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Innovative Approaches to Delivering Microfinance Services: The Case of VSSU, West Bengal

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for *MicroSave*

July 2002

Acronyms and local terms

ASCA	an informal savings and loan club
bibechona	'special consideration' – a hallmark of VSSU's approach
CASHE	a microfinance programme of CARE India (an NGO)
CGAP	Consultative Group to Assist the Poorest, at the World Bank
VSSU	Vivekananda Sevakendra O Shishu Uddyan
DFID	Department for International Development
IDPM	Institute for Development Policy and Management at the University of Manchester
ITDG	Intermediate Technology Development Group, of London
M-CRIL	Micro-Credit Ratings & Guarantees India Ltd
MFI	microfinance institution
NGO	Non-government organisation
ROSCA	a rotating informal savings club
SIDBI	Small Industries Development Bank of India
TOR	Terms of Reference

in mid 2002 one US dollar ($) is equivalent to 48 Indian rupees (Rs)

Preface

MicroSave*, an initiative to promote financial services for poor people in Africa, commissioned* ***Stuart Rutherford****, an independent consultant, to conduct a review of the innovative microfinancial system developed by* ***Vivekananda Sevakendra O Sishu Uddyon****, (VSSU) an NGO based in West Bengal, India. The main aims of the review were to study the work of VSSU and to assess the opportunities and constraints facing the improvement of its microfinancial services and their replication elsewhere.*

Vivekananda Sevakendra O Sishu Uddyon (VSSU) is a local NGO registered under the Societies Registration Act. It is based in the South 24 Parganas District of West Bengal in north-east India, and works in six blocks of the District. It has a unique approach to microfinance which, since 1994, it has been developing alongside a range of social development programmes. Until recently the microfinance work was financed entirely from local sources including client deposits. In late 2001 it received a loan from SIDBI, an Indian development bank. Further details about VSSU can be had from their founder Mr Kapilananda Mondal on vssuu451@hotmail.com.

MicroSave supports the development of microfinancial services for the poor of Africa. As part of its work it commissions reports on microfinancial initiatives of particular interest. Its Director, Graham Wright, visited VSSU briefly in December 2001 and subsequently commissioned this paper as part of ***MicroSave*'s** series on 'Innovative Approaches to Delivering MicroFinance Services'. More information about ***MicroSave*** can be found on their web site, www.***MicroSave***.net

Stuart Rutherford is an independent writer, researcher and practitioner of financial services for the poor. He is the founding Chairman of *Safe*Save, a Dhaka-based MFI, and a Visiting Fellow at the Institute for Development Policy and Management (IDPM) at the University of Manchester, UK. He has done research previously for ***MicroSave***. More information about Stuart Rutherford can be had by emailing him at stuart@safesave.org, and about *Safe*Save by viewing its web site at www.safesave.org.

S K Sinha is Stuart Rutherford's assistant, and has worked with him on numerous consultancies: he is also the Secretary of *Safe*Save. Sirajul Islam is the Program Director, and Anowar Hossain is a Program Officer, of BURO, Tangail, a Bangladeshi MFI well-known for its interest in innovative financial product development. Hossin Islam Ripon is the General Manager of *Safe*Save. Mark Staehle is a consultant who currently resides in Dhaka and acts as *Safe*Save's interim Director. Md. Monirruzaman is a chartered accountant and audit manager for the leading accounting firm Acnabin and Co. of Bangladesh.

This Review was carried out in two visits. One was made in early April 2002 by Rutherford, Islam, Hossain, Sinha and Ripon. A second was made in June 2002 by Staehle and Moniruzzaman and focussed on producing a fresh set of financial statements and at investigating in greater detail VSSU's unique forms loan-guarantees and the cost of its savings products. The overall aims of the Review are 'to study the work of VSSU, and to assess the opportunities and constraints to the improvement of VSSU's services and to their replication elsewhere'. The full Terms of Reference are reproduced in the Appendix.

This Report was written by Stuart Rutherford and Mark Staehle, who accept full responsibility for any errors. Questions about the Report may be sent to Rutherford at the email address given above or to Staehle at Staehle@mail.citech-bd.com. A draft was read through by VSSU, and Edward 'Mac' Abbey of PLAN Bangladesh also read a draft and made helpful suggestions. In accordance with the TORs, the Report follows a prescribed structure which can be understood by reference to the Contents page.

The team would like to thank VSSU for its generous hospitality and assistance. They are also grateful to ***MicroSave*** for giving them the chance to experience VSSU's work at first hand, an experience from which we all learned a great deal.

During part of our visit, Harish Chotani and Madhurantika Moulik of CARE India, and Abhijit Ray of the SIDBI Foundation for Micro Credit were also visiting VSSU: we benefited from conversations with them and thank them for that. We also benefited from work done on VSSU by Tara Pahwa of Oxfam America, and we thank her for that.

Very little has been written on VSSU so far. R K Mukherjee, the Managing Director of Grameen Kosh, awakened interest in VSSU by writing a message to *Sharenet*, an email discussion list on Asian microfinance. In our own work we have benefited from the *Micro-Finance Capacity Assessment* (or rating), carried out by M-CRIL (Micro-Credit Ratings & Guarantees India, Ltd) in May 2000.

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A remarkable MFI

VSSU is a young MFI serving a remote rural corner of the Indian state of West Bengal. It is small, with just one office, fewer than 7,000 clients, and a loan portfolio of barely half a million dollars. By modern microfinance standards its management systems are low-tech and labour-intensive. VSSU is dominated by a dynamic leader with minimal knowledge of how microfinance is practised internationally in the twenty-first century.

But international microfinance can learn from VSSU. This is an MFI that:

Is entirely local, works with men as well as with women, conducts most of its business with individuals rather than with groups, has built its capital base on client deposits and has taken no donor funds[1], has received no 'capacity-building' advice or training, offers products that are essentially savings plans with loans as an optional service, and derives all its income from those loans which are priced at only 24% a year

And yet:

Regularly makes surpluses big enough to fund an array of charitable work and to re-invest in its own growth.

The secret

This remarkable outcome can be almost wholly ascribed to a single cluster of factors: intelligent product design and delivery, imagined by a dynamic individual possessing a strong instinctive understanding of the local microfinancial market and the charisma to motivate a small band of modestly-paid workers. Other factors conventionally regarded as important to good microfinancial practice turn out, in VSSU's case, to be weak or absent.

The products

VSSU's product type is not new. In so far as VSSU is innovative, the innovation lies in adapting existing rather than inventing new products. The main product is a contract savings plan with regular daily or monthly deposit amounts. Clients agree to make an invariable deposit at a regular interval for a fixed term. In return, they receive their accumulated deposits along with interest on maturity. Premature closure or premature withdrawal of part of the deposits is allowed, but is penalised by fees and loss of interest. Clients who deposit regularly may also borrow, with the loans secured partly against deposits and/or a number of other forms of security – guarantors, referees, post-dated cheques, mortgaged assets, or simply a good previous track record. Clients also receive a number of incentives, including cash gifts on successful maturity, and some insurance cover.

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[1] Until very recently, and then only in small measure

The most popular variant of this scheme is the Daily Plan, with savings deposits made daily over an 18 or 24 month term. There is also a Monthly Plan, with deposits made monthly over terms of up to five years. In addition, there are conventional Fixed Deposit accounts with terms up to six and a half years.

Such products have been popular in India for many years, and VSSU competes with local banks (and, increasingly, with other MFIs who are copying VSSU's work). Like them, VSSU finds most of its clients among the shopkeepers, stall-holders and sidewalk traders of the area's numerous fixed markets. It currently works in twenty-six such markets, where some two-thirds of its 6,990 accounts are held, most of them of the Daily Plan type. VSSU bank workers, known as 'Motivators', visit each client daily. At any time, between one third and one half of account holders have loans. VSSU also works in some 220 village neighbourhoods although (as the numbers would suggest) their presence there is patchy. Virtually all clients who are served, monthly, in their village homes (for, of course, most of the traders who are served daily in the market also have village homes) hold Monthly Plans, and their deposits and loan values tend to be smaller.

The savings element of the Plans satisfies the needs of many clients (a key lesson for credit-based MFIs), and demand for loans by those who do choose to borrow is managed through the setting of permitted ratios of loan size to Plan size, and through rules governing how long depositors must wait before they receive their loan. The result has been that VSSU has always held more deposits than loans outstanding (in April 2002 the ratio was 1.02) and has been able to finance its portfolio entirely from deposits. With most loans priced at 24% a year (there are some cheaper loans for certain 'social' uses), and with interest rates paid on savings held at a very low effective overall rate through fees and penalties, the actual yield on the microfinancial work taken as a whole has averaged 22% a year for the last five years. This has generated enough income to cover VSSU's modest costs (cost control is ferociously enforced) and still leave enough spare to finance social work of about $12,500 a year, and to re-invest in steady expansion.

Reaching the poor

VSSU has no 'poverty focus'. It regards the whole of its area as poor and in need of development. It aims to address poverty, but not through directed financial services. Its financial services are open to any adult within reach of them, and VSSU actively strives to recruit better-off clients in order to remain cost-effective. It has given one loan of $10,000 and several bigger than $1,000, as well as many loans as small as $20. In February 2002 it opened 154 new Plan accounts with deposit values of $2 a month or less, and nine with a deposit value of $20 a month or more. VSSU has clients (both savers and borrowers) from all walks of life, but the most common client type is the poor, upper-poor or middle-income male trader running a shop, stall or sidewalk business in a market. Its client profile (though not necessarily its range of loan sizes) can be said to resemble that of many mainstream Latin American or East African MFIs.

Other factors

We have seen that VSSU's products, its dynamism, and its commitment to cost control, explain much of its success. Other factors conventionally regarded as important to successful microfinance are absent or insignificant. Until very recently there has been almost no contact with the wider world of microfinance. Management systems are 'home-grown' and unconventional, and fall well-short of standards currently considered essential by the industry. In particular, accounting and information systems are home-made and labour-intensive, a fact which would throw more doubt over the 'successes' described above were it not for the fact that M-CRIL, a respected Indian credit-rating institution, examined VSSU in May 2000 and adjusted its financial statements to reliable standards. Internal control is weak, and as with many MFIs, there are probably abuses occurring as you read this. VSSU's legal position is frail, and its governance rudimentary. Human resource management gets along without job descriptions, personnel files and many other devices that one would expect to discover in an organisation of 52 staff. An expensive new HQ building has gone up in the last eighteen months, weakening the adequacy of VSSU's reserves.

Expansion and replication

VSSU is at a turning point, and knows it. Growth has already slowed, and VSSU cannot expect to resume healthy growth until it addresses the causes of the slow-down. It *must* improve its systems, partly to control error and fraud, partly because it has reached the point where a single individual – its dynamic founder, Kapilananda Mondal – can no longer expect to know every worker intimately and to be involved in almost every day-to-day decision. A shift to a branch structure, away from the current NGO-like organisation, is likely. Computerisation will certainly have to happen, but not before basic systems are re-designed, or there is the danger that the software company, rather than VSSU, will ‘own’ the output. The legal identity quandary must be addressed. The emerging relationships with investors (an Indian Development bank, and a local bank), and with NGO partners (at least two international NGOs) have to be managed: they will demand much management time and as things stand now there is no-one besides Mr Mondal to provide it, and he is already over-stretched. New competitors, who have copied VSSU’s work-style but probably lack its integrity and its commitment, have to be seen off, and that can best be done by shifting to even higher standards of client service. And for that to happen, ‘*bibechona’* needs to be re-thought. ‘*Bibechona’* (a Bengali word signifying something like ‘special consideration’ and meaning, in effect, that Mr Mondal can change any rule any time he wants to) is a double-edged weapon in VSSU’s armoury. It has been used to maintain a flexible relationship with clients and to enable changes to be made as lessons are leant. So far so good. But it is also used to centralise decision-making to a dangerous extent, and it has the effect of making VSSU’s products and services much less transparent and reliable than they should be. A more rule-bound, codified approach will be needed if growth is to be accompanied with reliability.

VSSU, then, simply doesn’t have a ‘model’ or a ‘system’ that is replicable elsewhere. But what it does have is an approach: an understanding that financial services are to do with helping people manage their money, and finding imaginative ways to maximise their ability to exploit their capacity to save, through both savings and loan products. Such an approach, as VSSU shows us, can lead directly to startling results while bypassing much of the machinery – above all such devices as donor involvement and external funding – that our industry is assembling in our efforts to popularise and expand microfinance.

Summary profile of VSSU

(Figures are as at March 31st 2002 unless otherwise stated)

Name	Vivekananda Seva Kendra O Shishu Uddyan (Vivekananda Service Centre and Children's Park)
Address	Ullon Village, Ramlochanpur Post Office, South 24 Parganas, West Bengal, India 743336
Phone and email	03174-77451 vssuu451@hotmail.com
Founder and Secretary	Shri Kapilananda Mondal
Legal status	Voluntary Society
Premises	One consolidated HQ and training centre, in Ullon: recently built and owned by VSSU
Working area	About 25 kilometres in extent, centred on Ullon. Clients are found in 26 markets and 220 village neighbourhoods
Staff numbers	52 (including 4 juniors on trial)
Financial products	Recurrent savings Plans (Daily and Monthly); Fixed Deposit Accounts; associated loans
Number of accounts	6,996 (of which about two-thirds are Daily plans)
Number of borrowers	Approx 2,475 accounts have loans outstanding
Client deposits held	2.51 million rupees ($524,000)
Portfolio outstanding	2.45 million rupees ($510,000)
Other significant liabilities	Loan of 3 million rupees ($62,500) from SIDBI, a development bank. VSSU has also borrowed against its cash reserves at its local bank.
Other significant assets	HQ building: value unknown, construction cost about 6.2 million rupees ($130,000)
Net surplus (year to end March 2000)	830,000 rupees ($17,250)
On-time saving deposits	Probably about 80% on-time at each month-end

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1 Introduction

1.1 The Context

Historical

VSSU is the creation of Kapilananda Mondal, whose home is in Ullon, the village that houses VSSU's headquarters and is at the centre of its working area about two hours drive south of Calcutta in the Indian state of West Bengal. Reared in a modest rural household, Mr Mondal gained a local high school pass and then took a variety of jobs, including that of a reporter for a Calcutta-based newspaper. In the mid-1980s he founded VSSU, firstly as a youth club with a commercial tree nursery (which still runs) and later as a general-purpose development NGO financed wholly by local contributions. Some years later a conversation with a rickshaw-puller convinced him of the potential contribution that regular savings can make to economic development. He threw in his job, and became the full-time driving force behind VSSU's growth as a provider of the mix of savings, loan and insurance products described in this Report. In 1997 the financial services part of VSSU's work was repackaged as a microfinance institution (MFI), and named *Swanirbhar Gosthi* (self-dependency group), though no new legal identity was formed and most people still use the name 'VSSU'.

