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SHARE MICROFIN LIMITED:
MANAGING TRANSFORMATION FOR GROWTH

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SHARE Microfin Limited: Managing Transformation for Growth

Sukhwinder Arora[1] and Somanadha Babu

1. Context

1.1 Background to the Study:

MicroSave is working with CGAP to develop a "Managing Rapid Growth of MFIs" toolkit to assist MFIs to manage rapid scale-up and growth. The toolkit will enable senior executives and Board members to review and think about the key issues that they are likely to face as their microfinance institutions (MFIs) grow. It will therefore be a "what you will need to worry about/manage" toolkit with cross references to other toolkits/resources drawn from across the industry, particularly from CGAP and *MicroSave,* that can be used to understand the "how to" manage rapid growth of MFIs.

As part of the preparations to do this, *MicroSave* has commissioned a series of studies on MFIs that have grown rapidly, to examine the issues that they faced and how they managed them, with a view to identifying common issues, themes and strategies as well as to develop case studies for the toolkit. SHARE Microfin Limited (SML) is one of the MFIs selected for the study.

1.2 Introduction to SHARE

When Mr. Udaia Kumar returned after completing his Masters in Development Studies from Birmingham University, he along with eminent scientists set up an NGO. This NGO provided development services in rural areas in various fields (agriculture, animal husbandry, irrigation, health etc.) and conducted training programs in vocational skills development for the rural poor. However, the trainees were unable to access finance in order to use their acquired skills, limiting the impact of the training received. Most of this work was implemented through various NGOs in Andhra Pradesh and funded by another NGO, Rural Development Awareness Services (RDAS). Mr Kumar was also invited to evaluate NGO projects, funded by Government of India (CAPART). Doing this work, Mr Kumar realised people could not use the skills they were learning due to lack of capital. He did not know much about microfinance but, was told briefly about SEWA Bank, Ahmedabad.

At this stage, Mr Kumar got an offer to start a Venture Capital Fund in India for funding small businesses and was invited to a conference in Bangkok. During this workshop, he heard about Grameen Bank from his room mate, who was a Grameen staff member. Soon after this, he was called to assess the impact of a flood relief project in Bangladesh, which provided him an excellent opportunity to visit Grameen Bank and meet Dr. Yunus. Subsequently, he went back to Bangladesh at his own initiative for a more detailed study of Grameen Bank. Impressed by Mr. Kumar's interest and commitment, Asia Pacific Development Centre offered a repayable grant of $25,000 to start an Action Research Project in India. Grameen Trust also offered a similar grant of $33,000. In all, Mr Kumar had mobilised Rs.1.8 million, but all of it had to be repaid. This provided the seed capital for the Action Research Project (ARP) in 1991-94. ARP was especially crucial, as there was no scalable microfinance model in India at that point.

Even though getting the grant disbursed was a difficult[2] experience, a much bigger challenge was convincing his colleagues at the NGO. When Mr. Kumar discussed this idea with his colleagues, all the senior scientists rejected the proposal as they did not want to get involved in lending, especially from borrowed capital. While

[1]SML provided office space and ready access to its staff and documents for this study. Their enthusiastic participation made our task easier and we thank them for their support. The lead author thanks Graham A.N. Wright and Manoj Sharma at *MicroSave* for inviting him to contribute this paper as a part of series on 'Managing Rapid Growth'. Sukhwinder Arora and Somanadha Babu visited SML during 26 May to 8 June, 2008. The lead author would also like to acknowledge useful feedback from Vijay Mahajan. The views expressed here are those of the lead author and are not necessarily shared by SML or *MicroSave*. The lead author can be contacted at arora_psd@yahoo.co.uk .

[2] With changes in Grameen Trust leadership, release of the sanction got considerably delayed.

undergoing studies in UK, Mr. Kumar had noted some of its key strengths in delivering education services[3], and on return to India had set up another NGO to promote education 'Society for Helping and Awakening Rural Poor through Education (SHARE)'. As SHARE's bye-laws did not prohibit lending, the action research was started through the SHARE NGO in 1992. Two senior bankers and two social workers (Masters in Social Work) were recruited, but they could not relate to the proposed credit methodology under the action research project and this team was disbanded.

The first few years were really tough, as there were no grants to cover operating losses and the loans taken from international sources had to be repaid. Sir Dorabhjee Tata Trust gave a small grant for staff salaries only in the year 1996-97. During 1997-98 and 1998-99, CGAP sanctioned US $2 million for operating costs and loan capital. Mr. Kumar regularly sent monthly reports on the action research project to anyone who could be possibly interested in what SHARE was attempting. A World Bank staff member had been diligently maintaining monthly reports she received from SHARE and expressed an interest in visiting its work during a trip to India. This visit was being coordinated by NABARD and this unexpected request to NABARD led them to assess what SHARE was doing. This engagement finally triggered a Rs.20 million loan from NABARD in 1995-96.

1.3 Rapid Expansion of SHARE programme

After running a successful action research pilot, SHARE began its microfinance operations in 1993 in the rural areas of Andhra Pradesh. SHARE was one of the earliest replicator of Grameen Bank methodology in India. Initially only two branches were operated for three years (1993-96). This reflected not only natural caution to move slowly to test and improve the products, procedures and to train staff but also the hard constraints of limited funds. With improved funding and systems, during 1996-2000, branches, staff, and loan portfolio were increased over ten times. By 1998-99, 87% operational self sufficiency was achieved. As Mr. Kumar explained, it was not important to make profits in an institution registered as a non-profit, and with rising profitability, SHARE further expanded its operations by opening new branches. By March 2000, SHARE was serving 30,629 active clients through 20 branches and had built up a loan portfolio of Rs.105 million. But SHARE also experienced numerous constraints in delivering financial services through a non-profit institutional structure (see section 2.1) and concluded that a change in legal status was necessary.

The move to a regulated financial institution in the year 2000 significantly eased the key constraint (access to funds for on-lending) and allowed rapid expansion. For example, active clients (net borrowers) expanded 20 times from 48,868 to almost a million over the period 2000-2008. During the initial 'learning years' 1993-94 to 1996-97, active clients grew rapidly by an average annual rate of 193% from a very small base of 1,157 active clients in March 1994. During the 'transformational period' the active clients almost doubled every year (98% CAGR[4]). During the 'growth period' average annual rate dropped to 50%, mainly due to the significant slow down during the last two years caused by external factors (section 1.5 below).

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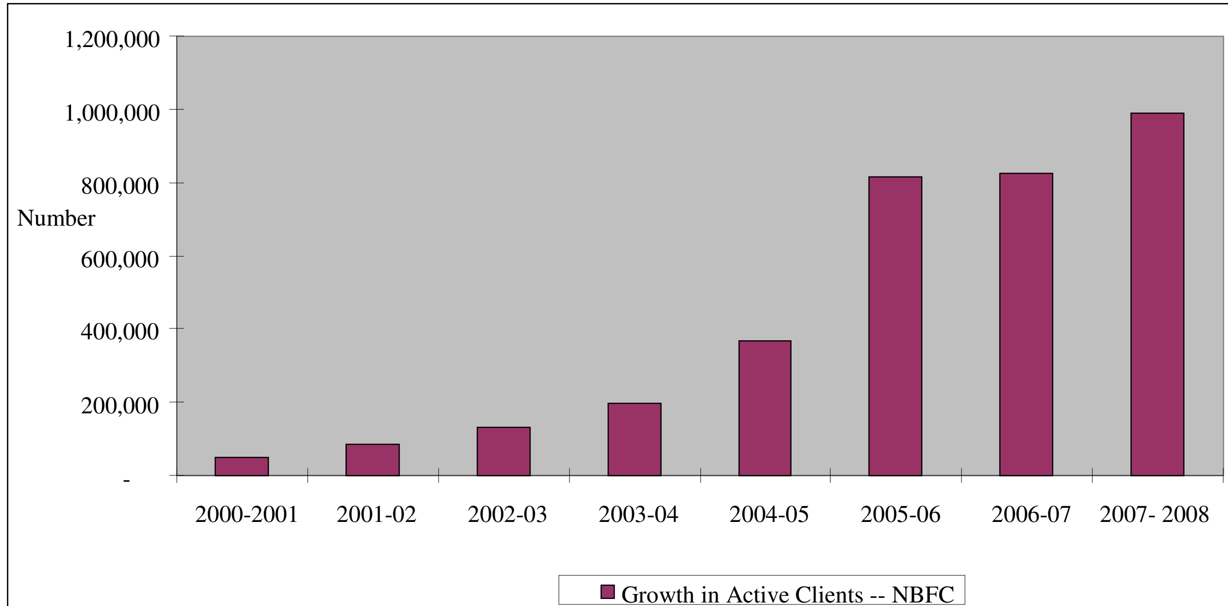
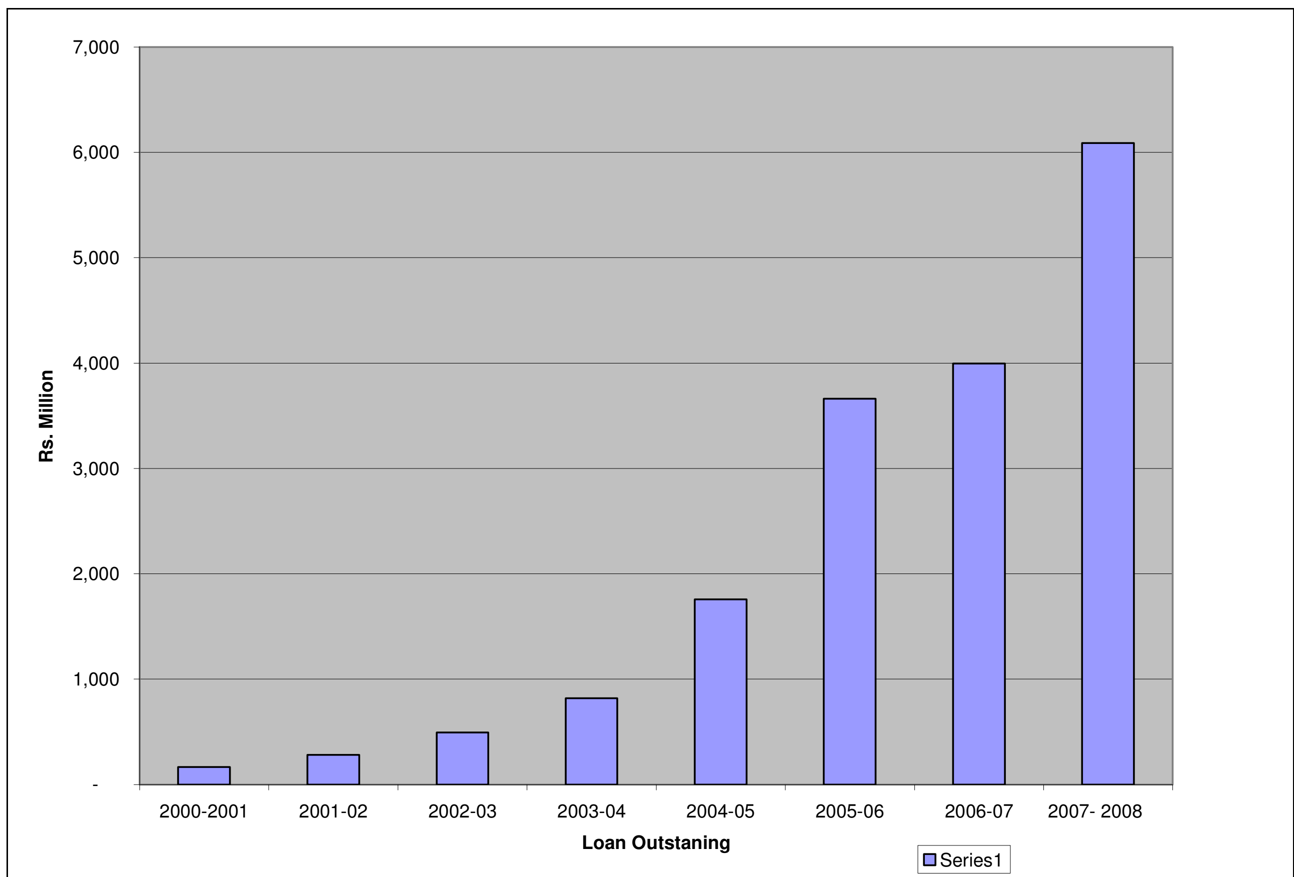
[3] Such as the willingness of teachers to be less formal with students and focus much more on facilitating and motivating learning rather than provide a single formulae.
[4] Consolidated Annual Growth Rate

