institutions (MFIs) should be able to sustain themselves for a long period. Bangladesh has been the pioneer in the field of microfinance movement and a significant contribution to the development of the country has been made by the several MFIs. Grameen Bank, BRAC, ASA and Prashika are some of them. Therefore it is interesting to compare the financial performance of MFIs of India and Bangladesh and to see where they stand against each other.

This study has found that from last five years i.e. from 2005 till 2010, the Indian MFIs have performed better than the MFIs of Bangladesh in most of the financial indicators.

Portfolio quality in India (PAR>30 days = 2.4%) is far better than the Bangladesh of 12.1% and global median of 3.1%. The operating efficiency of Indian MFIs is better and increasing because of the higher growth in outreach and better utilization of manpower (the main operating expense of MFIs). Despite the improvement in operating efficiency, the yield of Indian MFIs is rising. This means that Indian microcredit borrowers are now paying a relatively high cost for their microcredit. And at the same time there has been a substantial widening in the margin available to the average MFIs for covering financial expenses, loan loss provisions and surplus. The MFIs of Bangladesh are having relatively better Capital to Asset ratio but the trend is increasing for Indian MFIs. Still Indian MFIs have to increase their capital base so as to serve the large poor population.

In terms of outreach or the absolute number of active borrowers, both the countries are at the same level. However, the growth rate of Indian MFIs is much higher (60% CAGR in the last five years) as compared to Bangladesh (stagnant). Though the market penetration is quite low in India particularly in UP, MP, Bihar, Orissa, Chhattisgarh, which shows that there exists huge business opportunities for Indian NBFC MFIs. However, at the same time the Indian MFIs will have to explore the cost effective means to reach to the least densely populated

area.

In case of Operational Self Sufficiency, Yield to Gross Loan Portfolio and Return on Asset, no significant differences have been found between Indian MFIs and the MFIs of Bangladesh. However, it can also be observed that both these countries have above 90% clients as women borrowers, which justify the social commitment of MFIs of their respective countries.

In Return on Equity indicator, the equity holders will be more interested in investing into India MFIs than the MFIs of Bangladesh, as they will earn higher return on their investment.

It has also been concluded that the MFIs, which are converting themselves into NBFC, are financially more viable and their outreach is high.

The Young MFIs of India are creating better quality asset and at a faster rate while the mature MFIs are utilising administrative and personnel expenses in a much better manner.

Through the analysis of the second objective, it is found that the outreach and capital adequacy are the prominent factors, which are affecting the financial sustainability of MFIs. Nevertheless, the capital structure does not affect the sustainability. In case of Bangladesh, the asset quality and capital adequacy are the main factors which affect the sustainability of MFIs. Again, the capital structure does not affect the sustainability of MFIs.

A model for checking financial sustainability of MFIs is also suggested which is used to create a sustainability index for various countries and help the regulator identifying the strong and weak areas of the sector. In addition, the existence of new model is also expected to facilitate MFIs to access to capital markets. Having access to sustainability information may reduce some of the transaction uncertainty.

While microfinance remains a small proportion of the overall financial system in terms of portfolio size, it is growing much faster; bank credit grew by 17.5% during 2008-09 while microfinance portfolios grew by around 100%. As a result, in terms of portfolio size as well as number of clients served it is becoming an increasingly significant part of the financial system.

LIST OF ACRONYMS & ABBREVIATIONS

ACTB	Number of Active Borrowers
ADB	Asian Development Bank
BPSM	Borrowers per Staff Member
BRAC	Bangladesh Rural Advancement Committee
CA	Capital to Asset Ratio
CAR	Capital Adequacy Ratio
CGAP	Consultative Group to Assist the Poor
CIBIL	Credit Information Bureau India Ltd.
DFID	Department for International Development, United Kingdom
FSS	Financial Self Sufficiency
GDP	Gross Domestic Product
GLP	Gross Loan Portfolio
IFC	International Finance Corporation
IPO	Initial Public (Stock) Offering
IRDA	Insurance Regulatory and Development Authority
JLG	Joint Liability Group
M&A	Mergers and Acquisitions
MFI	Microfinance Institution
MIX	Microfinance Information Exchange
MSME	Micro, Small, and Medium Enterprise
MYRADA	Mysore Resettlement and Development Agency
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non-Banking Finance Company
NGO	Non-Governmental Organization
NPL	Nonperforming Loan
OELP	Operating Expense to Loan Portfolio
OSS	Operational Self Sufficiency
PACs	Primary Agricultural Credit Societies