Until recently, VSSU had little contact with the wider world of microfinance. This, and the organisation's dependence on the visionary ideas of a single strong individual – Mr Mondal – has given VSSU the remarkably 'home-made' character to which it owes most of its strengths and weaknesses, as this Report will show. An incident from its history can illustrate this. In early 1998, when VSSU had a staff of ten, eight of them collectively resigned without warning, hoping, probably, to gain better working conditions and more say in the affairs of the organisation, which, as Mr Mondal happily admits, he was running 'as a dictatorship'. Mondal called their bluff, accepted their resignations, appointed the office messenger as Manager, and worked round the clock to visit all his clients, which at the time numbered about 3,000. The new Manager now heads a staff of over 50.

***** * *****

A quarter of a century ago, or more, many formal banks in India offered daily-collection deposit schemes for small savers. Popularly known as 'pygmy banks', they were run using commission agents who recruited and collected deposits from clients who became eligible to borrow small sums if they saved regularly. Despite their popularity, many of these schemes were abandoned, partly because they were difficult to run profitably given India's anti-usury policy of interest rate caps on small loans, and partly because unionised bank labour objected to the use of non-unionised commission agents. They became rare, surviving in a few places only, mainly in Co-operative banks[2]. In the mid-1990s they had something of a revival as India moved towards deregulation of its financial services, but there is evidence that many have again closed down. In the case of the VSSU working area, a number of banks have been trying the scheme again lately, but the only bank still offering it (as far as we found in our short stay in the area) is the United Bank of India (based in Calcutta), whose scheme is known as the '*Salpa Sanchay*' (mini deposit) scheme. VSSU's main product (as will be shown later) is based – with some important modifications – on these schemes, which thus form part of the financial history behind VSSU's work.

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[2] See Malcolm Harper's informal paper on the Urban Co-operative Bank of Cuttack, Orissa (available on the ITDG web site which is also accessible through the CGAP site, www.CGAP.org). By coincidence, it was an earlier visit to this bank that had sparked Stuart Rutherford's interest in daily savings and led eventually to the founding of *Safe*Save in Bangladesh.

Economic

VSSU works in the coastal fringes of the Bay of Bengal, a low-lying area enjoying ample rain and suitable for a single annual paddy crop, but prone to cyclones and inundations. The working area has a total population in the order of 1.4 million, although VSSU's coverage is patchy (see Section 3.1). The area's proximity to Calcutta, by rail and now by metalled roads, gives it some advantages over other similar stretches of the coastal belt, such as in neighbouring Bangladesh. There are many busy markets. Many men regularly carry produce such as fish, crabs, vegetables and fruits to market in Calcutta, and many women work in Calcutta as domestic servants: early morning trains into that city are crowded.

Although about a quarter of all households are landless or near landless, agricultural or other day labour is available year-round in many villages rates of pay rarely dip below a dollar a day. In some villages, however, we found that work is available for only nine months a year and men are idle during the lean season in the late autumn. Nevertheless there is little out-migration for agricultural day labouring work. Most children, even those of the landless, attend free government-run schools.

1.2 The Local Financial Landscape

Like most places in South Asia, the VSSU area is fully monetised and has been for a very long time. Nonetheless, village households still choose to hold at least some of their reserves in kind (in grain or livestock, for example).

Commercial bank branches are to be found in most of the markets and – compared with some countries – reach low income groups. The United Bank of India has the daily-collection service already referred to, and Allahabad Bank also has a good number of low-income clients in villages and markets who have deposit accounts and may take loans. The West Bengal Co-operative Bank has deposit account holders among shopkeepers large and small. To some extent VSSU competes directly with these banks. Banks also administer a number of government-subsidised schemes designed for poor people, many of which are in disarray. The Post Office savings bank is well used by many small businessmen and by some villagers.

Insurance companies and deposit-taking non-bank financial companies, most notably the Lucknow-based Sahara and the Calcutta-based Peerless, run agents that reach well down the income scale, and their passbooks are be found in the hands of market shopkeepers if not in the villages.

The semi-formal sector is not well represented: VSSU is by far the biggest MFI in its area, though it has less than 7,000 active client accounts. The typical NGO-run MFI in India organises 'self-help groups' – groups of poor people (usually women) who form simple informal co-operatives in order to save and to pool their savings into loans. *Durganagar Sabuz Shangha* is an NGO of this type, and we heard of one other operating in VSSU's area, though neither is of any size. But VSSU has spawned a large number of copy-cats – no less than sixteen according to one report – of which many have folded and a handful continue. The biggest is probably *Ullon Social Welfare Society*, the organisation formed by some of the VSSU staff who resigned in 1998[3]. They told us that they have 3,000 clients, but we had limited access to their books and we could not satisfactorily verify any of their claims regarding the size of their operation.

Informal services are dominated, as elsewhere in South Asia, by interest-free reciprocal borrowing and lending among friends and relatives. Informal interest-bearing money-lending appears to be common, according to reports we got from poorer villagers: rates are around 5% per month for cash loans taken from kin or neighbours, and our informants insisted that these rates are strongly enforced (unlike some

[3] Others are *Bijoyganz Polli Unnayan Samity, Roghunathpur Maakali Khudra Shonchoy Prokolpo, Maduabpur Nibetita Shonchoy Samity, Tantir Hat Salpa Shonchoy Samity,* etc

countries where they can be negotiated down after some weeks). Informal pawn-backed loans were reported to us, with rates that are similar to those I have heard of in many parts of India: 5% per month for cash secured against gold, 8% against silver, and 10% for unsecured loans.

We did not come across any ROSCAs, even though we enquired about them in the likeliest places – among the traders in the markets: but we were told by others that they do exist, in the form of local informal ‘chit funds’. ASCAs, too, seem to be absent or in decline, although we didn’t have time for an exhaustive search. For example, we heard from traders in Bijoyganz market that the *Bazar Business Samity* is no longer operational. Money-guarding in various forms is, as everywhere, common: the most conspicuous case as far as we were concerned is the guarding, by market shopkeepers on behalf of their village kin and neighbours, of cash destined for VSSU or rival bank deposits.

International NGOs taking an interest in the area include CARE, whose ‘CASHE’ project already supports *Durganagar Sabuz Shangha* and is taking a keen interest in VSSU. Oxfam America has also visited VSSU.

2 VSSU’s Model

2.1 Products and Services

Product descriptions

VSSU’s financial services are offered to anyone within reach of them: a discussion of client selection criteria and outreach can be found in a later section (section 3.1).

The main financial products are ***term savings plans***, of both the **fixed** and **recurrent** (or ‘accumulating’ or ‘contractual’) kind. The recurrent plans require equal regular deposits on a daily or on a monthly basis (there are still some weekly and fortnightly plans but they are rare and are being discontinued), and are collected by VSSU staff at the client's doorstep. The term for the daily scheme is either 18 or 24 months, and terms for the monthly scheme range from 12 to 60 months. Fixed deposits are accepted on terms ranging from 6 to 78 months. In all cases interest (ranging from 4% pa for the daily recurrent plan up to 11% pa for the longest-term monthly recurrent and fixed plans) is paid on maturity, and premature withdrawal, in part (where allowed) or in full, is penalised by loss of interest. ***Loans*** may be taken by account holders of any kind of plan, and are substantially secured against the plan deposits: interest on these loans ranges from 6% to 24% pa and forms the bulk of VSSU’s income. Certain types of ***insurance*** cover are provided to plan account holders at no extra cost, as an incentive or bonus. Finally, a range of ***other benefits***, including cash gifts and matching grants for social development projects, are also provided free of cost to plan account holders as a further incentive. VSSU is also planning, but has yet to introduce, a set of insurance products designed for low-income groups, especially women and girls.

Tables one, two, and three describe the savings plans, the loans, the insurance benefits and the other benefits, in more detail.

Table One, Savings Plans

Type and # of scheme	Description
Daily deposit plan approx 4,159 accounts at year end 2001 (nearly all of them on the daily basis, though there are a few weekly and fortnightly plans still current) started 1994	Based on the popular 'pygmy bank' schemes run by Indian banks in the past. Regular daily deposits in fixed amounts (minimum Rs 5 daily, no maximum), collected at the client's doorstep by full-time VSSU employees. Interest paid at term maturity at 4% pa (simple) for deposits that continue uninterrupted and without withdrawals for 18 months or more. Withdrawals during the first 12 months attract a fee equal to 4% of the withdrawn amount or Rs 60 (whichever is greater). Withdrawals may not be made while a loan is current (except to pay down a VSSU loan). Withdrawals during the last 6 months attract no fee but all interest on the plan is forfeited. Loans, normally up to twice the value of deposits made to date, may be had after 3 months of continuous savings deposits: see Table Two for the range of loan types. Incentive benefits are available either immediately the plan account is opened, or immediately on term maturity, or for a fixed period after term maturity: see Table Three for details of benefits.
Monthly deposit plan (known as the 'recurrent plan') approx 1,797 accounts at year end 2001 (this number includes 'Savings deposit' accounts described below) started 1994	Regular monthly deposits (minimum Rs 50, no maximum), for fixed periods (minimum 1 year, maximum 5), collected at the client's doorstep by full-time VSSU employees. Interest paid on maturity at 10% or 11% pa (depending on term), compound. No withdrawals allowed except in case of premature closure in which case all interest is forfeited if closed in first year. If closed in subsequent years interest is reduced by 2% pa. Rs 20 charge for such withdrawals. Loans, normally up to twice the value of deposits made to date, may be had after 3 months of continuous savings deposits: see Table Two for the range of loan types. Incentive benefits are available either immediately the plan account is opened, or immediately on term maturity, or for a fixed period after term maturity: see Table Three for details of benefits.

Type and # of scheme	Description
Fixed deposit plan approx 233 accounts at year end 2001 started March 1996	A one-time deposit (minimum Rs 500, maximum 45,000) for a fixed term (minimum 6 months, maximum 6.5 years) Interest paid on maturity at 8% to 11%, compound, depending on term. No withdrawals allowed except in case of premature closure in which case all interest is forfeited if closed in first six months. If premature closure occurs after 6 months, interest is reduced by 2% pa. Rs 20 charge for such withdrawals. Loans, normally up to twice the value of the deposit, may be had: see Table Two for the range of loan types. Incentive benefits are available either immediately the plan account is opened, or immediately on term maturity, or for a fixed period after term maturity: see Table Three for details of benefits.
'Savings deposit' plan approx 50 accounts at year end 2002 started 2000	Available only to those who are already enrolled in another savings plan. A passbook savings facility with a minimum initial deposit of Rs 500 and a minimum balance of 500. Deposits and withdrawals can be made at will but 90 days' worth of interest is lost on the withdrawn amount. Interest paid at 5% pa (simple).
Monthly Income Scheme New product: only one client as at end February 2002	A one-time deposit (minimum Rs 5,000 maximum 50,000) for a fixed invariable term of 60 months on which interest at 9% pa (simple) is paid out monthly as income. Personal accident insurance cover is provided during the term of the plan: see Table Three for details

Note: other new products are in the pipeline including an 'Account-to-Account' scheme that will allow account holders to transfer the proceeds of any mature plan into a new general account paying 12% pa for a minimum term of two years (3% pa if held for less than two years).

Table Two, Loan Products

Type	Description	Secured against one of:
General (or Regular) loan (and 'Board use') running since inception	A 'regular' client is one who saves strictly according to their chosen savings plan. (E.g. in the case of a daily saver, one who saves 30 days each month). Such clients can take a 'regular' or 'general' loan after 3 months regular savings. The loan can be taken for any use chosen by the borrower. Loan value normally double the savings deposit balance, but can be more (sometimes much more). Term 18 or 24 months Repayment of principal: schedule is chosen by the client, and normally involves regular equal instalments in rhythm with the periodic savings deposits (which must continue to be made according to that plan's norms). Clients may however accelerate this schedule, or choose to pay in a balloon repayment (often by allowing the debt to be netted off against savings deposits). Interest charged at 24% pa on declining balance, paid monthly 1% of disbursed amount deducted at source (to allow VSSU to build an insurance fund) For subsequent similar loans of greater value, the 1% is applied to the additional value only Savings may not be withdrawn (except for sums in excess of the loan outstanding balance) while a loan is current. In addition to loans being secured against the borrower's savings, it must be additionally secured in one of the ways listed in the right-hand column. 'Board': if the borrower can display a VSSU signboard, the interest is reduced from 24% or 22.5% pa, or to 21% if, in addition, the client is paying regularly into their savings plan (at least 26 days in each month for the daily scheme, for example)	'ABC' – a three-client solidarity or guarantor group who may forfeit savings in case of default 'Group' – a larger solidarity group of 6 to 20 clients 'Guarantor' – guarantors selected for the purpose by the borrower 'Special person' – the character of the borrower as perceived by VSSU 'Post-dated cheque' from secure salaried employment 'Track record' – the transaction behaviour record of the borrower 'Leasing, hire' – a lien on any new physical assets there are plans to extend this list
Education, and latrine construction running since 2001	Similar to general loan but enjoys a lower price in consideration of a 'social' use. Value normally up to twice the value of savings deposits (can be more exceptionally). Interest at 6% pa on the declining balance, paid monthly The education loan is given after an assessment of the student's academic record Term 12 or 18 months Other terms and conditions as for general loans	'ABC'; 'Group'; 'Guarantor'; 'Special Person'; 'Post-dated cheque'; 'Track record'; all as described above

Type	Description	Secured against one of:
Rickshaw or Rickshaw Van running since 1999	Another reduced-price version of the general loan: requires a savings balance of at least Rs 1,200. Loan value up to the price of one vehicle (Rs 4,000). Term: up to 18 months Interest at 12% pa on the declining balance, paid monthly Other terms and conditions as for general loans	'ABC'; 'Group'; 'Guarantor'; 'Special Person'; 'Post-dated cheque'; 'Track record'; 'Leasing, hire'; all as described above
'Within deposit' running since inception	Any saver under any plan can borrow up to 99% of their savings deposit balance, subject to individual assessment and providing they hold no other loan. No 1% deduction. No fixed term. No fixed repayment schedule. Interest at 18% a year on the declining balance (or 24% if savings balance is 500 or less), paid monthly.	none needed
'Uddyan Card' running from 1999 to 2001	Unsuccessful and now withdrawn: it was a short-term loan facility under which a sum up to the current savings balance could be borrowed on payment of 10% interest on the disbursed amount at time of disbursement, and had to be repaid in a balloon repayment within 2 months.	None
Default	Not a loan category in itself. Listed as such by VSSU because their policy is that if a loan of any of the above types remains overdue after the term end the balance is transferred to 'default loan' status and is charged at 30% pa on the declining balance.	not applicable

Table Three, Insurance And Other Benefits, Provided At No Additional Cost

Type	Description	Criteria
1 Accidental death insurance	A life insurance under which, following accidental death, Rs 10,000 is paid out for each Rs 10 saved daily on a regular basis (or for each Rs 300 saved monthly)	Cover begins automatically with the opening of ***daily*** (and weekly or fortnightly), ***fixed*** and ***recurrent*** savings plans. Cover continues as long as savings deposits are being regularly made. (VSSU re-insures risks of Rs 100,000 or more with a commercial insurance company.)
2 Assistance with personal and social development projects	An open promise to pay 50% of the cost of any approved personal or social development project (e.g. to construct a piece of infrastructure, or to arrange a social event). (Financed from a fund composed of 15% of all loan interest and fee income.)	Promise effective on opening of ***daily*** (and weekly or fortnightly), ***fixed*** and ***recurrent*** savings plans. Promise continues as long as savings deposits are being regularly made.