Figure 1.1: Growth in Active Clients



As more members borrowed bigger loans, the loan portfolio (loans outstanding) grew even more rapidly (from Rs.164 million to Rs.6.08 billion (by 37 times) during the same period, 2000-08.

Figure 1.2: Growth in Loan Portfolio



In the last five years, SHARE has added over 2000 staff and over 800,000 customers and is today one of the top ten MFIs in Asia (ADB-MIX, 2008). Its rapid progress during the last five years is summarised in Table 1.1 below:

Table 1.1: SML Performance Summary 2002-08

	Indicator	March 2002[5]	March 2005	March 2008	Increase 05-08	Growth %	CAGR (05-08)
1	Branches	57	184	462	278	151%	36%
2	Staff	688	2,006	3,022	1,016	51%	16%
3	Active Clients	85,644	368,996	989,641	620,645	168%	39%
4	Loan portfolio outstanding (Rs Million)	283	1,758	6,089	4331	246%	51%
5	Portfolio Yield	37%	33%	26.99%	-6%		
6	Operating Expense Ratio	23.5%	16%	10.59%	-5%		
7	Portfolio at Risk > 0 days delinquent	0%	0%	1%	1%		
8	Operational Self Sufficiency	105%	112%	106%	-6%		
9	Financial Self Sufficiency	100%	110%	102%	-8%		
10	Return on Assets	1.4%	4%	.1.3%	%		

Data source: SML

In 2002, Mr. Kumar was honoured with "Lifting Up the World with Oneness - Heart" award by the UN Peace Foundation. The other well-known recipients of this award include Mother Teresa, Desmond Tutu, and Nelson Mandela. He is also the proud recipient of the "Change Makers Award" from the Dr. Reddy's Foundation and "Excellency in Micro Credit" award from the Rockefeller Foundation and Grameen Foundation USA for his pioneering contribution in the field of microfinance.

1.4 Microfinance in Andhra Pradesh

SML started its operations in Andhra Pradesh (AP), which is considered a leading state for microfinance development and growth in India. Women self help groups (SHGs) have been promoted by state government, NGOs and actively supported by donors and banks[6]. Even though AP accounts for only 7% of the national population and only 4% of the poor in the country, by March 2007, AP accounted for 23% of the 2.92 million self help groups financed by the banks in the country.

1.5 The Krishna District Microfinance Crisis

Readers will note from Figures 1.1 and 1.2 that SML portfolio in AP was growing rapidly. However, growth rates significantly slowed down during 2006-07. For example, during 2005-06, by adding almost half million additional members, active members increased by 120% over the previous year. What caused this growth rate to drop to only 1% in the next year?

On 8th March 2006, District Administration of Krishna District temporarily closed almost all branches of microfinance institutions operating in the District. The administration filed criminal cases against the MFIs, the press carried screaming headlines and the borrowers were advised that MFIs were undertaking unlawful activity, and so the borrowers need not repay the MFI loans. Mr Ghate, in his book 'Indian Microfinance' elaborates the various causes of this crisis and draws key lessons (Ghate, 2007). On the key allegations against MFIs, he concludes that these were: high interest rates, coercive collection practices and over-lending. Summary comments on these issues are provided below:

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[5] March 2002 data provided to enable comparison over the two periods of three years each (2002-05 and 2005-08)

[6] Self Help Groups were initially promoted by NGOs.

Interest Rates: Leading MFIs were charging 24% to 28% in Andhra Pradesh when the crisis occurred. In comparison with subsidised government programmes[7] charging 3% per annum, the MFI rates appeared quite high[8]. However, very little attention was paid to the cost of MFI borrowing from mainstream banks and the high transaction costs incurred in lending small amounts to dispersed borrowers in their village/ward, as well as the potential risk of unsecured lending. Many District officials also did not notice that many of the MFIs were in fact financial institutions regulated by the central bank and were allowed to set their own interest rates. Speaking at a Bankers Conference in the Andhra Pradesh state capital seven months later, the Indian Finance Minister P. Chidambaram[9] put this in perspective, "We have a mindset of microfinance in India that any interest rate not less than 20-25% is exploitation. A rate of 25% charged by money lender may be usurious. But for funds generated from Banks, that pass through intermediaries and reach the end consumer, there is a cost in the process. We have to recognise that microfinance activity carries a price and educate people accordingly".

Coercive Collection Practices: The allegation was that MFIs were using aggressive and abusive practices to collect repayments from borrowers and in extreme cases, these resulted in borrowers' suicides. MFIs responded by pointing out that majority of its credit assistants are men working with members at least 50 kilometres away from their own village areas. For a single man, not from the same community, to exert undue pressure on a 30-40 member women's group is not only culturally unacceptable, but is also risky. Much of the pressure on individual borrowers was from group members wanting to ensure high repayment, but whether a Rs.15,000 to Rs.20,000 loan had triggered the reported suicides was hard to confirm. While widespread microfinance activity can produce a few extreme cases, MFIs were taken aback at the widespread allegations and inability of the press and the government to put this in perspective and distinguish between responsible and irresponsible MFIs. After significant dialogue with Government representatives, these cases were withdrawn.

Over-lending: MFIs acknowledge that this is a very difficult area and cannot be addressed without better co-ordination amongst various financial service providers operating in the same geographical area. In addition, many borrowers participate in informal arrangements such as chits and loans from moneylenders. It is quite hard for financial institutions to accurately assess incomes, multiple sources of borrowing and debt servicing ability, especially for those having most income from informal livelihoods. Rapid expansion of MFI programmes and growing competition accelerated the phenomenon of "overlapping" membership. Who is to decide whether the borrowers' decision to borrow from two or more sources is due to inadequate funding by the MFI or over-extending behaviour of the borrower? How long can a MFI persist with conservative lending, in the face of aggressive competitors? During the crisis, all borrowers were projected as passive recipients. An alternative view could also be taken by commentators that the majority of borrowers are also active economic agents maximising opportunities and seeking the best bargains, just as any other consumers of goods and services, and sometimes they also make mistakes.

This crisis is not the core focus of this short paper and therefore no attempt is made to cover this complex crisis in detail. However readers can appreciate that this episode in just a few weeks in March-April 2006, subjected SHARE and other MFIs to intense strain and distorted media attention. After some time the District administration took back the orders and asked the clients to repay regularly. However, the MFIs suffered significant short term and long term damage on account of substantial loan write offs, forcible reduction in interest rates, damaged reputation and stunted growth. SHARE was forced to reduce interest rates to 7.5% flat (about 15% declining)[10]. Borrowers became reluctant to submit title deeds for SHARE's

[7] Some studies have highlighted that low nominal interest rates from banks and government programmes don't fully reflect the high transaction costs to the customer in such programmes: un-certainty, inadequate funding and sometimes the need to pay bribes. A World Bank study found that on an average 27% of the households who borrowed from a bank paid a bribe and the bribe amounts (as a percentage of loans) varied from 10% for commercial banks to 18% for regional rural banks (Basu, 2006)

[8] Money lenders and other informal providers charge over 60% per annum.

[9] See Economic Times 4 November 2006 'FM defends interest rates on micro-loans'

[10] Interest rates were raised subsequently and are currently at 12.5% flat

individual lending programme. SML, which was proud of its 100% loan repayment record, saw its portfolio at risk (> 90 days) for overall portfolio escalate to 7.45% as on March 2007. During 2006-08, SML wrote off Rs.147.3 million of bad debts and made provisions for another Rs.15.1 million. During 2006-07, the loan portfolio grew by 9% as against 108% the previous year. Net profit after tax in 2006-07 at Rs.10.3 million was only 15% of the previous year.

For SHARE, this episode also helped sharpen its focus on client relationships, consolidation of operations, staff efficiency, expansion outside Andhra Pradesh and better awareness of and engagement with political leaders, government officials and the media. During 2007-08, SHARE resumed expansion and opened 150 branches and expanded outreach to 160,000 additional clients. By March 2008, PAR (> 90 days) was brought down to 1.56% from 7.45% a year earlier. SHARE was able to significantly strengthen its equity capital with Rs.1 billion foreign direct investment by private investors and received a highly credible mfR2 rating[11] from CRISIL in November 2007, despite facing a major crisis in the previous year.

2.0 Organisational Form and Governance

2.1 Legal Form

Society for Helping and Awakening Rural Poor through Education (SHARE) was set up in 1990 and started microfinance operations in April 1992. Most microfinance programmes in India have been initiated by societies registered under the Society Act, 1860. Charitable status and the prospects of limited interference from the society registrar has made this a popular route in the past for most development activity. As long as the NGO is handling grants, society status provides certain benefits, including tax exemption. However societies providing financial services face a number of challenges:

- Societies do not have a clear legal mandate to undertake microfinance.
- Regulation for financial services provision under society act is weak and Reserve Bank of India (the central bank) has no role in this regard.
- Societies do not have a capital structure (only corpus grants can be capitalised).
- Board members have individual unlimited liability.
- It is much more difficult for 'non-profits' to charge interest rates[12] that cover full costs of efficient operations and fund mobilisation.
- Societies can not accumulate profits to become financially independent.

