# *MicroSave* India Focus Note 11

## Capacity Building – Needs and Challenges in India

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**The Story So Far …**

The Indian microfinance sector has witnessed extraordinarily fast annual growth, of about 45%, over the last years. As per the recent quick report (August 2007) Sa-Dhan's member MFIs alone had a total outstanding of over $1 billion and were providing financial services to 10.5 million poor families. Even with the rapid growth, MFIs were able to manage very low defaults, with PAR>60 days at 1.77%. And for all the concerns about high costs, the average operating cost ratio of the Indian MFIs is 15.9% (compared to an Asian and global averages of 17.2% and 21.5% respectively). There is a significantly higher flow of funds from the commercial banking system, which now see microfinance as a good business. Given the healthy growth and large size of the market, several venture capital funds (including Bellwether, Lok capital, Unitus, Aavishkar and Opportunity International, Australia) have started operations in India; and others are set to follow. In terms of national interest, NABARD and SIDBI have both established equity funds with a view to invest in MFIs. And, of course, private equity funds such Sequoia, and Legatum have recently made significant investments in leading MFIs.

**However Challenges Remain …**

To maintain the laudable growth in microfinance outreach, MFIs need much larger *access to finance*. The partnership/ banking correspondent models are not effective, long term substitutes to robust balance sheet, including an adequate debt-equity ratio. The commercial banks lending to MFIs are now showing signs of reluctance to provide larger loans for low net worth institutions, and so MFIs will need to increase the equity on their balance sheets. In addition, to maintain the confidence of (and thus fund flows from) the bankers, MFIs will need to improve their systems, governance, management and transparency. Surveys and informal discussions reveal that the central bank, and commercial banks lending to the MFIs, continue to be concerned about their *weak governance and second-line management*.

Political imperatives and a social development focus maintains the *demand for low interest rates* (typically <24% seems to be viewed as the desirable benchmark). This means that MFIs will need to increase the efficiency of their processes[1]; and to use IT and (eventually) e-banking systems optimally[2]. MFIs themselves will have to *manage the competition* that is coming from both the expansion of ambitious MFIs such as SKS, Spandana and Share, and from the new-entrant NBFCs such as Citi and Fullerton. This will require strategic decisions on whether to compete on price, quality/range of products and/or customer loyalty.

There is a persistent, and growing, belief that finance alone may not have adequate impact on poverty. According to a 7 year longitudinal study of SIDBI, two thirds of clients felt that there was no significant improvement in their income levels. This finding should be treated with caution however, since many observers note that MFIs in India were providing significantly inadequate loan funds to their clients until 2-3 years ago; and extensive empirical studies Bangladesh have repeatedly and clearly shown growth in financial, physical and social assets of MFIs' clients (but only after 4-5 years of participation). Nonetheless, if clients do not, or are unable to, use their loans for appropriate income generation activities, they may fall into debt trap. A large number of mature MFI clients are

[1] *MicroSave*'s Process Mapping Toolkit provides an excellent methodology for approaching this.

[2] See *MicroSave* Indian Focus Note # 4 "E-Banking: The Next Revolution?" and *MicroSave* Briefing Notes # 31, 47, 51 and 52 for more on this.

demanding business advisory services to raise their income levels. But livelihood services have not had a successful history and require specific skill-sets that are often hard to find.

Nonetheless, the 15-20% of group members who are indeed real entrepreneurs will need larger, individual, cash-flow based, loan products; and there is a gaping "missing middle" of small businesses waiting to be served.

As part of the move from first generation, mono-product microcredit, there is a growing recognition of the importance of *social protection*. This will comprise savings services (perhaps delivered through the business correspondent model) and social security cover for clients such as life, health and asset insurance; old age pension etc. The customer must, and will have to, be at the centre of the second generation, market-led microfinance.

**The Single Biggest Challenge …**

Addressing all the above challenges will require investment in human resources and systems through capacity development encompassing both training and technical assistance. *Worldwide (and in India too) training and capacity development remains the single biggest challenge for microfinance.* MFI leaders report that there is no regular supply of trained manpower either at the grass root level or at the management level. As a result MFIs are forced to rely on *ad hoc* in-house training methods and infrastructure, which does not yield the professionalism and competencies that they need to build strong and effective financial institutions. India still needs a cadre of high quality technical service providers to train/ service the sector in the future.

**Capacity Development – Supply Side**

The current availability of service providers is inadequate in terms of numbers; and even and capacity in some areas. India will have to look beyond the traditional microfinance training and technical service providers and start to involve accounting firms, management consultants etc. In India, as across the globe, too many trainers struggle to use adult education techniques fully and many are unable to translate the theory of the classroom into practice in the field. High quality, effective training combines classroom theory and on-site follow-up to drive the learning in to practical action and change in the institutions. MFIs responding to *MicroSave* training needs assessment of 2005[3] also put particular emphasis on the need for step-by-step "how to" guides or workbooks to guide the change process.

Furthermore, capacity building must be tailored to meet the differing needs of the nascent/emerging MFIs and of the expanding/mature MFIs. There is a pressing need to develop comprehensive, relevant and integrated training modules on a wide range of topics to professionalise Indian microfinance – thus building the much sought-after second tier management in MFIs. The industry continues to grow, and so does the demand for competent middle management. Currently, these are typically sourced by MFIs from the rural institutes of management. But these rural institutes are using curricula largely based on the one developed by SIDBI nearly a decade ago – and it is high time to revisit this curriculum, to update it both in terms of content (to reflect the new realities in India microfinance) and in terms of its delivery (to use multi-media/practical examples, and thus bring the courses to life with video clips, case studies and field-based exercises that take the students out into the field).

**Capacity Development – Demand Side**

Currently, not enough attention is being paid to training for senior management. This probably stems from a combination of three constraints:

1. A thinking that senior management does not really require training;
2. A mindset that senior management does not have the time to attend training; and
3. Inadequate capacity of senior management to implement the outputs of training within MFIs.

In line with private sector business, MFIs need to start seeing *training as an <u>investment</u> rather than <u>expense</u>*. As part of this they need to pay more attention to training and capacity development as a part of an integrated HR management that includes HR retention.

**Conclusion**

Given the political sensitivity to the client segment served, the governance and behavior of MFIs is increasingly coming under the public scrutiny. If growth and sustainability were the key concerns of microfinance industry during the first half of this decade, good governance, client focus and networking with other development institutions are the new challenges. MFIs must gear themselves up to address these new demands.

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[3] See *MicroSave* Briefing Note #46 for more on this – parts of this India Focus Note were taken from this Briefing Note.