Type	Description	Criteria
3 Medical expense insurance	One year's insurance cover: similar to accidental death insurance, but payments range between half and one quarter of the value described for that benefit.	Cover starts after savings plan term maturity of ***daily*** (and weekly or fortnightly), ***fixed*** and ***recurrent*** savings plans. Cover lasts for one year only. These risks VSSU re-insures with a commercial insurance company (NIC).
4 Orphans' school expense insurance	One year's insurance cover: similar to accidental death insurance, but payments are only half as much for daily deposits above Rs 1,500. Paid only to orphans currently attending school.	
5 Cash gifts	Range from Rs 25 for those saving Rs 10 a day (or equivalent in other plans) up to Rs 425 for those saving 6,000 per day. For those saving Rs 1,500 a day or more, a further gift in the form of a railway ticket.	Available once on term maturity of ***daily*** (and weekly or fortnightly), ***fixed*** and ***recurrent*** savings plans
6 Personal accident insurance	Pays out up to 4 times the current savings balance in the event of a serious personal accident	Available only to clients enrolled in the ***Monthly Income Scheme***, for the duration of the plan term

In addition to these benefits, VSSU is planning an extensive range of insurance products for subsidised sale to 'weaker sections'. They may include insurance against personal accident, debt, and school expenses, with special terms for women and girls. The subsidy will come from income on loan products (specifically, the 1% levy on the disbursed amount).

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'Bibechona': special consideration

Although these tables capture the main outlines of the product rules, it is important to note that VSSU in practice interprets them extremely broadly and allows many exceptions. For particular individuals, and sometimes for whole groups of people, loan values may be raised (sometimes startlingly), charges waived, or timetables and schedules curtailed or extended, according to a wide range of unwritten criteria. Poorer clients with low-value transactions may be allowed bigger loans or relaxed schedules or have their loan over-dues overlooked on what a field worker called 'social work' grounds. Others may have bigger loans approved on the basis of their relationship with VSSU or certain of its staff. We were even told that 'polite behaviour' towards staff can help a client get favourable terms, and this was defended on the grounds that part of VSSU's mission in the area is to raise social standards in general, including inter-personal behaviour.

The Bengali word *bibechona* ('special consideration') appears frequently in VSSU's published rulebook and even more often in conversation with VSSU staff, above all with the Secretary, Kapilananda Mondal. The rulebook specifically informs its readers that all rules are subject to interpretation by VSSU on the basis of *bibechona*. As we shall see in later sections, the principal and practice of *bibechona* is common throughout VSSU and is a defining characteristic of its organisational personality. The promise to contribute 50% to any personal or group-based social initiative by clients (Table Three, item 2) looks extraordinary until one understands that in practice *bibechona* is used to limit what looks like an unlimited exposure.

Conventional *loan appraisal* is, of course, a quite proper form of *bibechona* widely practised in financial services when, especially with larger loans, a judgement needs to be made as to whether the loan represents a wise use of the MFI's resources. What makes VSSU's *bibechona* exceptional is that it permeates all aspects of the MFI's conduct, not just loan appraisal.

There are other factors which make it hard to lay out VSSU's products clearly and simply. One is that rules tend to be complex, with many sub-rules, not all of which have been shown in the tables above. Another is that several products have been withdrawn, and others are subject to frequent modification. For example, Table Two notes that the 'Uddyan Card' has been withdrawn (though there are still some active accounts) but there was also at one time a 'Group Loan' facility that has also now been discontinued but of which traces remain in the field. A third factor is that changes in terms, rates and charges can occur without written notification to clients: recently, for example, the minimum charge for a withdrawal from the Daily Deposit plan was raised from Rs 30 to 60 and the minimum term lengthened from 15 to 18 months: we came across several clients in the field who resented this change when they found out about it only when they came to make a withdrawal. A final factor is that since VSSU lacks a systematic way of recording modifications to rules, different staff carry round in their heads different versions of the rules, so that we often heard contradictory interpretations of them.

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Product design

Product design originates almost wholly from the imagination of Mr Mondal. Although he discusses proposed products (and changes to products) with staff (primarily with the Financial Services Manager) and, perfunctorily, with members of the Executive Committee, he retains the final say. His imagination is fed from two main sources: existing products offered by other institutions, and shafts of illumination following personal observation of financial behaviour.

The daily recurrent plan is based, as we have seen, on the *salpa sanchay* or 'pigmy bank' schemes that have been widely popular in India. Many of the features of these schemes, as practised by formal banks, have been incorporated into the VSSU version. The practice of giving depositors individual receipts for each deposit, and then making up passbooks periodically, for example, is taken from the original schemes. The monthly and fixed-deposit plans have similar counterparts in traditional banking practice in South Asia.

Innovations introduced by Mr Mondal include the larger loan sizes allowed to daily depositors, through the use of a wide range of other forms of security – daily deposit schemes run by banks normally limit loans to some fraction of the deposits held. Taking the monthly recurrent scheme into the villages to serve poorer households is also an innovation. The incentives given to clients such as the insurance cover, cash gifts, and support for 'social initiatives' represent an unusual and imaginative approach to recruiting and retaining clients and to publicity in general. An outside observer suggested to me that Mr Mondal is 'a financial services entrepreneur who uses social intermediation as publicity, not the other way round': the contrast is with other Indian NGO leaders who are primarily social entrepreneurs using financial services as an 'entry point' to social development work.

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Social development activities

VSSU is now primarily a non-formal bank, but significant social development activities continue alongside the financial services. There is a free-of-cost pre-primary school with forty pupils just outside the gates of the HQ office. On the way to the office one travels over roads dug and surfaced by VSSU and lined with some of the 80km of roadside tree plantation that VSSU has carried out over the years. If one waits for a bus, one can take shelter from sun or rain under cement shelters erected by VSSU at the bus stops. In some markets VSSU has built public lavatories and drinking water points. Food and clothing relief is given annually to about 180 poor families. Finally there is an annual drama festival, now in its second year, which attracts drama groups from all over West Bengal.

These activities are financed by the banking work, and show up in the income statement as expenditure. The drama festival, which was running while we were there, has a Rs 200,000 budget (US$4,150). Altogether, more than $14,000 was spent on social development work in financial year 2001-2002.

We have not, in this Report, attempted any assessment of the impact of this non-financial work, either on its recipients or on VSSU's performance or reputation as an MFI. It should be noted, however, that Secretary Modal is convinced of its significant contribution in both of these respects, a view which is backed by the opinion of at least one of the international NGO staff who has spent more time with VSSU than we did.

2.2 Organisational Structure: Ownership, Governance and Management

Ownership and Governance

VSSU was registered as a voluntary Society in 1986 and that remains its formal legal identity. As such, its members own its assets, but as is common with NGOs it is hard to pinpoint exactly with whom ownership lies. If you ask Mr Mondal who owns VSSU he says 'no-one'. There is a 'General Body' meeting each year attended by 'members' – clients, all of whom pay a small membership fee to gain access to the financial services. In theory they 'elect' a nine-person Governing Body, or Executive Committee, but in practice the composition of the Committee is decided by Mr Mondal who has retained his position as its Secretary since he founded the organisation. Under the Constitution it is this Executive Committee in whom 'the Funds and Properties of the Society shall be vested'. Alongside the Executive Committee Mr Mondal has set up an eleven-member 'Advisory Committee' and the two appear to have fused: the Minute Book records what seem to be joint meeting of the two bodies.

The Minute Book shows that the Committee meets frequently – sixteen times in 2001, for example, and discusses substantive issues (expenditure budgets, organisational rules, publications, credit-rating, salary levels, bank account operation, and building construction, to take a random selection of agenda items from recent meetings). However, the minutes themselves are perfunctory and one outsider who was invited to sit in on a meeting comments that the Secretary dominates proceedings and that the Committee's main role is to give formal approval to decisions made by Mr Mondal. Nevertheless, the M-CRIL Credit Rating report (May 2000) noted that the Executive Committee 'plays an important role' in VSSU's development, and described the management decision-making processes as 'reasonably participatory and adequate'.

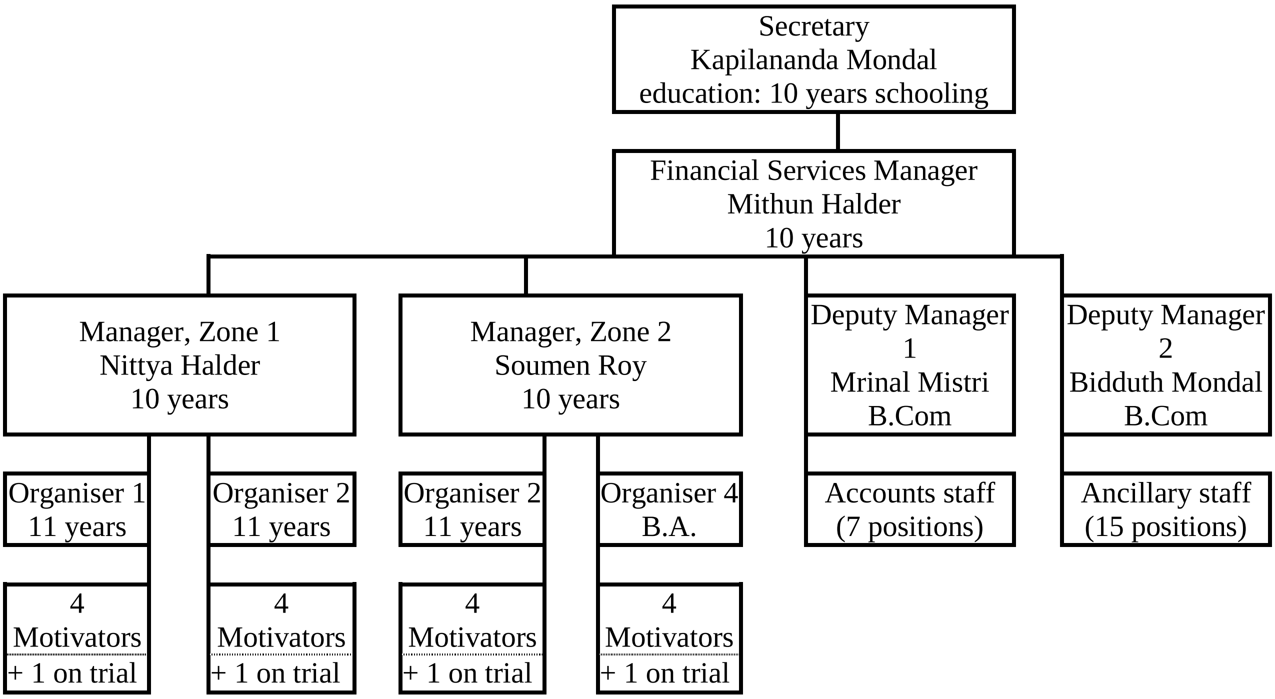
The Committee consists largely of local educated people, mainly school teachers and businessmen, and a bank worker. Two Committee members, of which one is the Secretary, are salaried employees of VSSU. We noted that Committee members may take loans from VSSU, and that at least one such loan is quite substantial. We also noted during our work in the accounts section that a Committee member had taken a cash advance from the cash-box (quite legitimately, in connection with the drama festival then taking place) but had failed to provide any kind of receipt.

The legal identity as a voluntary Society is problematic, since it confers no authority to raise deposits from nor make loans to the public. At one time (1990) VSSU tried to tackle this problem by taking a registration as a co-operative, but actual experience of operating within the co-operative Registrar's jurisdiction proved extremely difficult, and the registration was abandoned. Later, in 1997, VSSU repackaged its financial services work as *Swanirbhar Gosthi*, the name that appears on all its documents above the words 'A Division of Vivekananda Sevakendra O Sishu Uddyan'. No accompanying new registration was taken, however. VSSU's constitution includes a provision to set up a 'Trustee Board' that may serve as a vehicle for transition to some other form of legal identity in future.

The problem has grown more acute recently, now that VSSU is the object of much more attention from newspapers and the television, from interested investors and donors (SIDBI, CARE, Oxfam America), from researchers (such as ourselves) and from the authorities. Recently, the local authority wrote formally to VSSU warning them that their financial service work is not legal and suggesting that they stop. More serious is a request from the regional branch of the Reserve Bank of India (the country's Central Bank and financial services regulator) to make a visit to VSSU. Mr Mondal appears undisturbed by these developments, arguing that the local authority is effectively powerless and that the loan recently obtained from SIDBI confers *de facto* approval of his work by state-related bodies.

Management structure

Figure One: staff structure



There are 52 positions, including four Motivators who are currently on trial[4]. 'Motivators' are the grass-roots level Bank Workers who make the door-to-door visits to clients. They report to Organisers, who are essentially field supervisors checking the work of the Motivators and dealing with field level problems as they arise. The two Zone Managers are office-based, controlling the field operations and co-ordinating them with the Manager and Deputy Managers. One Deputy Manager is responsible for accounts and the other for logistics.

The offices are housed in one new purpose-built construction. There are no branch or sub offices. The structure is thus more typical of an NGO than of a bank. However, VSSU intends to shift to a branch structure soon - probably within 2002. Initially, three branches are envisaged, with three of the Organisers set to be re-designated as Branch Managers. Under the branch structure Motivators will continue to be full-time employees and there are no plans to use commission agents.

Salary levels are modest, though not wholly out of line with local NGO norms. Wages are supplemented by a wide variety of benefits. Wage differentials are small: officially, no-one earns more than Rs 5,000 a month (about $100).

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[4] Confusingly, the Salary Register we were shown shows only 42 positions, and it may be that there is some distinction between VSSU's financial work and other VSSU work that we failed to understand in full.

The M-CRIL May 2000 report noted that human resource quality will require considerable development if growth is to be achieved. Middle management needs to be strengthened in order to exercise proper supervision of operations, and to ensure that decision-making is more widely shared and not dominated by the Secretary. M-CRIL also observed that the staff does not have much exposure to other microfinancial programmes, and this remains true although the situation is beginning to change.

In our own investigations, we noted that many systems conventionally used to aid human resource management have not yet been developed by VSSU: we found no staff files, no job descriptions, no service rules, and very few letters of appointment.