The above factors have profound implications for organisational character and growth:

- Legal status as a society/ non-profit makes the lenders and investors very cautious of substantial dealings with a non-regulated financial institution.
- Commercial equity investors neither have an instrument nor an incentive to invest in a society.
- Giving and recovering loans entails risks and the absence of equity capital limits the organisational ability to adequately provide for and cope with these risks.
- Lack of prospects for financial independence limits its ability to attract and compensate professional staff or provide career opportunities.
- Substantial dependence on grants threatens efficiency and long term sustainability.

2.2 Transformation to SHARE Microfin Limited

Due to the constraints imposed by the legal entity (society), SHARE was never able to mobilise adequate[13] finances to expand, even though organisational capacity was expanding. SHARE concluded that a change in legal status was necessary to overcome many of the above constraints and was one of the first MFIs in India to transform into a regulated financial institution. During 1999-2000, SHARE incorporated a 'for profit' public limited company, SHARE Microfin Limited (SML), under the Companies Act 1956 and was

[11] mfR1 is the highest
[12] The barriers are more psychological and political than legal
[13] In fact, noting that banks will lend limited sums to NGO-MFI, Mr Kumar promoted another MFI Asmita to mobilise additional capital. He has since resigned from the Asmita board and sold his shares.

registered under section 45/IA as a Non Banking Finance Company (Non-Deposit taking) under the Reserve Bank of India Act, 1934. The outstanding portfolio and staff was purchased from SHARE (the NGO) by SML (NBFC) during 2000-02.

However even the transformation did not permit SML to offer savings services. Even deposit taking NBFCs can mobilise limited[14] term deposits but can not mobilise flexible regular savings from its customers. NBFCs are also ineligible to be business correspondents[15]. Various studies have confirmed that most poor people value access to flexible savings services.

2.3 Governance:

The Executive Committee (EC)[16] members of SHARE, the NGO were drawn from social network of the promoters. As a part of the registration for NBFC, SML constituted a new Board of Directors. The Board members were selected based on their expertise in banking, social development and management. The promoter, Mr. Udaia Kumar, has led the Board in his capacity as Chairman cum Managing Director since inception. To develop SML as a community based financial company, two elected community representatives joined the Board. SIDBI nominated a Director in 2001 and ICICI Bank nominee joined the Board in 2005.

SML ownership and the Board has been substantially revamped in 2007. Legatum purchased[17] 65% equity stake and now has three Directors on the SML Board. Aavishkaar Goodwell has purchased another 5% stake and has also nominated a Director on the Board. Managing Director and nominee Directors of two financial institutions (SIDBI and ICICI) have remained as members on the Board. The Board meets at least once a quarter. Discussions are now underway to further strengthen the Board with some high profile independent members. SML recently commissioned CRISIL to undertake a detailed governance and value creation diagnostic review exercise. The study focuses on the existing corporate governance practices of SML to understand the value that SML has created for various stakeholders. This will help highlight the gaps in the current governance standards compared to best practices and establish milestones for improvement The Board constituted various sub-committees to efficiently discharge its responsibilities and meet its regulatory obligations.

Table 2.1: The various committees constituted by SML Board of Directors

Committee	Functions
Nomination Committee	This committee considers appointment of directors with 'fit and proper credentials' as per the criteria envisaged by the RBI.
Risk Management Committee	This committee addresses the integrated risk of an organisation.
Audit Committee	Represented by two directors of the company, it ensures the sufficiency, fairness, credibility and transparency of the accounting policies and financial reporting
Project Advisory Committee	Comprising of experienced individuals from the banking and microfinance field, it appraises and advises the Board on policies, operational procedures and systems.
Remuneration/ Compensation Committee	This committee considers the general industry trends while fixing the remuneration of executive directors and senior personnel of the company
Share Transfer Committee	Comprising of selected Board of Directors, the committee approves transfers and/or transmissions of equity and preference shares of the company on behalf of the Directors.

[14] Limited by the net worth of the deposit taking NBFC
[15] Business Correspondents are authorised to collect savings deposits on behalf of licensed banks
[16] Board for the non-profit
[17] As the private equity investment in microfinance is a new trend and no microfinance institution has yet been listed on the stock exchange in India, there is lack of clear valuation parameters. Pricing is a matter of negotiations between buyers and sellers of the equity, along with discussions and agreement on vision and long term plans for the organisation.

Committee	Functions
Asset liability Committee	This committee monitors the asset liability gap and suggests strategic action to mitigate such associated risks.
Grievance Committee	This committee looks into redressal of grievances of stake-holders including clients, employees, investors, banks, share-holders etc.

2.4 Regulatory Compliance

SML falls under the central bank (Reserve Bank of India - RBI) category of *Systematically Important Company*, i.e. assets exceeding Rs.1 billion. SML has to submit a monthly financial statement (both online and hard copy) to regional office of the central bank by 7th of every subsequent month. NBFC Department, RBI visits both the SML headquarters and the field, every year for on-site inspection and also contacts SML, if the RBI team is already visiting some field locations and want to include an SML branch in the field visit.

At least once in a quarter, the Reserve Bank of India organises meetings for all the NBFCs in the region. In addition, SML will be contacted whenever there is any information/clarifications required. The objective of these meetings is to understand the present market scenario, operational systems and procedures and to discuss the regulatory requirements. As an NBFC, SML has to follow central bank mandated KYC (Know Your Customer) norms to confirm proof of identity and address of its customers. Identity and address proof together with photographs and signatures is now being collected for all borrowers and their spouses served by SML. Overall, the regulators are very supportive of the role SML is playing in the microfinance sector as the central bank is also encouraging *Financial Inclusion* in the country.

The Registrar of Companies (ROC) office functions as registry of records, documents relating to the companies, which are available for inspection by statutory authorities and the public. As an unlisted company, SHARE has no specific reporting to ROC other than filing Annual reports once in a year. It is also mandated to report any changes in constitutional documents (Memorandum of Association and Articles of Association), board of directors and capital structure.

2.5 Organisational Architecture

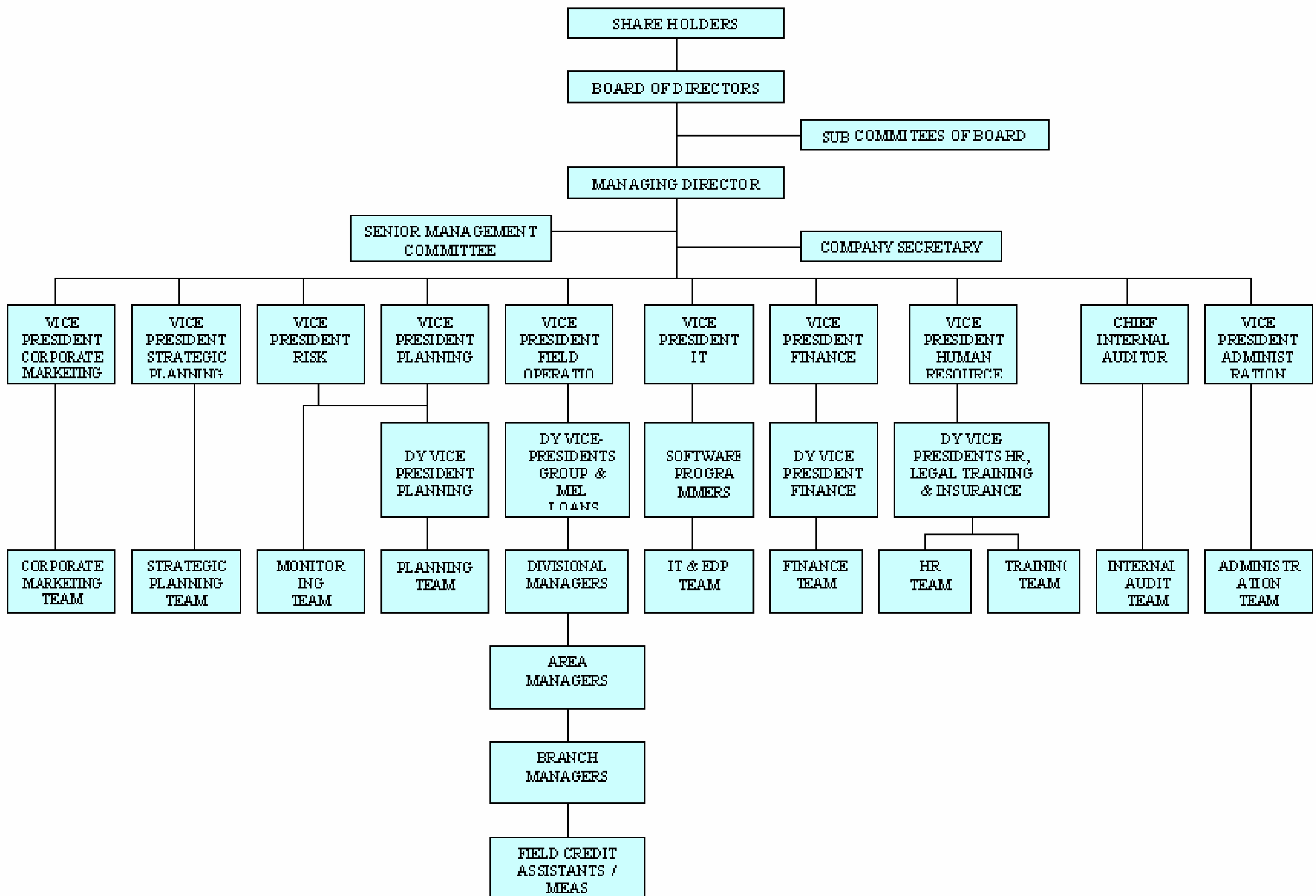
SML has expanded over 20 times from serving 0.06 million members in one state by March 2001 to 1.29 million members in 10 states by March 2008. Staff has expanded from 267 to 3,022 during the same period. The organisation's structure is evolving to reflect this growth and complexity. Senior Management has been significantly strengthened in recent years. Led by the founder Managing Director, the 14 member senior management team consists of Assistant/Deputy Vice Presidents, Vice Presidents (VPs), Chief Internal Auditor and Senior Advisor. Field Operations and Finance teams have been strengthened with two Vice Presidents each and new positions in risk management, planning, internal audit, information technology, corporate communications[18] and regulatory compliance have been created. Eight of senior managers have worked with SHARE for over 5 years, including three of the current senior management team members, who started at the front end as field staff. Four of the VPs were recruited in the last one year to further strengthen skills, profile and external relationships of SML.