PAR	Portfolio at risk
RBI	Reserve Bank of India
RFAS-2003	Rural Finance Access Survey 2003
ROA	Return on Assets
ROE	Return on Equity
RRB	Regional Rural Bank
RTGS	Real-Time Gross Settlement System
SBPL	Self-Help Group Bank Linkage Program
SEWA	Self Employed Women's Association
SHG	Self-Help Group
UN	United Nations
WB	Women Borrowers

KEY TERMS

MICROFINANCE: The provision of a broad range of financial services such as deposits, loans, money transfers, and insurance to small enterprise and households

CAPITAL/ASSET RATIO: Adjusted Total Equity / Adjusted Total Assets

It indicates how much of a safety cushion the institution has to absorb losses before creditors are at risk. Currently all NBFCs are required to maintain Capital Adequacy Ratio to Risk Weighted Assets of 15%.

NUMBER OF ACTIVE BORROWERS:

The number of loans extended per year and since inception shows the ability of the MFI to reach more clients and achieve a degree of scale.

PERCENTAGE OF WOMEN BORROWERS:

Percentage of Women borrowers shows the commitment of MFIs towards social welfare and poverty alleviation.

RETURN ON ASSETS: (Adjusted Net Operating Income - Taxes) / Adjusted Average Total Assets

Return on Assets is a measure of the productive use of the company's assets.

RETURN ON EQUITY: (Adjusted Net Operating Income - Taxes) / Adjusted Average Total Equity

ROE measures an MFI's ability to reward shareholders' investment, build its equity base through retained earnings, and to raise additional equity investment. By excluding donations and non-operating revenues, ROE demonstrates an institution's ability to generate income from its core financial service activity

OPERATIONAL SELF SUFFICIENCY: Financial Revenue / (Financial Expense + Impairment Losses on Loans + Operating Expense)

OSS Measures how well an MFI can cover its costs through operating revenues. It is the most basic measurement of sustainability, indicating whether revenues from operations are sufficient to cover all operating expenses.

YIELD ON GROSS PORTFOLIO: Adjusted Financial Revenue from Loan Portfolio / Adjusted Average Gross Loan Portfolio

Yield on gross portfolio measures the ability of MFIs to generate Financial Revenue from its Loan Portfolio. Therefore the higher Yield means the higher interest rate the MFIs are charging from its borrowers.

OPERATING EXPENSE/LOAN PORTFOLIO: Adjusted Operating Expense / Adjusted Average Gross Loan Portfolio

The Operating Expense Ratio highlights personnel and administrative expenses relative to the loan portfolio and is the most commonly used efficiency indicator. The lower the operating expense ratio, the more efficient the MFI.

BORROWERS PER STAFF MEMBER: Adjusted Number of Loans Outstanding / Number of Personnel

This ratio is defined as the overall productivity of the MFI's personnel in terms of managing clients, including borrowers, voluntary savers, and other clients. The ratio should also be evaluated in light of portfolio at risk to ensure that productivity gains are not at the expense of asset quality.

PORTFOLIO AT RISK> 30 DAYS: Outstanding balance, portfolio overdue > 30 days + renegotiated portfolio / Adjusted Gross Loan Portfolio

PAR is important because it indicates the potential for future losses based on the current performance of the loan portfolio.

FINANCIAL SUSTAINABILITY: Financial sustainability is defined as having an operational sustainability level of 110% or more, while Operational sustainability is defined as having an operational self-sufficiency level of 100% or more.

MIX MARKET ™: MIX market is a global, web-based, microfinance information platform. It provides information to sector actors and the public at large on microfinance institutions (MFIs) worldwide, public and private funds that invest in microfinance, MFI networks, raters/external evaluators, advisory firms, and governmental and regulatory agencies

Sa-Dhan: Sa-Dhan is the Association of Community Development Finance Institutions Founded by SEWA Bank, BASIX, Dhan Foundation, FWWB, MYRADA, RGVN, SHARE and PRADAN in 1999. Its mission is to help its member and associate institutions to better serve low-income households, particularly women, in both rural and urban India

MULTIPLE REGRESSION ANALYSIS: Statistical procedure that attempts to assess the relationship between a dependent variable and two or more independent variables. Example: Sales of cars (the dependent variable) is a function of various factors, such as its price, advertising, fuel efficiency, interiors and the prices of its major competitors (the independent variables)

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