2.3 Administrative and Operating Systems, and Financial Management

VSSU has attracted interest from the outside world primarily for its unusual product line and its excellent financial performance. We were therefore interested to see to what extent its performance can be attributed to innovation or economies in its management systems. We concluded that systems are in need of improvements that will most likely require technical assistance to complete. Although systems may have been cheap to develop and remain cheap to run (there has been very little investment in information technology, for example), and may have been adequate for the organisation's work to date, they may not in fact be very cost-effective, in some ways they do not perform well, and some are clearly open to serious abuse. In order for VSSU to grow beyond its current scale systems will have to be improved.

We found that VSSU's systems are not easy for the visitor to understand. This is partly because VSSU lacks management manuals, but also because many policies, such as loan-taking rules, are controlled by the Secretary in undocumented fashion. In keeping with its overall character as an institution that has learned by doing and is still relatively small, it has developed its systems piecemeal over the years and has yet to codify them. This 'home-made' approach has resulted in VSSU's adopting unconventional vocabulary for some of its key documents and processes, or ignoring entirely other processes conventionally regarded as essential (such as portfolio quality assessment that reveals the need for a loan loss provision) and relying on accounting methods not wholly suited to financial services (such as cash-based accounting that fails to account for interest payable on deposits). Hand-written information systems are slow and clumsy, leading M-CRIL to remark, justly, that 'the MIS is highly dependent on the accounting system for information, rather than generating it from its own flow of information.'

However, things are set to change, for a number of reasons. Firstly, investment in VSSU by outsiders, notably SIDBI which has already lent three million rupees (about $60,000) and plans to provide more, is driving a demand for better and more transparent systems. While we were at VSSU the SIDBI representative was on site. Second, as we have already noted, it is likely that VSSU will adopt a branch structure, presenting both a need and an opportunity for new systems. Thirdly, VSSU has itself recognised weaknesses in its systems and Secretary Mondal has declared his intention to make changes.

Because our aim is to learn from, rather than evaluate, VSSU, this Report will not detail system inadequacies that VSSU is already aware of, that outsiders are not going to emulate, and about which a formal assessment has already been made by M-CRIL[5]. Rather, we will continue this section with a descriptive account of the basic working practices of the field and office staff, in order that the product delivery system can be understood. A box will illustrate one way in which existing systems are open to abuse. Finally, a table will summarise some of the important observations made by M-CRIL during their May 2000 credit rating exercise.

[5] M-CRIL, 107 Qutab Plaza, DLF Qutab Enclave-1, Gurgaon 122002, India: email edarural@giasdl01.vsnl.net.in Readers who wish to see M-CRIL's report should obtain VSSU's permission (Secretary Mondal at vssuu451@hotmail.com)

Working practices

Motivators comprise about 40% of the work force and are the key front-line staff. Most are men, with workloads of between 250 and 400 accounts each. They work individually and usually make two visits to the field each day. They start from their homes and go first to make collections in a market place (where most clients use the daily savings plans), then go on to the VSSU office for lunch. In the afternoon they visit one or more of their village collection areas (where nearly all clients use the monthly plans). Finally they return to the office to complete their documentation. Most use bicycles, and may cycle up to 40 km a day (they tend to have one or two market sites each but several village sites which may be distant from each other). They work a six-day week, but cover for each other during the off-day so that VSSU remains open seven days a week and 365 days a year.

Motivators are responsible for recruiting clients (see section 3.1 below). Clients are provided with passbooks, and the most recent version of the passbook sets out a summary of the rules for the savings plans and their associated loans.

For clients of the monthly plans - that is, for the minority of clients who are visited monthly in the village - savings deposits and any loan repayments are collected by the motivator who makes an entry directly into the passbook and issues a receipt. However, for clients of the daily plans - that is, for the majority of clients who are visited daily in the markets - savings deposits and any loan repayments are collected against a receipt and passbooks are made-up monthly (see below).

On their return to the office in the afternoon Motivators are responsible for making manual entries, corresponding to their collection of savings deposits and loan repayments, into a number of ledgers (in effect, collection sheets arranged in various formats). The Motivator sums the entries and presents the corresponding cash to his Organiser for counting before the sum is formally received by a receipts clerk. This process sometimes proves time-consuming and it is not uncommon to find Motivators and other staff still at work late into the evening. As a result, the work may not be thoroughly checked, and errors can occur (see the M-CRIL report, and Box One below).

Loan applications are received from clients by the Motivators, who help them to complete the forms. The form passes up through VSSU's hierarchy, with each succeeding layer adding a comment and a signature. The Secretary currently provides the last signature and his decision on matters over which *bibechona* may be exercised (such as loan value and which type of loan guarantee is to be used – see Table Two column 3) is final. Following loan approval, an entry is set up for that client in the ledgers / collection sheets, and the payments clerk issues the loan.

The Accounts staff work from these documents to update deposit and loan ledgers and to produce monthly totals for the Manager who records them, with a certain amount of analysis, in his computer. This results in informal (and somewhat unconventional) Receipts and Payments Statements, Income Statements, cash-flow analyses, and monthly consolidated reports on deposits, disbursements, repayments and interest payments. The Secretary uses this data to conduct further analysis, again producing reports of a valuable but unconventional character. Formal financial analysis and documentation (Balance Sheets and Income Statements, for example) are produced only by the external Auditor.

Currently, VSSU is housed in one building, and the Secretary's office is adjacent to and opens into the accounts office. He is involved continuously in the day-to-day running of the organisation, and is frequently interrupted by staff seeking advice on quite minor matters of detail, or clarification on matters where *bibechona* is involved.

Box One, below, illustrates the kind of internal control risk that will limit VSSU's safe expansion until it is eliminated.

Box One: Controlling Passbook Error

In situations where deposits and repayments are made frequently, in varying amounts, by clients who may be illiterate, to bank staff working alone and in the field rather than over the counter in a branch office, careful control measures need to be in place to avoid both error and fraud. To understand how VSSU approaches this issue, we tracked the complete process from the collection of a deposit through the recording process in the head office and in the client's passbook, to the final closure of the account. Our example is of a client using the daily saving plan.

When the Motivator collects a deposit from a client he issues a paper receipt, a duplicate of which remains with the Motivator as part of a bound and numbered receipt book. The receipt is printed in English and the cells into which the savings deposits or loan repayments are entered are not clearly labelled. We observed that some clients carefully store these receipts on a skewer, some thrust them into a drawer, while others are less careful. The situation can be complicated when, as often happens, one client is also acting for several other clients and is therefore issued with several receipts.

When the Motivator returns to the office in the afternoon, he enters each transaction into a journal, totals his daily collection, and checks that it corresponds to the amount of cash he has collected. He then asks his supervisor, the Organiser, to check his work. We were told that the Organiser is supposed to verify each receipt against its corresponding entry in the journal, but in practice we observed that the Organiser merely checked the cash against the total calculated by the Motivator. In the absence of procedural manuals it was not possible to say whether required practice was or was not being followed.

At the end of each month the Motivator collects passbooks from each of his daily plan clients, for making up. We observed that it was the Motivator himself who made up the passbooks using the monthly totals that the Accounts staff had derived from the Motivator's own daily entries.

Finally, with the closure of the plan and any associated loans, Accounts staff review the history of the plan (which is likely to be 18 months or two years old by then), using their monthly total summaries to check that the plan deposits and any loan and its interest have been fully made.

Thus in most cases no independent check is made of the accuracy of the original entry on the receipt nor of the accuracy of its entry in the collection sheets. By the time the plan is mature it is no easy matter (for staff or clients) to review the individual receipts which may by then number several hundred.

That this system leaves room for abuse or carelessness by Motivators is attested by three observations. First, we spoke to a number of clients who had doubts about the accuracy of their passbooks but who were unable to produce all the relevant receipts or were uncomfortable with the idea of raising their doubts with the Motivator or the head office. Second, we spoke to a very small number of clients who had closed their accounts because they were dissatisfied with the accounting processes. Third, a rogue Motivator was dismissed in 2001 for abusing three accounts in this way and attempting to embezzle Rs 27,000 (about $550).

System improvements that would strengthen internal control include using the local language and clearer labelling on the receipts, and occasional but systematic field-level spot-checking of pass-books by supervisors. VSSU might also consider having direct entries made into the passbook at the time of the collection; having someone other than the Motivator make the entries from the receipts to the collection sheets and reconciling the total with the cash collected by the Motivator; computerised entry processes; and requesting clients to bring their passbooks to the office for making up by staff other than the Motivator (as practised, for example, in similar schemes run by commercial banks1). It would also help if account ID numbers included a code linking the account to the specific Motivator, and if clients were better trained in procedures.

[1] E.g. United Bank of India, Salpa Sanchay rules, paragraph 9(a).

Other observations

Table Four, below, sets out some of the recommendations from the May 2000 M-CRIL credit rating document, and provides further commentary on the current status of the issues involved.

Table Four, Other Administrative, Operating, and Financial Management Issues

Issues	M-CRIL observations (May 2000)	Current situation, and observations
Human Resources: staff costs	Low cost of staff contributes to VSSU's cost effectiveness but may limit its potential for growth.	Unchanged. However, better procedures and training should enable existing staff to be more productive: it should not be assumed that better-qualified and more expensive staff are required.
Human Resources: decision making	Concentration of decision making in the person of the Secretary limits the potential for growth.	Unchanged. The Secretary is aware of this problem and external resource-providers (such as SIDBI, CARE and Oxfam America) may soon provide capacity building assistance.
Human Resources: microfinance training	Staff at all levels require more exposure to and training in microfinancial approaches and management systems.	Beginning to change, with growing interest by outsiders in VSSU. But care needs to be taken to ensure that VSSU's unique advantages are not lost as it develops more conventional systems.
Accounts systems	VSSU should move from cash-based to accruals-based accounting.	Unchanged. Caution is urged, however, with this and all recommendations for major shift in practices without proper analysis.
Financial management	VSSU should create loan-loss reserves and make provision for future loan losses.	Unchanged. VSSU's current portfolio at risk is 17%. A loan loss provision of 31,250 rupees per month has been initiated for the 2002-2003 accounting year, but this amount may seriously understate present risk.
Financial control	VSSU should introduce an internal audit system	Unchanged. Whether by appointing internal auditors or by other methods, internal control needs to be improved if VSSU is to expand (see Box One above).
Financial control	Budgets and cash planning need to be made more formal	Annual budgeting by the committee is well documented, and appears in the audited financial statements as a matter of record. Budgets and cashflow are tracked carefully throughout the accounting year. But it is not clear how the committee decides budgets, or how decisions are made on allocating surpluses to investment, social development activity, and reserves.
MIS	VSSU should introduce loan principal repayment tracking	Unchanged. (Again, this recommendation derives from M-CRIL's suggestion that VSSU should develop loan products that are not linked to deposits.)
MIS	VSSU should improve the group-level MIS	Unchanged. However, VSSU's future is unlikely to focus on the 'self-help group' development that characterises much microfinance in India, so this recommendation may be of minor importance.
MIS	The organisation needs to immediately computerise its MIS	Under discussion. The MIS will need to be thoroughly redesigned, and its function and importance recognised by staff, before computerisation is attempted.

3 Analysing Performance

3.1 Outreach: Breadth and Depth

Geographical outreach

VSSU serves the markets and villages within cycling distance of it headquarters building in Ullon, the small village in the South 24 Parganas District of West Bengal where VSSU's founder was born. The area covers six ‘blocks’ (administrative areas) measuring some 25 kilometres in diameter, and has a total population of about 1.4 million. However, VSSU's main strategy is to target market centres, with the result that its outreach is concentrated in 26 such centres scattered across its working area, and although it has reached as many as 220 villages, many are only lightly served. A consultant working for VSSU, Mr Alok Ray Chowdhury, estimates that the markets and village neighbourhoods in which VSSU has a presence have a total population of about 425,000. There are plans to extend the area covered, particularly in a southerly direction towards the Bay of Bengal.

Clients reached

VSSU's information system tracks the number of accounts (savings plans which may or may not have associated loans) but not clients. As of 31st March, 2002, there were 6,996 accounts. Allowing for the fact that some clients hold more than one account we estimated that the total number of clients on that date was about 6,300. Assuming one client per household and an average household size of six, VSSU is probably serving households with a total population of around 40,000, approximately three per cent of the total population of its working area or ten per cent of the population of the markets and villages in which VSSU has a presence.

VSSU's main products, as we have seen, are term savings plans, and the most popular of these, the daily plan, has a relatively short term of up to two years. Now that VSSU has almost eight years of activity behind it, many of these plans have matured. Records show a total of 9,491 matured (closed) plans. Since an unknown number of clients open a new plan after an earlier one has matured, it is impossible to estimate either the total number of clients ever served, or (more importantly) VSSU's 'client retention rate' - the proportion of clients who continue to use VSSU's services by opening a succession of savings plans.

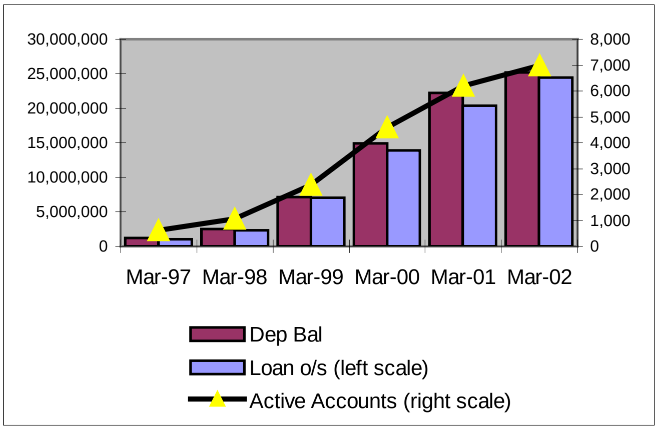
Improving the MIS to take account of these shortcomings is an important short-term task for VSSU. This is particularly the case in view of the fact that the organisation has recently understood the significance of client retention and is planning to offer a new product, the 'Account-to-Account' saving plan (see the note following Table One). The product is aimed at clients whose term plans have matured, many of whom have, in the past, re-invested with other providers or in kind[6].

Growth rates

Figure Two: Growth rates, 1997-2002

Secretary Mondal reports that growth in the earliest years of VSSU was very slow, as the organisation developed its products and learnt how to deploy them in the field. This is consistent with the experience of other MFIs, including that of *Safe*Save (which has pioneered daily savings collection in neighbouring Bangladesh). Growth in the number of active accounts since 1997 is shown in Figure Two (solid line, right hand scale).

[6] As observed by Secretary Mondal



In 1999 and 2000 the pace of growth was very fast, with annual increments in the order of 50 to 80 per cent. Since then growth has slowed, partly because of increased competition from VSSU look-alikes, and partly because VSSU began to run up against the growth-limiting aspects of its systems (see the previous section). It is worth remembering, when reviewing

VSSU's performance, that growth has been achieved without funding support from donors, or even, until very recently, loans from outside institutions.