All VPs are members of the senior management committee, which meets monthly to discuss various issues and review plans. The senior management also meets with the Divisional Managers every 3-6 months to review expansion plans and performance in various geographies. A senior field staff (normally a Deputy Divisional Manager) is appointed to initiate operations in a new state. All staff have clear job descriptions and decision making has been decentralised. Occasionally a small team is delegated to analyse and recommend specific policy/financial product and after consultation with concerned divisional heads, these recommendations are submitted to the managing director for approval and issue of circulars to all staff.

The organogram below provides details of the organisational structure.

[18] Few positions are new and are not yet reflected in the organogram.

Figure 2.1: SML Organogram



3.0 Growth Strategy

3.1 Strategic Business Planning

SML has been sharply focused on growth, cost efficiency and market leadership. Every annual report provides data on growth trends over the last five years and projections for the next five years. These projections are co-ordinated by the planning team and are based on extensive internal analysis of emerging opportunities and challenges. The planning team prepares plans considering current achievements and the future potential at the level of each division. Divisional managers, in turn, fix targets for each branch and review progress against previously set targets. This planning exercise helps in synchronising the efforts of various teams – such as operations, IT, fund mobilisation (both debt and equity), HR (staff recruitment) and training. The strategic plans are reviewed regularly at senior management meetings and other forums, and revised in consultation with the SML Board of Directors.

The 2006-07 annual report unveiled strategic plans to reach 6 million customers and $1.0 billion portfolio by 2012. Much more ambitious targets are now being drawn up, although these targets are still under discussions, and have not been approved by the Board as yet. Outreach to 15 million clients by 2013, and possible international expansion are being considered. Earlier the growth rate was about 100% except for the last two years. Two key binding constraints on growth were: i) ability to train staff and ii) financial resources – both equity and debt. With substantial equity injection in 2007, SML ability to take further debt has been significantly enhanced. To stay ahead of competition in the next phase of expansion, and to fully leverage enhanced equity, growth rates of 80-100 % are being considered for the next few years.

3.2 Change Management

In the process of transforming from a local NGO to a national NBFC, SML has had to manage a number of key changes. Revamped governance and management arrangements covered (see sections 2.3 and 2.5) have been crucial to make these strategic, substantial and simultaneous organisational shifts:

- 'Not for Profit' to 'For Profit' organisation.
- Decentralised Management with clear division of responsibility and authority; simultaneous expansion to 11 new states[19] in about 18 months have accelerated these trends. For example, Deputy Divisional Managers have been made responsible for all aspects of management in the new state.
- Induction of qualified staff members, many of whom have earlier worked in senior positions in other organisations and have directly joined at senior levels in SML with clear articulation of roles and responsibilities.
- Quickly adapting to different socio-economic context and language with a combination of trained SML staff and newly recruited staff from the implementation state (for example, while similar financial products may be offered, the culture, the political environment in Uttar Pradesh is very different from Andhra Pradesh).
- Change of auditors: The statutory auditors of the company for the FY 2007-08 has been changed M/s. S. R. Batliboi & Co, an associate of Ernst & Young, India. The appointment of Ernst & Young as statutory auditors, further strengthens the rigour, transparency, and credibility of external audit and facilitates adopting International Financial Reporting System[20] requirements and eases issue of bonds and stock exchange listing.

3.3 Growth Strategies

A number of interlinked strategies have been used to enable high growth without increasing risks and costs of scaling up:

- Organisational leadership has been crucial to build and motivate the core team, face external challenges and use the emerging experience to strengthen products and processes.
- Formalisation/Transformation (from Society to NBFC) has eased the financing constraint, which was seen as the biggest impediment to growth. Improved access to debt and equity funds have accelerated[21] scale up.
- Standardisation has played a crucial role in rapid expansion. Products, procedures and training programmes have been standardised so that even high school educated, freshly recruited Field Credit Assistants (FCAs) can be fully trained over a very short period and then are mentored and guided on the job. All the senior field staff (branch manager, area manager and divisional manager) started out as FCAs and acquired field expertise before moving up the hierarchy. Only standardisation can enable rapid expansion of staff without causing organisational chaos.
- Standardisation has also enabled decentralisation, and together with clear authority and accountability, relatively fewer field issues need to be referred to the headquarters.
- SHARE has refined its low cost model during 1992-2000. Ability to achieve branch viability in 1-2.5 years has enabled SML to be self sufficient and not to be grant dependent. Key ingredients include - achieving peak membership and loan portfolio for each branch, keeping delinquency rates very low and simplification of paper work, especially for field staff and customers. No external technical support is required to operate the system and offices are furnished with simple functional furniture and minimal amenities.
- Limited grants have been used even in the initial stages.
- Rising productivity has enabled SML to further reduce costs and pass on some of these benefits to members by lowering interest rates and attract even more customers. For example, an average staff handled 337 borrowers during 2007-08 as against 147 borrowers during 2001-02. Borrowers per FCA increased from 253 to 760 during the same period.

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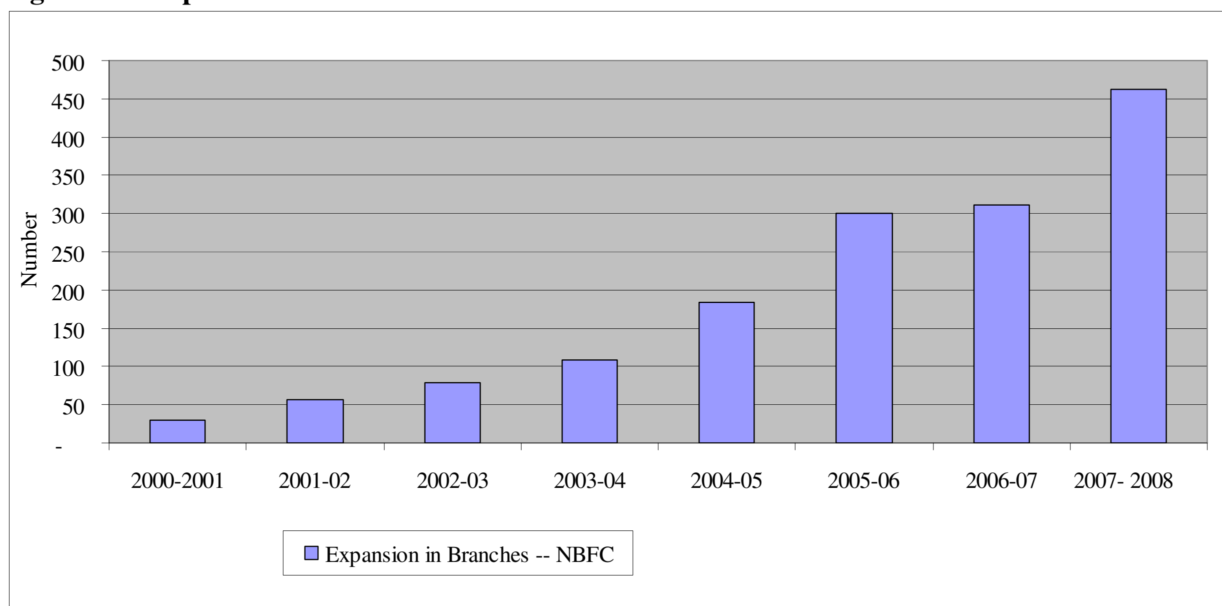
[19] SML expanded in five new states during 2007-08 and 6 more have been added during April-May 2008.
[20] IFRS will be compulsory in India from 2011 and IGAP, the current system is not very easily understood by international investors.
[21] If Krishna crisis had not occurred, the growth rates could have been much higher

- Rigorous and regular internal controls (cross-checks, job rotation, surprise visits and internal audits) have been established to reduce possibilities for errors and frauds. These have been supplemented by frequent external ratings and bankers' visits which provide independent assurance, enhance internal audit skills as well as improve organisational ability to negotiate much larger and better deals with funders.
- Benchmarks and incentives have been established so that all the staff are sharply focused on key indicators such as enrolment of new members, and growth in loan portfolio, while maintaining asset quality.

3.4 Physical Branch Expansion

From 30 branches in March 2001, the branch network was rapidly expanded to 300 branches by March 2006. During 2006-07, the branch expansion was slowed to deal with the after effects of Krishna crisis. During 2007-08, 150 additional branches were started and further rapid expansion is planned. Currently 68% of the total branches are in Andhra Pradesh.

Figure 3.1: Expansion in SML Branches



In existing areas, the branch expansion is determined by growing membership beyond the threshold of maximum number of clients served from the branch. If field staff assess that potential exists for more members to join from the neighbouring villages and an additional branch can become viable, a new branch is started. In a new area, two factors are considered. Transport, banking, telephone and other such infrastructure are important considerations to assess the proposed town/*mandal* for branch location. To analyse the business potential, secondary data (such as population, economic opportunities, income levels etc.) is used along with personal field visits by senior SML staff to assess potential for membership enrolment.

Branch viability depends on the economic potential of a new area. In Andhra Pradesh, the time taken to reach break-even for an SML branch has come down over the years – from 2.5 to 1.5 years for more prosperous coastal areas and from 4 to 2.5 years in Rayalseema areas. Currently 46% of the branches over two years old are viable.

3.5 Intensive and Extensive growth

SML has followed a combination of intensive[22] and extensive strategies to achieve growth:

- Provide incentives to staff so that the highest possible number of members and borrowers are achieved per staff and per branch (intensive).
- Introduce programme in new geographical areas: urban areas, new states (extensive).
- Introduce new financial products to meet existing members' diverse products needs: general, special, micro enterprise, housing and education loan (intensive).
- Introduce financial products for new target groups: loans up to Rs.300,000 for businesses in urban and rural areas (extensive).

4.0 Corporate Brand/ Identity

4.1 Brand Management[23]

As a leading microfinance institution in India, SHARE and its successor SML, are well known amongst those familiar with microfinance in India and abroad. Over one million clients interact with SML every week and many of these have benefited substantially from this relationship. Before introducing the SML programme in new village/slum, a public orientation meeting is held where SML vision, objectives and products are clearly explained in local language. Core messages are reiterated in pledges taken by the members and the SML staff before the start of weekly *Centre* meetings. Expanding in existing areas is relatively easier, as many of the residents already know about SML's work through comments/ recommendations from their relatives, friends and other acquaintances. While small sign boards provide directions and identity to the branch office, there are no sign boards in the locality where SML works.

Over 3,000 staff work for SML and many of these have built long term and successful career with the organisation. Most staff (Branch Managers and above) are brought together in an annual SML event to build the team, renew their commitment and to celebrate success. The imperative to explain SML to others strengthens the staff incentives to periodically refresh and reinforce their understanding of SML vision and objectives.

The Krishna crisis highlighted that many secondary stakeholders (political leaders, senior civil servants, members of the media and other opinion makers) were either unfamiliar or mis-informed about SML's role, legal status, ways of working, outreach and success. SML's expansion into new territories outside Andhra Pradesh; its ambition to be a leading microfinance provider across the entire country; the growing competition in the microfinance sector and SML's plans to mobilise significant human and financial capital for rapid expansion, have all further highlighted the need for defining and reinforcing an SML brand. The Managing Director and others acknowledge that not much attention has been paid to this agenda so far. SML has recently commenced its focus on corporate communications. SML is looking at strategic imperatives and options to build the SML brand, and possible communication strategies and media (street theatre, website, radio, newspapers and television) to inform various segments (clients, staff, media, investors, regulators and other stakeholders at local, national and international level) about SML.

4.2 Market Segmentation

SML vision is "To improve the quality of life of the poor by providing access to financial and support services". SML core product is an income generation loan to poor women (of Rs.2,000 to 15,000, repayable in 50 weeks). Annual Report 2001-02 reported the findings of an Imp-Act study[24], which found that 77% of the SHARE clients had reduced their poverty over the last four years. Summary details in Table 4.1 below:

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[22] Intensive strategy focuses on getting more out of existing infrastructure whereas extensive strategies focus on expanding infrastructure and geographical areas.
[23] While SML's own website provides limited details so far, MIX Market has substantial data on SML.
[24] Supported by Ford Foundation and Institute of Development Studies and conducted by SML during February-March 2001 with assistance from CASHPOR-PHILNET team. A follow up study is being prepared for Micro Credit Summit, 2008.

Table 4.1: Poverty Movement for SML clients

	Poverty Movement	%	Cumulative %
1	Very Poor to Moderately Poor	38.4	38.4
2	Very Poor to Non Poor	17.6	56.0
3	Moderately Poor to Non Poor	20.8	76.8
4	No Change	21.6	
5	Non Poor to Moderately Poor	0.8	
6	Moderately Poor to Very Poor	0.8	

Mr. Kumar noted that SML could not introduce new loan products initially as new loan products would have needed additional funds, which were unavailable. So starting with single product and one market segment, diversification (product, segment and geographic) is now fully underway and Table 4.2 below provides data for all the products offered.

Table 4.2: Different Financial Products for SML clients as of 31st March 2008

	Product	Number of Loans	Amount Outstanding (Rs. Million)	Average Loan Outstanding (Rs.)	% of Portfolio
1	General Loans	895,096	4,622.5	5,164	76
2	Special Loans	434,063	945.6	2,178	16
3	MEL Loans	26,176	501.8	19,170	8
4	Personal Loans	537	19.46	36,238	0
5	Housing Loans	333	0.45	1,351	0
		1,356,205	6,089.81	4,490	100%

Special loan: Special loans are given for business development/expansion after completion of 15-20 weeks from the date of disbursement of general loan.

Micro Enterprise Loans: To meet the needs of small business and diversify its products and clients, Micro Enterprise Loans (MEL) of up to Rs.300,000 were introduced in 2002. MEL product performance is good so far and rapid expansion is planned (more details in section 5.2).

Personal Loan: The Personal Loan is designed for those who have specific needs beyond the group lending model. These loans are given only to salaried individuals for meeting their personal needs.

Housing Loan: In order to meet the needs of the its mature clients, SHARE offered housing loans to its clients with a loan duration of 1-3 years.

Although SHARE initially introduced the micro-credit programme in the rural areas, the urban programme now constitutes about 25% of the total portfolio. SML offers life insurance[25] service to the borrower, and her spouse, as a part of the loan programme to provide protection to the borrower and SML. SML has recently tied up with UAExchange and Money Gram to leverage its wide geographical coverage for delivering remittance payments to leverage its existing network for additional fee income.

4.3 Market Research

The core loan product of an income generation loan repayable in 50 weekly instalments was brought from Bangladesh and tested during the action research 1991-93. Based on market response, this product was adapted for the Andhra Pradesh market, although most core features of the Grameen product were retained. Over time new products have been introduced. The focus at SML has been to standardise products for the

[25] At a premium of 0.6% of the loan amount, the member and her spouse are covered against death for the loan amount. After deducting balance outstanding, rest of the insurance claim is passed to the family. Most claims are settled within three months.

rural and urban mass markets. Although the need for systematic market research was never felt by the management, it is recognised that understanding market response is important for setting up and expanding operations. Market feedback is used to make changes to products or processes.

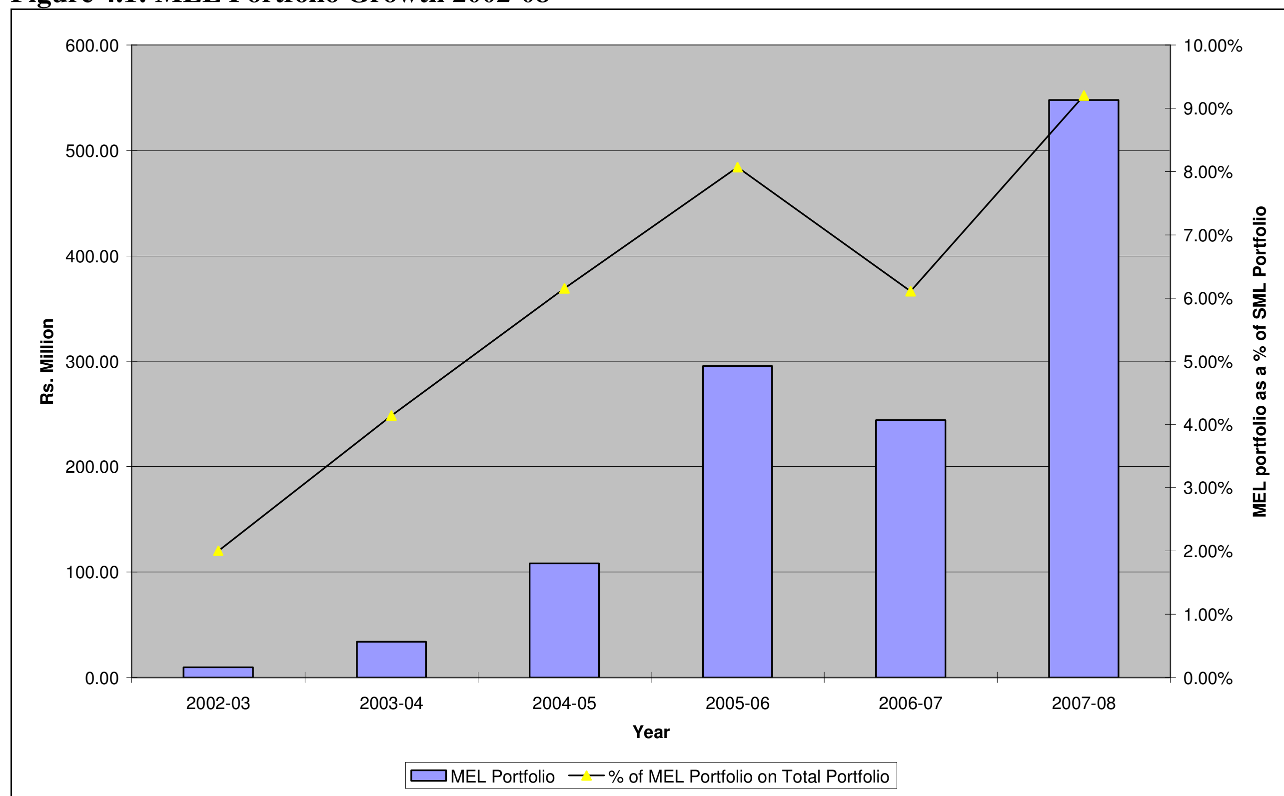
SML uses secondary sources for modifying existing products or introducing new products. At times, staff members are given questionnaires to leverage their experience and field network to assess the unmet needs of the clients. For instance, the recent idea to introduce an education loan came from the feedback given by the staff members. Staff feedback on existing product(s) and the need for new products can be sent directly to the Managing Director, who in turn discusses these suggestions with the senior management to identify substantive issues, and decide on possible options for SML. In addition to this, a session during the meeting between Divisional Managers and senior management is dedicated to finding ways of improving the current products, processes etc. New products are initially tried in 4/5 branches on a pilot basis, so that market and staff response can be reviewed by operations, IT, finance, internal audit and other teams and needed changes can be incorporated before wider roll out. These are clever surrogates for systematic market research. Another example of this approach is starting MEL branches in completely new areas, only after 3 months of operating a standard SML branch, to overcome the problem of lack of market knowledge and brand image.

4.4 Standardisation of products

This section uses the development of the Micro Enterprise Loan (MEL) product as an example of standardisation of a loan product. Micro Enterprise Loans were introduced in March 2002 and took off as a regular SML product in the year 2005. These individual loans are offered to mature microfinance clients or non-members with viable business expansion plans[26]. Apart from offering these loans from regular branches, 54 exclusive MEL branches[27] have been set up in high potential business areas. The product features have in built flexibility, and try to meet the needs of different businesses: loan size vary from Rs.30,000 to 300,000. 77% of the loans are below Rs.50,000 and average loan size is about Rs.33,500. Weekly, fortnightly and monthly repayment is allowed. Loans can be repaid in 6 to 24 months. The figure below shows the significant growth of MEL portfolio and rising proportion of MEL portfolio as a proportion of total SML portfolio. The current MEL portfolio is about Rs.550 million. MEL portfolio has grown by 124% during 2007-08 and further 200% growth is planned for 2008-09.

[26] Only Profit making existing business in trading, manufacturing and service are financed. No financing is provided for new businesses.
[27] Out of 54 MEL branches, 44 are located in Andhra Pradesh.

Figure 4.1: MEL Portfolio Growth 2002-08



The policies and processes for selecting a client, accepting a guarantor, appraisal, disbursement, repayment and handling arrears and other issues[28] are clearly documented in the 'Policy Guidelines for Individual Lending'. Credit Committees for loan approval, approval limits at different levels and payment disbursement through cheques, reveal the strength of internal controls for delivering this product. Manuals and training materials were revised in collaboration with Women's World Banking[29] in 2004 and have been further strengthened with emerging SML experience since then. The thoroughness of the systems developed and the time taken for developing this relatively high risk product have important lessons for new product development. Performance of this product is tracked and currently PAR (>1 day) is only 1.23 %. To ensure that MEL policies and procedures are followed rigorously, and staff have, or can acquire, business analysis capability, only graduates are recruited for administering MEL programme, as compared with many FCAs with only secondary educated qualifications.