Client selection and recruitment: market traders and villagers

The recruitment of clients is the responsibility of the Motivators. They describe the products to interested listeners in markets and villages and provide membership forms (at a cost of Rs 10) to those who wish to open an account. A signature card, a photograph, and an account opening form for the chosen savings plan are processed. Office staff then issue an account number and a passbook.

Many clients are recruited in the local markets where they trade, while others are recruited in their home villages. Since most market traders have village addresses it is difficult to give an accurate breakdown of the occupational split between market traders and other villagers who may be farmers, farm labourers, or professionals. The following table offers a proxy, by analysing client accounts by savings plan type.

Table Five: Accounts by Savings Plan Type

Type	Accounts ever		Accounts as at end March 2002	
	Number	*%*	*Number*	*%*
Daily	10,804	66	3,960	57
Monthly	4,908	30	2,650	38
Fixed	724	4	375	5
Other	50	-	33	-
Total	16,486	100	7,018*	100

* this figure differs from the figure of 6,996 given above because of differences in the sources used.

Two-thirds of all accounts ever opened, and almost three-fifths of accounts currently active, are of the daily plan type. This type is almost exclusively confined to the markets, where Motivators are able to make the daily visits. A proportion of the monthly and of the fixed deposit plans are also held by market traders, of course. An estimate along similar lines, using the outstanding values of loans, produces a similar breakdown: 64% of the outstanding loan value is estimated to be held by market traders.

Estimates using the number of loans indicate that 55% of all current loans are issued to market traders.

All this suggests that a comfortable majority of VSSU clients are market traders, but there is one important qualification to this observation. In the markets we found several clients who act as 'passbook keepers', holding passbooks on behalf of others. In many cases these additional passbooks belong to other market traders who find it convenient to keep their passbook in a more substantial shop where the Motivator is sure to call each day. Some are using the passbook-keeper as a 'money guard', fearing that they would not have the self-discipline to hold back enough cash to make their deposits regularly, while others borrow short-term from their passbook-keepers in order to keep up with VSSU plan deposits. But some of these additional passbooks undoubtedly belong to non-trading villagers – perhaps family or neighbours of the passbook-keeper – who nevertheless like the daily collection system. See Box Four, at the end of this Section, for an illustration of the 'passbook keeper' phenomenon.

Poverty, and depth of outreach

In the matter of selecting clients VSSU has no explicit poverty focus. A recent formulation of its vision[7] begins "To develop a sound and reliable MFI for… the individuals, groups, and micro-enterprises in the organised and unorganised sector in our area....." VSSU regards the area in which it works as poor and in need of development, but it does not restrict access to its financial services to any particular group. Accompanying Motivators to the field, our impression was that they seek to recruit those whom they regard as likely to make regular deposits and repayments, but that they are also willing to enrol poor clients, especially in the villages, on compassionate grounds that one Motivator described to us as 'social work reasons'.

We obtained no data on the ratio of men to women clients, but it is clear that while women are not excluded, most clients are men, by virtue of the concentration in the markets. VSSU has not adopted any measures to favour women, and gender does not appear to be an issue much discussed within VSSU.

Since it has no poverty focus, VSSU does not collect data on the economic status of its clients.

Nevertheless, we can gain some idea of the extent to which the MFI is reaching poor households in three ways: by noting what we saw in field visits, by reporting what we were told by VSSU staff, and by using proxies such as loan and deposit values.

Field observations

Members of our research team were able to make numerous visits to the field, sometimes accompanied by VSSU staff, and sometimes not. In three markets and four villages in particular, we conducted lengthy interviews with individuals and groups of VSSU clients and non-clients. Some of these interviews are reported in Section 4, following. On each occasion we came across clients from a wide variety of backgrounds. Among them, we met some very poor villagers, one of whom is profiled in Box Two. No 'typical' VSSU client can be identified by economic status, though of all the clients we met, the most common type was the small or medium shopkeeper of the area's numerous markets. An example of the latter is profiled in Box Three.

Box Three: A Market-Trading Client

We met SG at one of his two sweet shops in a market a few kilometres away from the VSSU headquarters. He is 35 years old and was educated to class nine. With four brothers he shares about four acres of land in a nearby village. His main income is derived from the sweet shops and he estimates that daily sales average Rs 4,000 (about $80). He first held a savings plan with VSSU in 1994, since when he has completed several plans and taken several loans. Currently, he is depositing Rs 100 per day into a daily plan and has a savings balance of almost Rs 20,000. He has obtained a loan against this plan with a face value of Rs 40,000, of which he has repaid about half. He has been gradually building up the volume of his transactions with VSSU, and now no longer holds any kind of account with other formal or semi-formal providers.

Box Two: A Poor Client In A Village Setting

LD is a widow of about 35 years of age. Her husband, a rickshaw van driver, once held a VSSU account, but had difficulties keeping up with the deposits, and decided to close it prematurely. He transferred the Rs 350 into a new monthly recurrent plan (at Rs 50 – about $1 – a month) which was opened in February 1999. They had made only one deposit, of Rs 30, when her husband died. LD applied for a loan on compassionate grounds, and - with her Motivator arguing for *'bibechona'* - was given one of Rs 1,000. The loan was spent largely on her husband's funeral and associated costs. After she received the loan, she made no further savings deposits, but her 15 year-old son, by then also a rickshaw van driver, made savings on her behalf until there was enough to repay the loan. LD then withdrew from VSSU, but in February 2001 the son (who, unlike his mother, can read) opened another monthly recurrent plan, again at Rs 50 a month. His passbook shows that since then he has deposited 14 times (that is, slightly more frequently than he was required to) but that the deposits fall short of the Rs 50 per month target. There is another, younger, son in school. The family lives in a rudimentary mud-walled thatched-roofed one-roomed hut. They own no agricultural land. LD appreciated the loan from VSSU: without it she would have had to borrow within the village, an alternative that would have been both more shameful and more costly.

Staff views

We took advantage of the 'feedback session' held with VSSU staff to ask their opinion of the economic status of VSSU clients. Using a classification system of their own choice, three field staff members offered estimates, which we have averaged in the final column of Table Six.

Table Six: Estimates By Field Staff Of The Economic Status Of VSSU Clients

Class	Staff 1	Staff 2	Staff 3	Average
Rich	5%	5%	5%	5%
Upper middle	10%	25%	10%	15%
Middle	20%	60%	40%	40%
Lower middle	30%	7%	30%	23%
Poor	35%	3%	15%	18%

In conversation with us, Secretary Mondal discussed poverty and the need to address it, but not in the context of any targeting of the financial-services work. He takes the view that the financial services should be open to anyone in the working area who wishes to use them, and that he needs to compete for the business of the wealthier traders, professionals and farmers in order to generate the surpluses that alone can guarantee the sustainability of his operations. Poverty is thus addressed indirectly, by using profits to subsidise the wide variety of charitable and social development activities described earlier.

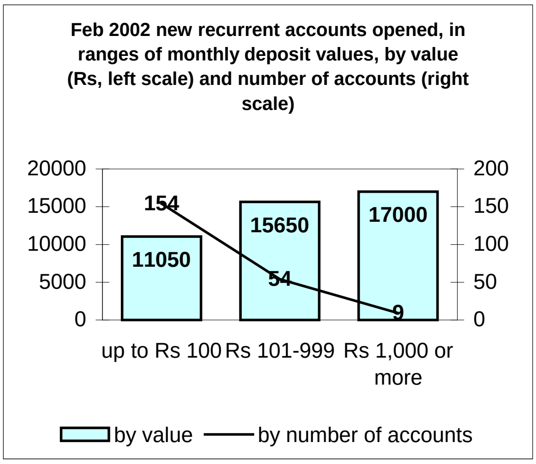
Nevertheless, Mondal is aware of the need to demonstrate that VSSU does indeed reach poor as well as non-poor clients. Loan sizes are often used as a proxy for depth of outreach in microfinance literature, and Mondal uses the following table to help him make his point.

Table Seven: Disbursed Loan Values

Range of disbursed loan values, rupees (and $)		**Percentage of all loans disbursed**
< 2,500	(approx $50)	42
2,501 – 5,000	($50 – 100)	24
5,001 – 10,000	($100 – 200)	19
10,001 – 20,000	($200 – 400)	9
> 20,000	($400)	6

However, the average outstanding value of current loans is Rs 9,900, suggesting an average disbursed value of around 15,000 ($300). The single biggest loan disbursed so far was one of half a million rupees (about $10,000) which was invested in an ice-making plant. Altogether, there have been 24 loans of Rs 100,000 (about $2,000) or more, 48 loans in excess of Rs 50,000 ($1,000) and 72 in excess of Rs 30,000 ($600). We were unable to complete an alternative to Table Seven using percentages of total disbursed value in the right-hand column (as opposed to percentages of loans) but such a table would show that although most loans are small (less than $100) most of the money lent goes to the bigger borrowers.

Figure Three: Saving plans by deposit values and number (February 2002)



In another exercise we looked at the 217 new recurrent plans that were opened during February 2002, and sorted them according to their monthly deposit value (irrespective of whether they were daily or monthly plans). Figure Three summarises the results.

Of the 217 new plans opened in the month, 154 (71%) are for monthly deposit values not exceeding Rs 100 (approximately $2). This very high proportion of low-value plans may indicate outreach to many clients of limited means, or it may indicate that many clients, rich or poor, are as yet unwilling to entrust VSSU with more than a small sum each month: the truth is likely to be a mixture of both.

Those 154 low-value plans should (if they are fully paid) generate deposits totalling Rs 11,050 each month. At the other end of the scale, the 9 plans opened in February with monthly deposit values of Rs 1,000 or more should generate deposits totalling Rs 17,000. Assuming that all plans cost the same amount to administer, the 9 high-value plans will be about 26 times more productive than the 154 low-value ones. In practice, the figure will not be quite so dramatic as that, since a higher proportion of the low value than of the high value plans will be of the monthly type, requiring only one monthly visit rather than a daily visit. Nevertheless, the outcome of the exercise certainly provides support for Secretary Mondal's insistence that he needs to work with high-value clients to make his business cost-effective.

Box Four: The Passbook-keeper Phenomenon

Kulpi Bazar is a large market on the river and railway, 12 km from the VSSU HQ. VSSU has some 230 clients there (counting active accounts of all product types). We talked to six of them, picked more or less at random as we walked through the market, and found that altogether these six were holding a total of 24 passbooks.

Of the 24 passbooks, 11 are owned by shopkeepers in the same market while the other 13 belong to businessmen but not based in the market – they are mostly traders who circulate various markets to sell groceries, vegetables, cosmetics, spices and so on, from mats on the ground, though some have permanent shops in other markets.

TH holds 4 passbooks. Two are his – he has a daily plan and a fixed deposit account. The other 2 belong to traders who live in his village (though they are not his relatives) but work other markets as described above. Similarly, SM holds 4 passbooks, one of his own and 3 from others in his village (again, not his relatives). D owns a big grocery store and holds 3 passbooks: one is his and the other two belong to his sons. D has a large Rs 120,000 loan from VSSU and has also borrowed from other similar providers.

Then we met SS, who holds no fewer than 14 passbooks (6 daily plans and 8 monthly plans). He told us that he used to hold 29 passbooks, but this became ‘a bit too much of a nuisance’. Of the current 14, one is his and the rest belong to others. Six of these others are traders in the same market who rely on SS for finance and for money-guarding The other 7 work other markets. Pressed to tell us more about the ‘nuisance’ of holding 29 passbooks, SS said that there were ‘problems’ with five of the accounts, arising from mismatches between the total recorded in the passbooks and the receipts. Amounts in dispute ranged between 200 and 500 taka. The Motivator, who was present, agreed that that these mismatches had occurred, and said that he had reported them to Secretary Mondal.

Further research into the relationships between clients, passbook-keepers, and VSSU staff would probably reveal a wealth of instructive data.

3.2 Financial Performance

Unaudited financial statements prepared by M-CRIL for 1999-2000, audited financial statements prepared by VSSU’s external auditors for 2000-2001, and unaudited balances from VSSU’s books were used to prepare a set of current financial statements. They are for the purposes of discussion, and should not be considered audited financial statements. Another external audit, and audited financial statements for 2001-2002 will be available in August.

Assets		Rupees
Cash	558,557	
Bank deposits	1,478,769	
Other current assets	744,326	
Loan portfolio – net of loan losses	23,791,162	
Reserve for loan losses	(0)	
Total current assets		**26,572,814**
Long-term loans and investments	2,437,948	

Net property and equipment	4,365,111	
Total Assets		**33,375,873**
Liabilities and net worth		
Short-term borrowing	750,000	
Member savings deposits	25,272,777	
Other current liabilities	429,073	
Total current liabilities		**26,451,850**
Long-term debt	2,464,285	
Total liabilities		**28,919,135**
Reserves and surplus		**4,459,738**
Total liabilities and net worth		**33,375,873**

Table Eight: Balance Sheet, 31st March 2002

Table Nine: Income Statement, Year to 31st March 2002

		Rupees
Interest received on loans	5,380,362	
Interest received on investments	311,008	
Other income	160,233	
Total revenue		**5,851,603**

Interest on borrowings	160,571	
Interest paid on client savings	903,997	
Other financial expenses	84,158	
Gross financial margin		**4,702,877**
Loans written off	245,762	
Provisioned for loan losses	(0)	
Net financial margin		**4,457,115**
Operating costs:		
Salaries	1,058,602	
Travel	103,290	
Depreciation	340,375	
Meetings and seminars	88,163	
Admin and office	167,626	
Other operating expenses	683,543	
Operating margin		**2,015,516**
Social development activities	711,585	
Net surplus		**1,303,931**

Commentary

There are features of these statements which set VSSU apart from most MFIs. First, we note the surplus generated in 2001-2002 of about $26,000, representing 22% of total revenue and earned on loans worth around $445,000. These numbers testify to the success of VSSU's products and to its commitment to cost control and efficiency. Financial self-sufficiency is 148%, putting it in the highest bracket of MFI performance world-wide.[8]

Second, as the Balance Sheet shows, this performance has been achieved without subsidy of any kind. VSSU has received no substantial grants and no concessional loans for any purpose whatsoever. Indeed, it had no loans of any kind until 2001[9], its only substantial liabilities being the client deposits it was holding. Thus – a third remarkable aspect of VSSU's work – its operations, including all of its lending, were financed entirely by deposits.

What makes all these figures even more remarkable is the relatively low cost of the loans. As we saw in Table Two, VSSU's most expensive loans (aside from penalty rates on overdue loans) are priced at 24% per annum, or 2% per month, well below average rates for MFIs internationally, and some loans are even cheaper.

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[8] Note that this figure is overstated by the lack of a proper loan loss provisioning policy. Nonetheless, financial self-sufficiency is at least 130% after adjusting for an adequate provision.