MEL is expected to become a core product for SML over the medium term and account for 25% of the total SML portfolio by 2013, as against 9.2% in 2007-08. MEL programme is currently managed by 262 staff members, most of which have been certified as Micro Enterprise Loan Analyst through SML internal assessment processes. Every alternate month, 20 new staff members are recruited in each state for this programme. MEL loans are promoted through pamphlets and the option of using the print and electronic media are being explored. Document requirements have been made more flexible in the past three years. Earlier title deeds were compulsory for every MEL applicant, but now a combination of security, including guarantors and post dated cheques, are considered. Original and xerox copies are collected, so that the HO can take legal advice on the quality of the security being taken.

[28] Such as accounting, storage of deed documents and cheques etc
[29] Appraisal techniques for assessing Business and Client Character

5.0 Strengthening Systems for Rapid Growth

5.1 IT Systems

SML tested various software options but concluded that most of the software applications did not fully meet the needs of an MFI. SML has a strong Head Office based software development team, which has designed a customised product with support from Venture InfoTech, Knowledge Architectures and Olive Technologies. To strengthen the systems further, the company has also tied-up with RMIT solutions. The team at head office can update the software as and when changes are made in existing products or new products are introduced. Vice President, IT is part of the senior management team and is closely involved in finalising changes to the products and field procedures. Over 40 IT staff are dispersed in the field, and visit each branch every week. SML's MIS has been rated as excellent by the high-profile HDFC Technology Team.

The entire microfinance field operation is supported by computerized systems using 'Microfin Manager', an MIS software developed by SML team. This software has three modules: a Portfolio Manager, an Accounting module and a HR module. Currently, integration of these modules is being performed. Simplicity and minimal documentation is the focus of the Information Systems at SML. Very few papers – just a one page daily collection sheet for each *Centre* are carried by the FCA to the *Centre* meetings.

Improving the productivity and efficiency of the staff members, user-friendliness of the software and cost efficiency have guided software development at SML. As majority of the FCA positions are filled with senior secondary level educated staff, the portfolio management module of the software has a very simple interface intended to make the usage very easy and quick. For example, one page loan collection sheet provides the names of all the members with up to date information on loan disbursed, outstanding and due in the weekly meeting. The FCA only has to take the printed sheet to the *Centre* meeting, mark the attendance, count the cash and ensure that the amount collected tallies with the amount expected for each group and the overall *Centre*. Both in the field and while entering records, the default setting is 100% loan repayment by every borrower and only exceptions need to be entered. On return, the FCA can enter the repayment and disbursement data onto the computer in less than 15 minutes. This generates a consolidated *Centre* wise cash collected statement, which is submitted to the Branch cashier along with cash. The MIS also captures soft indicators like client attendance which is useful in deciding on the next loan.

The IT department provides strong back up support. As and when changes are made in product features, or when a new product is added, the software is immediately updated and the updated version is tested in a few branches. Based on pilot results, updated version is sent to the field teams, which can install the newer version in all the branches within two days. To enable any immediate changes or address any urgent issues at the field level, the IT team is connected to the HO through e-mail and phones.

The database tracks staff performance in terms of case load, new groups formed and targets. These parameters are used for measuring performance and calculating staff incentives. Majority of the branches are connected to the HO through e-mail. SML has recognised the need for real-time connectivity for better monitoring and improved efficiency, but finds VSAT option too expensive for its entire operations. SML is currently in discussions with various providers to evaluate the most cost effective option.

While discussing the strategic importance of IT with the Managing Director, issues of efficiency, cost effectiveness, timeliness, reducing the need for multiple data entry obviously came up. But the most important argument highlighted by the discussion is normally missed in such analysis: the generation of large number of receipts and other papers. The MFIs have to not only consider the climate change implications of so much of paper generation but also the more immediate concerns around record protection against fire, insects and other damage. According to law, these documents should be available for inspection for eight years. Mr. Kumar mentioned that the last time the tax authorities wanted to see SML records, he had to commission vehicles to transport these. It would have been so much easier to carry a few disks.

5.2 Delivery Channel Strategy

The branch is the basic distribution point and all products are delivered through SML staff located at branches. Initially savings mobilisation, loan disbursement and loan repayment were all managed at the *Centre* level. Savings collection has been discontinued. Loan disbursement has been shifted to branches to reduce risk of carrying large volumes of cash and to improve cash management. Apart from increasing staff efficiency during centre meetings, this increases the efficiency of cash management and improves documentation of loan disbursements[30]. Loan repayments collected in the morning can be used for fresh loan disbursements the same day at the branch office. Members continue to deposit loan repayments at the *Centre* level and need to visit branch only when fresh loan is disbursed. Insurance premiums are also collected at the time of loan disbursement.

Micro Enterprise Loans are distributed both through regular and specialised branches, using a similar process. Individual ME Loans are assessed at the business venue and mostly disbursed through cheques. Though partnership model and portfolio buy out (see below) had different cost and sources of funds for SML, there was no difference for members, in terms of pricing, product or distribution at the field level.

5.3 Partnerships: Managed Portfolio

To keep risks manageable, the central bank does not allow NBFCs to lend more than 10 times[31] the current shareholders' funds (equity and retained earnings). Since most MFIs are capital constrained[32], ICICI Bank and SML initiated the partnership model in 2004. Under this arrangement, SML earmarked specific branches where loan origination, monitoring and repayment collection was done on behalf of ICICI Bank. SML earned handling fees (group mentoring and meeting charges)[33] but the loans were directly financed by ICICI bank. The accounts were reconciled on a monthly basis. This enabled ICICI bank to expand lending in rural areas and meet its priority sector obligations without opening new branches. To cover the banks' risk, ICICI bank asked for 8% first loss guarantee. ICICI Bank sanctioned an overdraft limit to SML, which could be revoked in case of losses. Similar arrangements were made by SML with HDFC bank.

In addition to partnership model, banks also approached SML on a quarterly basis to buy out SML outstanding portfolio to meet their priority sector obligations. SML was the first MFI to package its assets for securitisation. Just as in partnership model, SML was entrusted with the task of enforcing repayments in case of portfolio buy out/securitisation, for which it was paid a fee by the bank. The main difference between the two models is that in case of partnership model, SML and bank had a strategic partnership and branch expansion was planned accordingly; whereas in case of buy out, it was more opportunistic, as the deal depended upon the bank's need to meet priority sector targets and SML need for additional funds.

These alternative funding sources rapidly grew in importance for SML and by March 2006, 42% of the SML loan portfolio was managed on behalf of other banks. Some of the partnership funding was channelled into branches that were directly affected by the Krishna crisis. As the crisis was triggered by external events, SML persuaded banks not to invoke the first loss guarantee on the managed portfolio. Banks have also taken hits from this crisis and have written off some of the losses. SML losses of Rs.162 million were noted in section 1.4 above. SML has however continued to collect overdue loans on behalf of itself and the banks. Together with write offs and recoveries, SML managed portfolio has significantly dropped from Rs.1,540 million in March 2006 to Rs.961 million by March 2008. Since the overall SML portfolio has expanded from Rs.3,662 million to Rs. 6,089 million over the same period, managed portfolio now accounts for only 16% of the March 2008 portfolio, as against 42% earlier. The RBI has also tightened guidelines for partnership

[30] Branch Manger re-checks and approves the loan form and cashier disburses to the women borrower accompanied by her husband or guardian.
[31] From April 2009, RBI has increased capital adequacy ratio to 15% (10% currently). This will curtail future leverage for NBFC as risk adjusted loan portfolio cannot exceed 7 times the shareholders fund
[32] Limited capital compared to expansion plans
[33] There was no difference for SML clients on interest rate and other conditions. Interest earned from clients less interest charged by bank was the handling fee for SML.

model on account of know your customer requirements and the need to have client performance data on real time basis. While the former is not an issue as SML is already collecting identity/address proof for every customer, the latter will remain a challenge till such time that all SML data is available online, and efficient mechanisms to share this data with the bank on real time basis are established.

5.4 Bank accounts for MEL Loan

MEL clients are encouraged to have a bank account, so that loan disbursement is routed through the clients' bank account and post dated cheques provide an additional security and can be collected at the time of disbursing the loans. This, however, increases the risk of losing some customers to the banks. As the bankers become aware of the transactions of these MEL clients, and know that these clients have already been appraised by SML, some of the banks start offering direct loans to these clients. However, SML is not too worried as yet, as many banks cannot handle small ticket loans, especially around Rs.33,500, the average loan for its MEL clients. Moreover, currently there is ample space for everyone in financing the large untapped small business financing market in urban and rural India.

5.5 Branch Establishment and Management

SML is a field based organisation and only 5% of its staff, operate from the headquarters in Hyderabad. SML members/clients form themselves into 5 member groups, led by a group leader. Each of 6-8 groups constitute a *Centre* and select a *Centre* leader. The key interaction is between over 2,000 Field Credit Assistants (FCA)[34] and the over one million clients, who come together weekly at the *Centre* meetings. The rest of the organisation is structured to finance, support, monitor and improve this weekly interface. Box 1 below profiles a typical day for a FCA (5.3% of the FCA are women). Currently each of 2,000 FCA (including 964 trainees) cover on average 494 borrowers[35] and excluding trainees this efficiency indicator rises to 760 borrowers per FCA.

Box 1: Life in the day of an FCA

Most FCAs stay in the office premises, which by design have space for both office and residence. A typical day for an FCA starts at 6.00 AM and ends at 7.00 PM, with breaks during the day.

6.00 AM to 6.30 AM – gather the Daily Collection Sheet from the computer in the branch and proceed to the field.

6.30 AM to 10.00 AM – conduct four to five *Centre* Meetings. The primary responsibility is to collect repayments and loan applications from members. Outside Andhra Pradesh, loans are disbursed in the field. In Andhra Pradesh, loans are disbursed from branches.

10.00 AM to 11.00 AM – break fast and rest.

11.00 AM to 1.30 PM – enter repayment data from the sheets into the computer system, submit cash to the cashier, disburse loans to the clients and update the accounting records.

1.30 PM to 4.30 PM – lunch and rest.

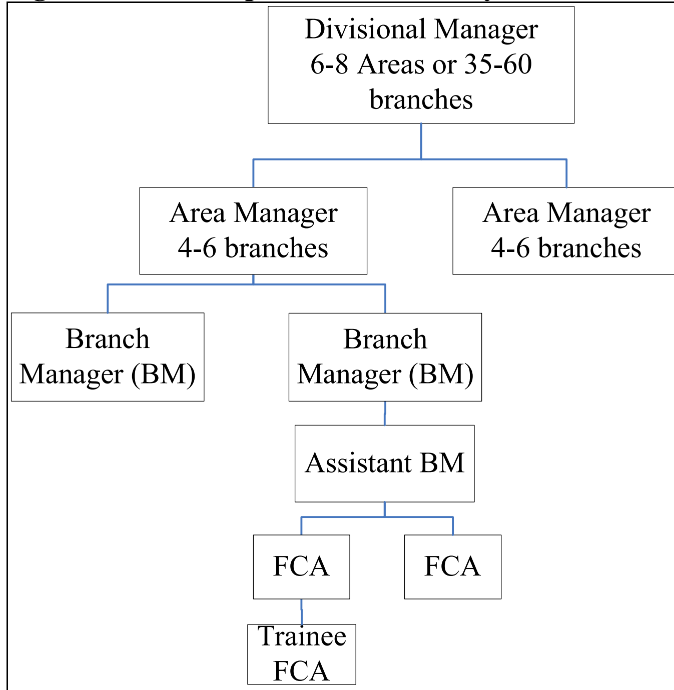
4.30 PM to 7.00 PM – back to the field to form new groups, conduct group trainings, undertake post loan disbursement utilisation checks and follow up arrears or any other problem cases.

Branches typically cover a radius of about 20km in rural areas and about 8kms in urban areas. FCAs cover their areas of operation on motorcycles. SML provides loans for the purchase of motorcycles and pays transport allowance based on the distances covered for operations.

FCAs report to Branch Managers, who in turn report to Area Managers. Each Area Manager oversees 4-6 branches and visits a branch every week. The entire field work (including new states) is divided up into 16 divisions, overseen by a Division Manager or a Deputy Division Manager, each of which oversees 35-60 branches.

[34] Including 964 trainee FCA and 262 Micro Enterprise Analysts (MEA)
[35] i.e active borrowers per staff

Figure 6.1: Field Operations Hierarchy



5.6 *Customer Service*

Discussions with field staff revealed a strong sense of customer service. The *Centre* Meetings are kept short so that both the members and FCA can quickly deal with repayments and move on to other issues. Staff are expected to reach the *Centre* in time for the weekly meeting. Loan applications received by SML have to be processed and cash arranged within 7 days, so that when the members come to the branch to collect loan disbursement (one week after the loan application), they can receive loan disbursement with in a short time of reaching the branch office. Similarly, despite extensive documentation, the MEL loan from specialised branches is normally disbursed in 3-5 days.

5.7 *Risk Management and Internal Controls*

SML has built up rigorous risk management and internal control systems. The Audit Committee at the Board level meets at least twice a year to ensure the sufficiency, fairness, credibility and transparency of the accounting policies and financial statements of the company. The Risk Management Committee (also constituted by the Board) addresses the integrated risk of the organisation. The Vice President Risk is specifically responsible for external risk assessment and mitigation. The Chief Internal Auditor leads an independent team of 80 auditors (55 senior and 25 junior staff) to assess internal risks and controls and reports directly to the Audit Committee and also to the Managing Director.

Internal audit in the field is performed by field teams, comprising of a team leader and an assistant. These internal audit teams are outside the normal reporting structures, such as Divisional Manager and directly report to the Internal Audit Manager. With rapid expansion into new states, the State Head for Audit, reports to the Chief Internal Auditor, through the Zonal Head, who is in charge of 4 states. An Audit Plan is prepared which allocates number of branches to be visited during the year and the sequencing of visits. This is known only to the State Head and his seniors. There are 2 kinds of audit: Complete Audit (done thrice in a year, normally takes 3-7 days and covers all branch transactions since the last audit); and Follow-up/Brief Audit (done thrice in a year, normally takes 1-2 days and it reviews previous audit findings and random branch transactions).

Audit Work is divided into 3 parts: field audit, audit of financial transactions and audit of non-financial transactions. Field audit has eight major issues on which a *Centre* is graded and there are 32 items in the

checklist for the audit. During this audit, all passbooks and loan amounts are verified. The role of *Centre* leader, group leader in the *Centre* meeting as well as discipline and attendance are also assessed. Loan utilisation of a few members is also checked. Audit Report is based on a checklist to be filled for the branch and the *Centres*. Branch and field staff are also annually rated.

All audit reviews are surprise checks. On the first day, the team visits the *Centres* and then proceeds to the branch. Each audit team has to visit around 1-4 *Centres* per day, considering: a) *Centres* of all the FCAs are covered; and b) *Centres* not visited earlier and/or suspicious[36] *Centres* are covered. During the audit, the audit team also has one-to-one discussion with each of the staff members to enquire not only about their business, but also assess other issues such as relationship with other staff members, working style of the team and the Branch Manager. Audit findings are discussed on the last day in a staff meeting at the branch. About 3-4 complete audits as well as 3-4 normal audits are done each month by an internal audit team.

To be appointed as an Internal Auditor, the applicant must have worked with SML for at least 1.5 years. Once selected, the prospective Internal Auditor is attached to a senior for about six months. After this, an exam is conducted to assess the auditing ability of the potential Internal Auditor. Till now, FCAs, BMs and have been inducted into the IA team. Currently, on a pilot basis, new staff are also being directly recruited to the IA department to meet the expanding needs.

Checklists used for Internal Audit are updated as and when necessary and at SML, this updating is very frequent and immediate. The internal audit reports also trigger changes in policies and procedures. For example, earlier incentives were based on net members enrolled and this has been changed to net borrowers. Similarly, fixed assets at the branch office are being numbered to track all assets. Feedback from the IA reports has also triggered changes in the document formats.

In addition to a strong internal audit system, examples of other internal controls at the field level are as follows:

- Regular monitoring by the AM (every branch once a week), DM and the EDP team.
- Every six months, *Centres* are re-distributed amongst FCAs to discourage any informal arrangements between staff and SML borrowers and to prevent collusion with the clients.
- Every 2-3 years, BM and higher level staff are transferred or promoted.
- Cheque signatories and cashiers, for disbursements from the branch, are changed every 3 months.
- The IA team composition and the branches to be audited also are changed within 1-3 years.
- Tenants are no longer accepted as members of the *Centre* (only home owners are considered).
- To tackle fraud, all MEL loan appraisal reports by the Micro Enterprise Analysts (MEAs), have to be verified by the BM. Depending on the loan size, verification is done by the senior officials and loan is approved by a Credit Committee.
- The software also has very strong internal control features. For example, FCAs can only enter data for a particular *Centre* on the day of the meeting[37]. The FCAs cannot change the pre-fed values like date of record, loan amounts disbursed and client names. Client codes are generated for every active client by the software. Information once captured can only be altered by seeking an activation code from the head office and that activation code is also valid for only one correction.

Currently, SML is planning to grade branches at the beginning of the year. Based on this grading, the audit frequency will be decided. Also, a new plan of receiving audit reports on a daily basis through mail is being discussed.

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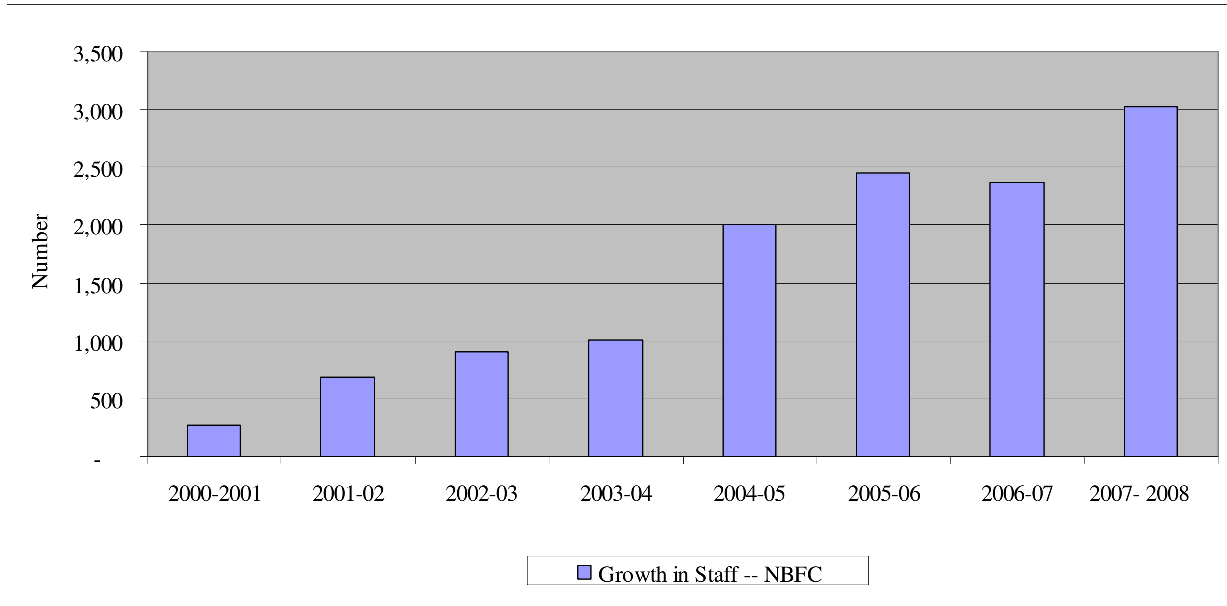
[36] For example, FCA arrives late from a particular Centre meeting

[37] Data for a centre having weekly meeting on Friday (which is pre-fed into the computer) can only be entered on Friday.

6.0 Human Resource Management

Staff Recruitment, Induction and Training: Despite increasing deployment of technology, successful microfinance is essentially about trained staff providing personal financial services in villages and towns where the poor households are located. It is a manpower intensive programme, and to manage growth, SML has rapidly expanded recruitment and training capacity to meet this need. The figure below shows that SML staff has increased over 10 times in the last eight years.

Figure 6.1: Growth in SML Staff 2000-08



Only 5% of the SML staff is located at the head office and the rest 95% are in the field. Only 5% of the SML staff are women, and 87% of these female staff work in the field. With rapid expansion planned in other states, 30% of the SML staff is already located outside Andhra Pradesh. Considering that the staff will further grow exponentially in the next few years (over 30,000 staff projected by 2013), human resource management will remain one of the major challenges for future expansion. However, the existence of well-established systems[38] for recruitment, training and performance management should make this less daunting than it might seem to an outsider.