[9] A loan of 5,000,000 rupees has been taken from SIDBI, the Small Industries Development Bank of India, in August of 2001. The rate for the four-year loan is 11%.

It is important to note significant repayment and interest overdues– a matter that management is addressing both through increased effort at the field level and a new loan loss provisioning policy begun as of April 2002. The following figures were determined from reports provided by VSSU management, for the portfolio as of May 2002:

Table Ten: Overdue Loans As At May 2002

All overdue loans	4,666,124	17%
Loans overdue more than 30 days	3,181,076	12%
Loans overdue more than 60 days	2,403,606	9%
Loans overdue more than 90 days	1,857,063	7%

Forced savings?

Arguably, the savings plans, VSSU's base product, could be regarded as 'forced savings', and loan interest rates recalculated to take this into account, in which case they would look very much more expensive. But for many clients this would be a distortion. VSSU's product range is offered primarily as an illiquid savings service, satisfying a short-term 'illiquidity preference' on the part of clients who require a combination of both convenience and discipline in order to maximise their savings potential. For many such savers the loans are an additional facility, not the main reason for the savings. At any one time, less than half of all account holders have outstanding loans – in late March 2002, for example, there were about 2,475 borrowers among the 6,300 clients holding the 6,996 savings plan accounts (i.e. 39% of clients and 35% of accounts are borrowing). Moreover, the savings are 'forced' even if the account holder takes no loan, in the sense that savers suffer interest earnings penalties if they fail to deposit on time or withdraw their savings prematurely. It is fair to argue that VSSU helps clients build short-term financial assets which they can, if they wish, use as security against inexpensive loan products.

Recent changes

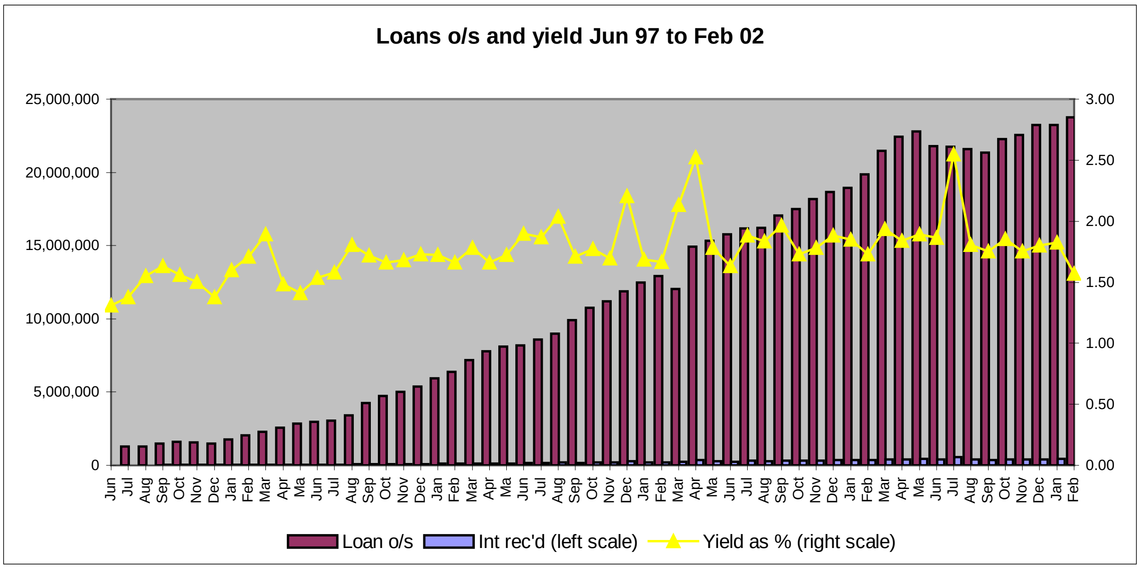
Since M-CRIL's visit in 2002, the last time that financial reports consistent with microfinance practice were prepared, there have been a number of changes.

First, of course, the programme has grown. At 31st March 2002, client deposits stood at Rs 25,272,777 (up from 14,863,161) and loans outstanding of 23,791,162 (up from 13,696,404), representing growth over two years of 70% for deposits and 74% for loans. In the same time period the count of active accounts climbed from 4,591 to 6,996 (up by 52%, indicating growth in savings balances and loans outstanding per account). Please refer to Figure Two, Growth Rates, in the previous Section. The average deposit balance per account on 31st March 2002 was about Rs 3,600 ($72) and the average loan outstanding per borrower (*not* per account) was about Rs 9,600 ($193).

VSSU's balance sheet now shows an additional liability, the first instalment of the SIDBI loan, for three million rupees at 11% per year. On the assets side the balance sheet now includes the book value of VSSU's large recent investment in its new headquarter building, which has cost more than four million rupees to date.

Portfolio growth slowed during 2001-2002, although as Figure Four shows, yield has remained fairly steady within a narrow band between 1.75% and 2.25% per month, with occasional peaks and troughs as seasonal or other extraneous factors intrude.

Figure Four: gross Portfolio Yield and Loans Outstanding, 1997-2002



The four main product lines

The relative weights of VSSU's products during business at year-end 2001 were as follows:

Table Eleven: Product Weighting By Balance Sheet Value

Savings plan	**%**	**Loan type**	**%**
Daily (includes weekly, fortnightly)	62%	General (24% pa)	80%
Monthly	26%	Group and 'within deposit' (18% pa)	15%
Fixed	10%	Rickshaw etc (12% pa)	3%
'Savings deposit'	2%	Education, latrine (6% pa)	2%
Total	100%		100%

The cash flows through the more important of these products during the year 2001 – 2002 were as follows:

Table Twelve: Cash Flows For Key Products, April 1st 2001 to March 31st 2002 (in millions of *rupees*)

Product	**Pay-ins to VSSU**	**Pay-outs from VSSU**	**Year-end balance**	**Growth in balance, over year 2000, %**	**Pay-outs as % of year end balance**
Savings plans:	*Deposits*	*Withdrawals*			
Daily	21.1m	21.2 m	not available	not available	not available
Monthly	4.7 m	3.4 m			
Fixed	2.8 m	1.2			
'Savings deposit'	.5 m	.4 m			
All savings plans	29.1 m	26.2 m	25.3 m	113%	104%
Loan types:	*Repayments*	*Loans*			
All loan types	23.9 m	27.4 m	23.8 m	116%	115%

This Table shows that the velocity of circulation through both the savings plans and their associated loans is high, with withdrawals from the daily plan even exceeding deposits in the year. High transaction values and low balances are a feature of much microfinancial work, and VSSU's pattern is not a matter of concern. Nevertheless, better client retention, with mature plans being more often re-invested in Fixed deposits would be a trend worth fostering.

Savings Interest and the impact of early withdrawal on VSSU's income

Close to 60% of all savings plans are encashed prior to maturity. Savings plans that are withdrawn prematurely suffer penalties both in terms of the fees charged and the final rate of interest applied by VSSU when it calculates interest owed. The fees charged are called "collection charges" and are accounted for in VSSU's books as income – their effect, however, is to reduce the amount of interest paid to the customer when they encash a savings plan early.

The effective rate paid on savings for the 24 months from April 2000 to March 2002 was 3.5%. That rate is further reduced by collection charges to a final effective rate of 3%. This overall figure is below the advertised rate of 4% for daily plan savings, and well below the rates for other plans, which range from 8% to 11% (see table one). Early encashment fees and adjustments to interest earnings dramatically reduce VSSU's expense for savers' interest, contributing significantly to profitability.

Referring back to table 10, a weighted average expense for savers' interest would be as shown in the table on the following page:

Table Thirteen: Weighted Average Cost Of Capital Raised From Savers

Plan type	Weight	Interest paid
Daily Deposit	62%	4%
Monthly Deposit	26%	10.5% (average of advertised rates)
Fixed Deposit	10%	9.5% (average of advertised rates)
Savings Deposit	2%	5%
All Savings Plans	100%	6.3% (weighted average)

A payout of 6.3% on the average deposit portfolio for 2001-2002 would have cost VSSU around 1,500,000 rupees, as compared to approximately 800,000 actually spent (after collection charges). Paying advertised rates on prematurely encashed plans would have cost VSSU more than half (54%) of its retained earnings for the year.

During the six months ending with May 2002, plans valued at 7.6 million rupees reached maturity. Those plans earned 457,566 rupees. It is difficult to determine the overall effective yield to the client for plans that reach maturity, as the information required for that analysis is not maintained by plan type, and maturities within plan types can vary. But the difference between payments on plans that reach maturity, and plans that do not, is informative.

During those same six months, plans encashed early had a value of 5.6 million rupees, but interest paid was only 50,195 rupees. That interest paid was then nearly perfectly offset by collection charges of 45,364 rupees. After collection charges, less than 5,000 rupees were paid on premature plans with a value of more than 5 million rupees.[10] In effect, VSSU pays (on average) no interest on savings plans that are encashed early.

Moreover, the rules on early encashment of savings contribute indirectly to a very lucrative product on the loan-taking side: "Loans Within Savings." Although the interest rate is lower for these loans (18%), there is no risk to VSSU's capital. As will be seen in the next section, these loans contribute significantly to VSSU's income. Penalties for early withdrawal of savings motivate such 'borrowing of one's own funds.'

The effectiveness of collateral and guarantee strategies

The results from VSSU's variety of collateral and guarantee schemes are mixed (refer to table two for the rules on security for each loan type). On the following page is a breakdown of loan-taking for each of the loan products during the month of June, 2002:

[10] The reader should note, however, that non-financial costs are not being included in this analysis. Any institution that offers daily deposit collection services incurs significant non-financial expense in the process. No judgement is being made in this section as to the appropriateness or inappropriateness of not paying interest on plans which are encashed prior to maturity. Indeed, reserving the benefit of interest for savers who maintain their contracts is defensible as an appropriate way to allocate costs for the savings service itself.

Character-based loans to individuals

"Track Record" Loans:	
Average loan size	7773
Number of loans	44
% June loans	19%
% June loan capital	38%
% June loan risk taken	46%
capital composition:	
member capital	19%
vssu capital	81%
risk compostion:	
member capital	19%
vssu capital	81%
garantor capital	-

"Special Person" Loans:	
Average loan size	18646
Number of loans	7
% June loans	3%
% June loan capital	18%
% June loan risk taken	22%
capital composition:	
member capital	-
vssu capital	100%
risk compostion:	
member capital	-
vssu capital	100%
garantor capital	-

Higher Education Loans:	
Average loan size	586
Number of loans	7
% June loans	3%
% June loan capital	0.6%
% June loan risk taken	0.7%
capital composition:	
member capital	-
vssu capital	100%
risk compostion:	
member capital	-
vssu capital	100%
garantor capital	-

Guaranteed loans to individuals

Loans Within Deposit:	
Average loan size	2698
Number of loans	99
% June loans	42%
% June loan capital	-
% June loan risk taken	-
capital composition:	
member capital	100%
vssu capital	-
risk compostion:	
member capital	100%
vssu capital	-
garantor capital	-

Deposit Guarantor (member)	
Average loan size	6277
Number of loans	53
% June loans	23%
% June loan capital	30%
% June loan risk taken	17%
capital composition:	
member capital	33%
vssu capital	67%
risk compostion:	
member capital	33%
vssu capital	31%
garantor capital	35%

Other Guarantor (salaried non-member)	
Average loan size	3275
Number of loans	4
% June loans	2%
% June loan capital	1%
% June loan risk taken	2%
capital composition:	
member capital	27%
vssu capital	73%
risk compostion:	
member capital	27%
vssu capital	73%
garantor capital	-

Loans to members in groups

Large-group loans	
Average loan size	7941
Number of loans	17
% June loans	7%
% June loan capital	10%
% June loan risk taken	12%
capital composition:	
member capital	46%
vssu capital	54%
risk compostion:	
member capital	46%
vssu capital	52%
garantor capital	-

"ABC" group loans:	
Average loan size	5487
Number of loans	5
% June loans	2%
% June loan capital	3%
% June loan risk taken	2%
capital composition:	
member capital	26%
vssu capital	74%
risk compostion:	
member capital	26%
vssu capital	35%
garantor capital	38%

How borrowers fall into the various categories of products, and the actual volume of activity for each product in the month of June vary as follows:

Table Fourteen: Loans By Type, By Numbers Of Borrowers And By Proportion Of Funds

	Percent of all borrowers[11]	Percent of all loans in June	Percent of all funds in June
Individual Loans			
Deposit Guarantor	30-40%	23%	30%
Loans within deposit	15%	42%	n/a
Track Record	15%	19%	38%
Post-dated Check	5%	<2%	1%
Special Person	<5%	3%	18%
Education and other	< 5%	3%	<1%
Group Loans			
ABC Method	5%	2%	3%
Large Group Method	20-25%	7%	10%

Immediately apparent is the prevalence of loans within the amount of the client's deposit, which present no risk to VSSU. In June, 99 of 235 loans were taken in this fashion (42% of all loans) – presumably by clients anxious to protect their interests accrued on savings on contracts.

The two types of loans to individuals which require nothing more than VSSU's estimate of their worthiness as a borrower[12] – "Special Person" and "Track Record" loans – absorbed 56% of all capital lent in June. A closer look at how those two types of loans contributed to the risk taken in June is even more revealing. Because some loan products involve the guarantee capital of others, the risk taken by VSSU in any given month is less than the overall amount of capital employed. Adjusting for this effect, Track Record and Special Person loans represented 68% of all risk taken in June. While character-based lending is a commonly accepted form of financial intermediation, that it continues to be such a high percentage of both capital employed and risk taken by VSSU is alarming.

One of VSSU's responses to risk, at the recommendation of various outside parties, has been to emphasize group-lending. But borrowers in groups, especially those in the large groups, receive a small share of both the volume of loans made, and the volume of capital employed. VSSU's estimate of 25-30% of all clients in some form of borrowing group is probably accurate – however the fact that they received 9% of all loans and 13% of all capital in June is indicative of the low velocity in the group-lending portfolio. This may be a significant contributor to fail or failing large groups, which appear to be occurring in significant proportion.

A careful study of the effectiveness of each type of guarantee scheme would be an exhausting exercise. The nature of a loan decision is not explicitly stated or tracked in the loan records, and there is no method for assessing how each type of loan contributes to the present portfolio at risk without a manual review of loan records conducted jointly with the secretary, who can explain how each loan decision was taken. While VSSU does maintain an account-wise record of its write-offs, and some assumptions can be made from information in the relevant account histories ("party ledgers," in VSSU terminology), interviews with the secretary and financial services manager about the overall risk picture were the most

[11] These numbers provided by VSSU management.

[12] Legally enforceable contracts referred to as "stamp papers" are used in the case of large loans.

effective means to assess the source of loan delinquency. A brief estimate of the outcomes and effectiveness of the significant guarantee types is given here:

Loans within deposit

These loans are risk-free to VSSU. As long as clients continue to find them attractive in light of lost interest on savings contracts, they will continue to be an effective, profitable, and zero-risk product.