Nearly two thirds of the current staff is at the level of FCA (Field Credit Assistant) and MEA (Micro Enterprise Analyst). Recruitments are initiated through an advertisement in the local newspapers. Eligibility criteria[39] for an FCA are: a) passed Class XII; and b) aged 19-25. For recruitment, candidates go through a short written test[40] followed by an interview. During a short personal interview, the candidate's interest and how keenly he/she wants this job is assessed. The efficiency of the system is demonstrated by the fact that about 400 candidates can be assessed in a single day to recruit up to 100 field staff. A special recruitment (and promotions) committee of HR, Operations and Training is responsible for recruitment and aims to go through the entire process of written test and interview, so that selected candidates leave with employment offers at the end of the day. On appointment, the candidates have to submit their original academic certificates and provide guarantee letters from two government employees.

[38] The Managing Director reminisced about his ability to quickly identify whether a potential candidate will be suitable for SHARE but recognizes that now the scale of recruitment is much more substantial and he has to delegate these tasks. He noted that some errors in selecting the right candidates may occur, but there is no alternative to building systems for handling growth.
[39] Eligibility criteria for an MEA are: a) Graduate, preferably with a Commerce background; b) Aged 19-26.
[40] These differ. For example the MEAs are assessed more on quantitative analysis of financial data.

Flexibility to respond to the market situation is demonstrated in the changes to the eligibility criteria. Earlier only graduates were recruited but considering the demand supply mismatch and standardised systems needing lower education at the FCA level, the eligibility criteria was brought down to Class XII. However, this has been changed again in new states, to ensure that the recruited FCAs are ready for quicker promotions, as expansion will create demand for trained branch managers and more senior staff, preferably from within the state. Another related example of flexibility is the willingness to recruit Branch Managers directly from other organisations in the new states, rather than wait for the newly recruited FCAs to be trained to take on more senior positions.

The new staff are trained through a combination of field based and class-room sessions. Till 2003, SML used to conduct trainings/workshops for the staff by inviting them to the Head office, where Mr. Kumar, along with other professional staff, conducted the training. SML now has 11 Regional training centres, which conduct the classroom sessions. Existing branches are used for the field training. An initial round of in-field attachment is followed by a class room session. After this, the testing process starts – on-field targets are given to the trainee and then a test is conducted at the Regional Training Centre (RTC) to assess the trainee's understanding of the job. If the performance is above a certain minimum, the trainee is confirmed and posted as a regular employee. One of the non-negotiable criteria for confirmation is the possession of a permanent driving licence, as staff conduct field visits on motorcycles.

New staff members for the MEL branches undergo a two-month training programme – one month at the Regional Training Centre (RTC) and one month in the field at an existing MEL branch. After the training, the concerned Branch Manager (where the training took place) prepares a *Trip Report* on the performance of the new staff member. If this report is satisfactory, then the trainee is assessed by the Manager of the Regional Training Centre to become a certified Micro Enterprise Loan Analyst (MEA).

Performance, Promotions and Staff Retention: Salaries are divided into fixed and variable components for all staff. For FCA/MEA the workload such as number of borrowers, size and quality of portfolio determines variable pay and drives performance. The variable component is one of the motivating factors. Along with growing productivity and profitability, salaries have been substantially increased for SML staff. For many staff getting rapid promotions, the cumulative effective of growing salary scales and promotions has meant that their absolute salary is about 8 to 10 times of what they started with 4-5 years ago.

Promotions to the higher levels are based on achievement of targets, approach towards the work, improvement in knowledge of accounts and office procedures (circulars), punctuality and quality of interaction with clients. Each staff member being considered for promotions has a file generated by the seniors on these parameters and this forms the basis for the decision by the Promotion Committee. Feedback from the Internal Audit team on particular staff members is also used for deciding on promotions and training. The existence of many levels in the field – Trainee FCA, FCA, Senior FCA, Assistant Branch Manager, Trainee Branch Manager, Deputy Branch manager, Branch Manager and Senior Branch Manager are seen as a motivating factor for the staff to continue to perform.

Any staff member involved in manipulation, embezzlement, indiscipline or facing other charges is terminated from service and a formal compliant is lodged with the police. If there is any genuine reason, based on the internal enquiry, the concerned employee is transferred or de-promoted.

With growing economic opportunities and expanding microfinance sector, retaining trained staff has become an issue for SML. The 2006-07 Krishna crisis also shook the staff confidence and some of the staff left SML. The table below shows that staff attrition rate has significantly gone up in recent years. SML management notes that the difficult phase is past and with the entry of new investors and resumption of SML expansion, together with increasing salaries, will further improve staff retention.

Table 6.1: SML Staff Attrition Rates, 2004-05 to 2007-08

Year	Average Staff during the year	Staff Joined during the year	Staff left During the year	Staff attrition rate
2004-05	1,505	1,084	82	3.93%
2005-06	2,231	555	105	4.01%
2006-07	2,409	68	161	6.37%
2007-08	2,692	889	230	7.04%

Employees are encouraged to take up different roles and responsibilities – Field Operations, Internal Audit, Training, Planning, Monitoring and Risk – and thereby acquire different skills within a few years of time. The high growth of the organisation itself has been a great motivator. Those who have joined SML as a small organisation handling a few branches now take pride in being part of a pan-India MFI.

Recruitment and Retention of Senior Management Team: Until 2007, almost all[41] recruitments happened at the FCA/MEA level and many of these staff rose through the ranks to take up senior management positions. With rapid expansion plans in place and increasing complexity in operations (new geographies, new products along with sheer scale, regulatory compliance and other pressures/opportunities), the senior management team has been significantly expanded with external recruitment. For example, a few ex-bankers/corporate managers have joined to manage various functions e.g. Planning, HR, Operations and Communications. Once a role was identified, careful short listing through references from the banking, finance, insurance and consulting sectors was used to identify and assess the best possible fit between expectations of SML and the identified candidates. To attract senior staff, best salaries in the industry are offered.

While the field level employees receive training mainly on operational and behavioural aspects, middle and senior management team receive training on leadership skills, communication skills and management development. Apart from the salaries, these trainings play an important role in motivating the team and building future leaders for expansion. Growing scale, profitability, growth prospects and significant private equity and debt financing have also played a contributory role in attracting the recently recruited senior staff.

Scaling up requires right kind of staff to handle diverse geographies[42] and opportunities. These people should be experts in finance, should have a social focus, leadership abilities and should be loyal to the organisation. To encourage loyalty, SML is in the process of finalising ESOP (Employee Stock Option Plan) offering for its employees.

7.0 The Future

What is driving this SML quest for rapid growth? The primary growth driver is to retain leadership and international profile in a rapidly expanding field. SML wants to ensure that it is not seen as being left behind by younger and more aggressive MFIs. Transformation in to a commercial financial institution and induction of new investors has sharpened the focus on scale, efficiency and profitability. This will also increase the pressures to serve customers with larger fund requirements and quickly expand into newer and even riskier[43] territories. Will this dilute the focus on marginal customers, whose needs are small or more expensive to service?

SHARE mission is "To mobilise resources to provide financial and support services to the poor, particularly women, for viable productive income generating enterprises enabling them to reduce their poverty". SHARE still sees its social objectives as important and the focus on profitability as a means to build a sustainable

[41] There were few exceptions such as Manager Accounts
[42] Andhra Pradesh is saturated and has limited growth potential
[43] In new locations/ states much less time is being spent in understanding the local customers' needs and social, economic and political context (No time for Action Research and slow build up)

institution. However, retaining the social mission will be a real challenge. SML is proposing to tackle this in two ways:

a) To initiate an ultra poor programme.
b) Conduct a study in two years to assess how many of its clients have moved out of poverty.

In any case, readers should be careful in drawing hasty conclusions. In pursuit of rapid growth, SHARE may still have a greater overall poverty impact than a poverty focused but small MFI. This could be both due to larger number of poor people served, even though the proportion of clients served who are poor may decrease (direct impact)[44], and/or the indirect impact unleashed by the non-poor clients creating local opportunities for the poor at the village/ward level. In the final analysis, evidence rather than perceptions should be the indicator of success in meeting social performance.

SHARE has been a pioneering microfinance institution in India, which is quite proud of its achievements. SHARE has been amongst the leaders to transform into a regulated financial institution, package microfinance assets into securities, and attract significant foreign direct investment into an MFI. SHARE is drawing up big plans for national expansion and possible international forays. SHARE has opened offices in 6 states during April/May 2008, and now covers 16 states in India. The last two years have been difficult but have also provided an opportunity to further strengthen and improve its internal systems and expand senior management capacity. The Krishna crisis has really tested the strength of the organisation but has also strengthened its resolve to retain its leadership of the microfinance sector in India.

As this paper has demonstrated, what started as change of legal identity has unleashed other changes, which have transformed its ownership, governance, management and ambitions. SHARE seems ready for the big league.

[44] For example, even if the proportion of poor clients served reduced from 80% to 60% overall, due to rapid expansion between 2005 and 2008, this could still mean doubling the total number of poor clients served.

Box: Advice to aspiring CEOs/ promoters, wishing to emulate SHARE's Success

Mr. Kumar noted that microfinance sector has transformed in the last few years. The initial problems faced by MFIs are not there anymore and there is increasing recognition as a mainstream profitable activity. Microfinance is also more readily accepted as a means to reduce poverty. The sector has now become attractive to professionals and investors. However, there are not yet many MFIs that have built up successful systems and processes. Mr. Kumar offered the following practical advice for MFI promoters in India:

- You need commitment.
- Study different models of delivering microfinance services.
- Build your own capacity before starting, especially in financial skills, management and leadership – growth was slower earlier, so first generation CEOs had the opportunity to learn at a relatively slower pace. This is not the case now.
- Start small with 5 branches to gain field level experience (during this time, the CEO performs all roles from GM to GM – Gate Man to General Manager). If necessary, recruit a Branch Manager level staff from a large MFI for setting up these 5 branches.
- Then recruit field staff, train them and plan for a scale up. Go slow in the first 3-4 years. Head Office functions can be performed by just 2 people during these years. In a time span of 4-5 years, aim to reach 100 branches till which time there is no need for senior management staff.
- Have a strategic plan for 5 years and cover your costs as soon as possible. Scout for low cost funds for the initial years to cover operational costs.
- Have a Governance Structure (Board) with experienced people from the sector - bankers, regulators or staff members, especially those people who will inspire trust and confidence of the Financial Institutions.
- Approach financing organisations such as SIDBI, FWWB, and Blue Orchard, who may consider giving loans without a track record.
- Use technology from day one and a number of service providers are now available (FINO, Crane, Atithi).
- Key Challenges to be addressed:
    - How to get the initial risk capital? (Specifically Rs.20 million for an NBFC which would be the right legal structure for business) and
    - How to negotiate with equity investors?

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