Special person loans

In the past, character-based loans made by subjective decision were more common than they are at present. Perhaps a few loans are made to "special people" each month, and while the basis for the loan decisions is not documented, senior management knowledge of each client, the terms of the loan, and the value of the client's assets is high. Nonetheless, these loans absorb as much as 20% of funds, and management exhibits growing discomfort with the associated risk. Transparent policies for loan assessment, and careful documentation of loan decisions are needed.

Track record loans

According to VSSU management, track record loans contribute the majority of VSSU's losses. Management is actively seeking to reduce this segment of the portfolio. They note that in the past, track record lending accounted for 40-45% of all loans. While that figure has fallen significantly, these loans continue to account for around 20% of volume, 30-40% of funds lent, and 40-50% of risk taken. Losses would seem to arise from weaknesses inherent in the practice of basing a client's loan-taking potential on their deposit history. Some clients stop making contract savings payments when loans are received, never returning to a regular pattern of pay-ins to the collector. It may be that some clients save to get a loan, and are then 'satisfied,' and that others run into problems saving and repaying at the same time, and become disheartened when accrued interests on savings are lost. Whatever the cause, it is clear that savings performance has been an inadequate predictor of loan repayment behaviour.

Loans backed by the savings of a deposit guarantor

Deposit Guarantor loans are an interesting case – large loans backed by large deposits do not appear to produce significant losses. Smaller loans, or loans which have been largely repaid but for which small balances remain, however, are producing a small but persistent stream of losses. When clients appeal to VSSU for "consideration" on small outstanding balances, it is often given. Management views this as forgiveness of interest rather than capital owed – the amounts forgiven are generally within the total amount of interest that has already been paid on the loan. Management is generally unwilling to call on guarantors to back the small remaining balances.

It is also worth noting that many market clients have developed the habit of guaranteeing the loans of a large number of clients. Two such clients we spoke to maintained responsibility for 8 to 12 loans at a time. Neither had ever been asked to pay for an uncollected amount. While these individuals provide VSSU with valuable information and assist VSSU in maintaining relationships and working with new clients, the direct financial value of their guarantees is low. The habit of forgiving small amounts in the end-phase of a loan cycle is probably tied to this system, and the careful maintenance of the relationships involved.

Large-group loans

VSSU's secretary has taken the advice of third-parties who are familiar with India's self-help groups or the methodology of Grameen Bank, and has begun to promote large groups to reduce VSSU's risk. But common predictable problems are appearing – clients wait a long time for a loan, groups are difficult to maintain, attendance is spotty, and willingness to back each others' loans, especially following the breakdown of the group, is unclear. Group leaders have on occasion exercised their power to pressure VSSU into giving them special loans of larger than normal size. The portfolio of group loans has bears all the signs of a high-cost portfolio that will require cross-subsidization from the other products. Whether large group lending is appropriate will require careful study.

ABC group loans

This small but promising segment of the portfolio is doubly attractive – not only is there a personal guarantee by the two remaining members to back the borrowers loan, but the savings of those individuals provides collateral and lowers VSSU's capital requirement. In June, the ABC group loans extended required that VSSU put up only 35% of the loan capital. Risk is low.

Loans backed by a third-party (post-dated check)

This small but attractive segment provides the opportunity for a salaried individual (who may or may not be a client of VSSU) to guarantee a third-person's loan from VSSU with post-dated checks. VSSU management is extremely pleased with the result. These loans have yet to produce a loss.

Leasing-hire

Another small but attractive segment that poses little risk to the overall portfolio is leasing-hire. VSSU holds the title to the asset until the loan is cancelled. Clients produce a significant portion of the expense up front. One better off client we spoke to had used this loan to buy a tiller costing 100,000 rupees, paying 50,000 rupees and borrowing the rest. Over the span of a year, he repaid the loan, and considers the service received from VSSU to be excellent.

4 Explaining Performance

4.1 Clients' Perceptions of VSSU and its Services

From our conversations with individual and ad hoc groups of clients and non-clients we drew two main conclusions.

First, there is a generally high level of satisfaction with the product types, especially the daily plans. Many clients, especially market traders, are familiar with this style of product, which has been available in their communities, on and off, for many years. They especially appreciate the convenience of VSSU's door-step collection service, the face-to-face contact with the Motivator, and the flexibility of the products. VSSU can be encouraged by this: they are on the right lines and should pursue and improve their work.

Second, we often encountered complaints or expressions of dissatisfaction with specific aspects of VSSU's service or its price structure. For some, 'flexibility' can mean inconsistency and disappointment, when hoped-for loans are not provided or withdrawals are not available or are more costly than bargained for. VSSU should be concerned by this, and strive to put their business on a more rule-bound, consistent and transparent footing. For every client who benefits from *bibechona* there may be another who is put off by it.

Patterns of use

One explanation of VSSU's good performance is that its products are adaptable to a wide diversity of uses, especially when compared with the rather rigid fixed-term credit-centred approach used by many 'mainstream' MFIs[13]. VSSU's clients can choose a savings plan that suits them in terms of its deposit value and frequency. They then may or may not borrow against their deposits. If they borrow, there are no restrictions on loan use (except in the case of low-price loans for specific 'social' uses), and loan values (up to a ceiling) can be chosen (or even negotiated beyond the nominal ceiling, with the help of *bibechona*). Repayment schedules can, within limits, be chosen to suit cash flow and in effect can be changed as time goes by. Boxes Five and Six on the following page show cases illustrating this range of behaviours.

Box Five: Patterns of Use: In The Village

SH is an elderly rickshaw van driver living in a village not far from a main road. He has had a succession of low-value monthly savings plans which he regards as a form of security which helps him ensure income for his seven person family. At present he saves Rs 50 a month and has recently taken a Rs 1,000 loan to take care of some health costs.

CR lives in the same village as SH. She is married, and lives with her husband in the household of her father-in-law. The menfolk in the household provide more or less regular income through rickshaw driving and agricultural day labour. CR opened a monthly savings plan at rupees 100 per month, financed largely from occasional sales of milk from the cow that she tends as one of her domestic duties. She was an irregular depositor. Nevertheless the plan matured after a little more than two years and CR has invested the proceeds in tomato gardening. She took no loan and had no intention to.

About a kilometre away, and further from the main road, we came across BH. She is from a wealthier household and has been running a succession of monthly recurrent plans of Rs 100 or 150. The women of her household habitually make flower garlands during the festival season, and BH intentionally closed her first plan prematurely, knowing that she would lose all interest on it, but releasing a good sum of money to buy flowers at the appropriate time. With her second plan she tried a different strategy: she increased the deposit amount from 100 to 150 a month and took as big a loan as she could negotiate. In answer to our question, she said she was unsure which was the better strategy - the saving strategy was cheaper as there were no interest costs to pay, but the borrowing strategy produced a larger sum of money. During her third plan, also of 150 per month, she claims that she gave a deposit to her Motivator when she met him on the road but failed to get a receipt. There was a brief dispute, and BH closed her account prematurely. More recently, as she admits with a smile, she has swallowed her pride and opened a fourth plan.

For a better understanding of the detail of client payment behaviour, we studied some passbooks and discussed the issue with Motivators and with Secretary Mondal. Mondal asserts that not less than three-quarters of all daily plans account holders are fully paid up within the month. Our look at passbooks suggested that this estimate is about right, but since passbooks are made up monthly, it may well be that not all of the deposits are made according to the strict daily schedule. In the villages, where the monthly plans are popular, a Motivator told us 'we make an agreement, say, that a borrowing client should deposit Rs 50 and repay 50 each month – but most clients fail to keep to this schedule.' He went on, 'we try to be strict with big borrowers, but we don't bother with the little ones.' Similarly, the loan security systems (Table Two, column three) are often waived for small borrowers, he said.

[13] ***MicroSave*** uses 'mainstream' to refer to the MFI approach most common in, say, East Africa – solidarity-group joint-liability microcredit programmes with forced savings, often modelled on the Grameen Bank system developed in Bangladesh or on the Village Bank methodology from Latin America.

Box Six: Patterns of Use: In The Market Place

TP is a youngster who runs a small stall selling fresh fruit. He opened a daily plan with VSSU about four months ago, and deposits Rs 10 per day. He says that he doesn't know the rules of the scheme in any detail, but he believes that he will soon be eligible for a loan. It is the opportunity to take this loan that attracted him to VSSU: he says he desperately needs loan capital to increase the meagre stock of his stall.

SA runs a well stocked grocery store. He is not poor, sharing about three acres of agricultural land with three brothers, but he has only a primary school education. He has had a succession of savings plans with VSSU, and has reinvested some of them into fixed deposit accounts. As a result, he now owns about Rs 22,000 of deposits in the MFI. He has also taken several loans from VSSU, the latest had a face value of Rs 20,000 of which 5,500 remains outstanding. He explained that the loans have been used to increase his stock at the grocery store, while the deposits serve as his reserves against emergencies and old age.

PB is 30 years of age and well educated - he has a B.Com - but landless. He works as a priest and tutor. Using a friend of his who is a market trader as an intermediary, PB has opened a daily plan with VSSU, of Rs 20. He hasn't taken a loan and doesn't intend to, but he is aware that he has the right to a loan, a right that he might exercise if the need arose.

AM, an older man, finished primary school and now runs a tea stall. He estimates a daily turnover of about Rs 500. He has a daily plan with VSSU and two similar account with a rival MFI. As they mature, he invests them in the tea stall and in his village home. As long as things are going well he finds that he doesn't need to borrow, and he has had no loan from either of the MFIs.

Conversations with clients

In one market, Mondir Bazar at Kulpi, we made a brief survey of eleven adjacent small shops, to judge the take-up of VSSU and rival services. Table Fifteen shows what we found.

Table Fifteen: Eleven adjacent shops in Mondir Bazar: financial service use

Type of shop	Financial services used (data on informal services not collected)
Clothes	Life Insurance Company
Grocery/cosmetics	*Sabuz Sangha* Daily Scheme (VSSU-style NGO)
Restaurant	Post Office savings
Clothes	Post Office savings
Barber	VSSU Daily Scheme (now matured)
Phone	VSSU Daily Scheme (2 accounts, and holds VSSU passbooks for four other clients)
Tailor	Was VSSU Daily Scheme (withdrew prematurely); United Bank Daily Scheme
Tailor	None reported
Phone	United Bank Daily Scheme; Post Office; Standard Bank of India
Cosmetics	VSSU Daily Scheme
Restaurant	VSSU Daily Scheme

All but one of these shopkeepers uses or has recently used formal or semi-formal financial services, so our informants in this case were speaking from a background of some experience of the sector. We asked the tailor why he had withdrawn prematurely from his VSSU daily plan. He explained that he was depositing Rs 20 a day and by September 2001 held a balance of just over 5,000. At that point he requested a loan of 10,000 but was refused. Disappointed, he closed his account prematurely, and then was very angry at being charged a fee of 200 for the withdrawal as well as losing all interest earnings. He shifted to the United Bank and opened a similar daily plan, also at 20 per day, and recently received a 15,000 rupee loan. He is bitter about VSSU, claiming that they clearly broke their commitment to him. His neighbour, however, told us that VSSU denied the loan because the tailor refused to supply one of the additional security devices which VSSU require for loans that are not fully covered by deposits (see Table Two column 3). Whatever the truth of this story, and of similar ones we heard elsewhere, the clear lesson for VSSU is to ensure good relations through more transparent and more carefully explained rules and procedures.

Most of these shopkeepers understood how the savings plans and their associated loans work, though some complained that Motivators had barely explained the rules to them. In the villages, knowledge of the rules appeared weaker, and one Motivator agreed that he spends very little time checking that clients fully understand the plans. Another complaint was that rules were subject to change without notice: several clients mentioned their dismay at finding out – when they came to make a withdrawal – that the minimum withdrawal fee had risen recently from Rs 30 to 60 and the minimum term of the daily plan from 15 to 18 months. In one village several clients from poor households complained that VSSU was about to raise the minimum monthly deposit from Rs 50 to 100, and this was confirmed by their Motivator, who was with us at the time. But later, another Motivator said that the matter was merely in discussion, while Secretary Mondal told us that VSUU would like to move towards higher minimum deposit values (see Figure Three in the previous Section) but that *bibechona* would be used to ensure that poorer clients were not thereby excluded.

Asked to name the most frequent complaints expressed by clients to him, a Motivator replied without hesitation. First (for daily plan clients): confusion over the handling of the deposit receipts. Second (for borrowers only): many would like the option of ceasing saving deposits and concentrating on loan repayments until the loan is repaid.

5 Conclusions

5.1 Achievements, Challenges, Strengths and Weaknesses

VSSU's **achievement** is to have developed, from the ground up, an affordable and sustainable financial service system that responds to the needs of many households and businesses in its operational area.

This achievement is built on a key observation, made in person by VSSU's exceptional founder and Secretary, Kapilananda Mondal. He saw that financial services are built on savings. The essential tasks of financial services for low-income users are, first, to help them maximise their potential to save and, second, to help them transform those savings into usefully large lump sums for expenditure on a wide variety of personal, household and emergency needs, and on business and other opportunities. The savings can be transformed into the lump sums by either of two strategies: 'saving up' (finding a safe place where savings can be stored until they mature into a useful sum), or through loans ('saving down' – in effect taking an advance against savings that the borrower promises to make in the future). Mondal's system neatly links the two strategies.

The models that Mondal happened to have to hand undoubtedly helped him. He was aware of the 'pigmy bank' (or 'small saver') schemes run by many Indian banks, and of fixed deposit facilities. By building his products on these models, Mondal avoided many of the pitfalls that await MFI entrepreneurs who import 'microfinance' models from external sources: the pitfalls of an almost exclusive focus on credit, on group formation, and on women (to the virtual exclusion of men), and the pitfall of excessive dependence on grants, soft loans and 'advice' from others.

The **challenge** that now faces VSSU is to grow a good idea into a workable institution that can serve more than the six thousand or so clients now on its books.

Most of the **strengths** that will assist VSSU to face this challenge are personal and local while many of the **weaknesses** are abstract and technical. VSSU is embedded in its locality where it enjoys enormous respect. Its systems are wholly home-grown, the products its uses are already familiar to many of its future clients, its staff are all local, hard-working, committed, and known personally to its dynamic founder, himself a local man. VSSU abounds in energy and vitality. But VSSU must now invest in improvements to its management systems – above all for accounting and for handling information, but also for better human resource training and management, and for good transparent external relations. Computerisation is indispensable. VSSU's legal status is doubtful, and with several look-alikes springing up (the entry costs for setting up a VSSU-type venture are worryingly low) it is in danger of losing its market domination of its products.

Bibechona is both a strength and a weakness. It has allowed VSSU to accommodate itself to demand, and that has proved a good way of learning from the field. It has also allowed VSSU to present a friendly face to many clients, especially poorer ones, to the benefit of those clients and to VSSU's public relations locally. It is now time – as Secretary Mondal recognises – to digest what has been learned from the practice of *bibechona*, and codify the results into transparent codes of practice governing products, staff and office procedures. In the specific matter of loans, it may prove wise to distinguish between loans large enough to require careful analysis (a codified version of *bibechona*) and those small enough to be available as a right to clients who comply with simply-articulated rules.

5.2 Lessons for Mainstream MFIs

Low-income households and businesses require safe convenient ways to turn their savings into lump sums, and financial services for the poor can help them do this through savings as well as through loans: VSSU's experience shows that a mix of both can be both popular and profitable .

Flexible savings and loans products can be retailed profitably to low-income groups at prices of around 24% a year for loans, but only if well-designed products meet the real needs of clients and costs are strictly controlled; one key to cost control is containing interests paid on savings – in VSSU's experience it is appropriate to reduce or eliminate interest paid to short-term savers.

Sustainable institutions can be built without dependence on external grants and soft loans, but only if costs are strictly controlled.

Neither group formation nor an exclusive focus on women are necessary aspects of popular and profitable microfinance; VSSU's experience is highlighting the difficulty of operating group-based and individual lending portfolios at the same time.

The absence of a strictly 'targeted' poverty-focussed approach to client recruitment has not stopped VSSU from working successfully with small-scale market traders of the sort that form the core clientele of many mainstream MFIs.

At a certain stage of an MFI's growth – in VSSU's case after eight years having reached 7,000 active accounts – poorly developed accounting and management practices begin to impede further successful growth.

5.3 Recommendation for Donors

Care must be taken that outside assistance provided to VSSU be coordinated with the history and nature of the organization. Secretary Mondal comments: "…if a donor were to give us 50 or 100 lakh rupees, our staff would stop working hard."

VSSU is built upon local tradition and the intuition of its present staff. It is also build almost entirely on locally mobilized funds. Recommendations for modernization of systems, supplementing of staff and otherwise should be given with the caveat that patience and the preservation of what works underlies any intervention.

An area where donors could provide needed assistance is capitalization for the purpose of risk management. VSSU's current equity position is 4.6 million rupees, although the budget allocation for 2002-2003 fixed asset and social development expenditure would dramatically reduce that figure – perhaps to as little as one million rupees. When compared to VSSU's current debt position of roughly 29 million rupees, it is unclear whether conventional standards of capital adequacy are in place. Expenditures for fixed assets and social development activities are impeding the retention of sufficient earnings to ensure stability in the face of a crisis like a cyclone or flood. Donors might stabilize this situation with concessional debt subordinated, by agreement, to repayment of client deposits. The loan from SIDBI and the line of credit from United Bank of India provide liquidity, but are not explicitly intended as reserves.[14]

There are no 'best practices' for microfinance, only good practice. Good practice tests general principles against concrete experience. It is context-specific. It has to be imagined and re-imagined, designed and re-designed, tested and re-tested. You cannot construct a good MFI from a kit of parts bought in an international microfinancial supermarket. A house built of solidarity groups and loans to micro-enterprises, populated solely by women and paid for by capacity building grants from donors, may not stand on the sands of southern Bengal. Or, indeed, of the Sahara.

[14] For details regarding this figures, see Financial Statements Annex notes 4,7,10 and 11, and the Balance Sheet.

Appendix

Financial Statements

VIVEKANANDA SEVAKENDRA O SHISHU UDDYAN
Balance Sheet as of 31 March

PROPERTY AND ASSETS	Note	2002 Rupees	2001 Rupees	2000 Rupees
Current Assets				
Cash in Hand		558,557	390,725	1,148,159
Cash at Bank	3	1,478,769	353,084	164,072
Loan Portfolio - Net off Loan Loss	4	23,791,162	20,516,307	13,323,496
Other Current Assets	5	744,326	5,850	235,000
Long-term Assets				
Long-term Investment	6	2,437,948	1,972,948	209,835
Property and Equipment (Annexure 1)		4,365,111	2,518,616	1,161,820
		33,375,873	**25,757,530**	**16,242,382**
LIABILITIES AND RESERVES				
Current Liabilities				
Short-term Borrowing	7	750,000	195,000	1,625
Members Savings Deposits	8	25,272,777	22,406,723	14,863,160
Other Current Liabilities	9	429,073	-	91,256
Long-term Debt	10	2,464,285	-	-
Reserves and Surplus	11	4,459,738	3,155,807	1,286,341
		33,375,873	**25,757,530**	**16,242,382**

The accompanying notes are an integral part of the Balance Sheet

VIVEKANANDA SEVAKENDRA O SHISHU UDDYAN

Income Statement
For the year ended 31 March

		Note	2002 Rupees	2001 Rupees	2000 Rupees
A.	**Financial Income**				
	Interest on loans to mambers		5,037,097	3,911,615	2,390,982
	Collection charges		107,651	89,264	
	Members' subscription		17,319	16,699	
	Admission fee		17,570	16,819	
	Insurance (Help us to help you program)		200,725	185,671	
	Investment income (int. on fixed deposit)	12	301,235	36,863	5,917
	Interest on bank deposits		9,773	24,401	
			5,691,370	4,281,332	2,396,899
B.	**Financial Expenses**				
	Interest on borrowings	13	160,571	-	-
	Interest on members' savings		903,997	557,824	374,214
	Insurance Premium to NIC (HUHY)		67,012	49,175	-
	Insurance Claim (Compensation)		6,789	16,520	-
	Bank Charges		10,357	971	-
			1,148,726	624,490	374,214
C	**Gross Financial Margin (A-B)**		**4,542,644**	**3,656,842**	**2,022,685**
D.	Loan Loss		245,762	69,018	135,203
E.	**Net Financial Margin (C-D)**		**4,296,882**	**3,587,824**	**1,887,482**
F.	**Operating Expenses**				
	Salary and benefit	14	1,058,602	720,864	469,219
	Travelling		103,290	26,512	-
	Meeting and Seminars		88,163	43,220	-
	Printing and Stationery		101,802	55,775	-
	Repair and Maintenance		65,824	40,240	-
	Depreciation (Annexure - 1)		340,375	221,059	22,435
	Other operating expenses	15	683,543	598,755	605,631
			2,441,599	1,706,425	1,097,285
G.	**Gross Operating Margin (E-F)**		**1,855,283**	**1,881,399**	**790,197**
H.	Social Development Expenses	16	711,585	734,682	-
I.	**Net Operating Margin (G-H)**		**1,143,698**	**1,146,717**	**790,197**
J.	Other Income	17	160,233	181,360	39,700
K.	**Net Income/surplus for the year (I+J)**		**1,303,931**	**1,328,077**	**829,897**

The accompanying notes are an integral part of the Income Statement

VIVEKANANDA SEVAKENDRA O SHISHU UDDYAN

Notes to the Financial Statements
For the year ended 31 March 2002

1. The Organization

Vivekananda Seva Kendra o Shishu Uddyan (VSSU) is a voluntary social organisation. It was established in 1983 as a society. VSSU is the parent of Swarnirbar Gosthi (the MFI), which provides most of VSSU's income. However, as VSSU retains the assets, pays staff, and registers financial services clients as members, and because these two organizations appear to be one (VSSU) to the outside world, we have presented the financial statements in consolidated form.

2. Significant Accounting policies

2.1 Basis of Preparation of the Financial Statements

a. These financial statements have been prepared under the historical cast convention on a going concern basis. Revenue and expenses are recognised on accrual basis except interest on members loan and members savings which is being done on cash basis.

b. These financial statements do not constitute an audit. Annual audits are performed by VSSU's external audit firm (Guha and Matilal) and can be obtained by contacting VSSU directly. The most recent audited financial statements are for 2000-2001. These financial statements for 2001-2002 have been prepared at the request of MicroSave Africa (MSA). They are for discussion purposes only.

c. VSSU's accounting year is April 1st to March 31st. Financial data for the year 1999 - 2000 is taken directly from an assessment report prepared by Micro-Credit Ratings & Guarantees India Ltd. (M-CRIL), May 2000. Financial data for the year 2000-2001 is taken directly from audited financial statements prepared by Guha and Matilal, chartered accountants, July 2001. Financial data for the year 2001-2002 have been prepared with balances provided by VSSU.

2.2 Fixed Assets and Depreciation

Fixed assets are recorded at written down value and are depreciated using Reducing Balance method. Whole year's depreciation is charged on all applicable assets irrespective of the date of acquisition.

2.3 General

Figures in the financial statements have been rounded off to the nearest Rupee.

	2002 Rupees	2001 Rupees
3. Cash at Bank		
UBI LK pur Branch, A/c # 7894	56,580	7,912
UBI LK pur Branch, A/c # 8221	558	558
UBI LK pur Branch, A/c # 8222	38,397	330,846
UBI LK pur Branch, A/c # 5714	2,280	10,877
UBI LK pur Branch, A/c # 9217	32,294	1,253
UBI LK pur Branch, CD A/c # 189	1,337,768	-
CBI Raghunathpur Branch, A/c # 2043	569	482
UCO Sealdah Branch, A/c # 2665	10,223	1,056
SBI Mandhirbazar Branch, A/c # C1/149	100	100
	1,478,769	**353,084**

4. Outstanding Loans to Members

Opening balance	20,516,307	13,749,099
Add: Disbursed during the year	27,399,935	27,456,316
	47,916,242	41,205,415
Less: Recovered during the year	23,879,318	20,620,090
	24,036,924	20,585,325
Less: Loan Loss (Loan written off)	245,762	69,018
	23,791,162	**20,516,307**

<u>A note on loan loss provisioning</u>: VSSU has begun the process of provisioning for loan losses (this was not done in prior years), and plans to add Rs./375,000 to its reserve in the 2002-2003 accounting year; the adequacy of that policy depends upon the assignment of risk to each category of overdue. Working with VSSU senior management, we estimated an adequate provision to stand at 1.6 million rupees.

all overdue loans	4,666,124	17%
overdue > 30 days	3,181,076	12%
overdue > 60 days	2,403,606	9%
overdue > 90 days	1,857,063	7%
Total Portfolio, including overdue loans	26,899,230	100%

5. Other Current Assets

Security Deposit:		
Balance as on 01.04.2001	1,200	-
Addition during the year	2,300	1,200
	3,500	1,200
Stock of Vivek Det Raw Materials	126,155	-
Stock of Construction Materials	274,261	-
Grant Receivable from SIDBI	42,500	-
Interest Receivable - Fixed Deposit	293,260	-
Loan to Shishu Uddyan	4,650	4,650
	744,326	**5,850**

Construction materials include sands, cement, rod, woods, etc.

6. Long Term Investment

	2002 Rupees	2001 Rupees
Fixed Deposit		
UBI LK pur Branch	2,407,948	1,942,948
CBI Raghunathpur Branch	30,000	30,000
	2,437,948	**1,972,948**

VSSU started to accrue interests on fixed deposits from the year 2001-2002. As such interest accrued upto 31 March 2002 has been incorporated in these accounts.

7. Short Term Debt - Bank Overdraft

Opening balance	195,000	1,625
Made during the year	750,000	195,000
	945,000	196,625
Less: Paid during the year	195,000	1,625
	750,000	**195,000**

The above overdraft facility has been provided by United Bank of India (UBI), Lakshmi Kantapur Branch against mortgage of fixed deposit with the bank. Maximum limit of the facility as granted by the bank is Rs. 1.1 million and the interest rate is 12.5% p.a.

8. Members Saving Deposit

Balance as on 01.04.2001	22,406,723	14,894,647
Saving made during the year (Note 8.1)	29,077,702	25,571,678
	51,484,425	40,466,325
Less: Withdrawn during the year	26,211,648	18,059,602
	25,272,777	**22,406,723**

Although daily and monthly deposit accounts have stated maturities of 18 or 24 months, in practice around 60% are encashed prior to maturity. Fixed deposits have maturities of 6 months to 6.5 years, but in practice around 50% are encashed prior to maturity. For this reason, all client deposits are considered current liabilities.

For the same reason, until and unless the mix of products changes significantly and more clients are holding contractual deposit products to maturity, the current practice of cash-based accounting for payments of client interest is reasonable.

8.1 Saving made during the year

Recurring Deposit	4,730,621	3,741,152
Daily Deposit	21,092,637	19,581,867
Fixed Deposit	2,789,515	2,012,029
Saving Deposit	464,929	236,630
	29,077,702	**25,571,678**

9. Other Current Liabilities

Current portion of SIDBI Loan	428,572	-
Advance Agency Fee	501	-
	429,073	**-**

	2002 Rupees	2001 Rupees

10. Long Term Debt

Loan from SIDBI	3,000,000	-
Less: Refunded during the year	107,143	-
	2,892,857	-
Less: Current portion - due within next year	428,572	-
	2,464,285	**-**

This loan has been provided by Small Industries Development Bank of India (SIDBI) on 14 August 2001 for on-lending program of the organization which bears interest @ 11% p.a.

11. Reserves and Surplus

Opening balance	3,155,807	1,827,730
Retaing income for the year	1,303,931	1,328,077
	4,459,738	**3,155,807**

VSSU constituted some reserve funds out of its cumulative surplus income in previous years for building/acquiring fixed assets as per decision of the committee. Details of these funds are set out below:

Building Reserve Fund	1,292,027	1,292,027
Furniture Reserve Fund	454,797	454,797
Electrical Equipment Reserve Fund	103,505	103,505
Retained Surplus	2,609,409	1,305,478
	4,459,738	**3,155,807**

12. Investment Income

Fixed Deposit Interest received	7,975	-
FD interest accrued upto this year	293,260	-
	301,235	**-**

Details of interest accrued upto the year 2001 - 2002 has been presented in Annexure - 2

13. Interest Paid on Borrowing

Interest on Bank Overdraft	70,604	-
Interest on SIDBI Loan	89,967	-
	160,571	**-**

14. Salary and Benefit

Salary and Bonus	687,693	461,627
Honorarium	91,875	72,600
Staff Welfare	260,691	186,637
Staff Benefit	16,690	-
Leave Encashment	1,653	-
	1,058,602	**720,864**

	2002 Rupees	2001 Rupees
15. Other Operating Expenses		
Audit Fee	20,765	15,400
Taxes and Fees	795	1,825
Training	10,000	33,962
Security Staff Salary	81,846	10,890
Incentive and publicity	20,212	52,122
Press	129,981	152,080
Electricity	47,385	44,953
Fuel	6,754	17,528
Postage and Telephone	28,021	13,589
Registration and Renewal	525	4,000
Professional Charges	64,200	84,000
Entertainment	34,917	49,919
Gardening and Beautification	36,376	45,228
Law Charges	1,780	-
Car Insurance	373	-
Puja Expenses	5,252	-
Raw Materials for Shola	31,500	-
Vivek Det Expense	42,653	-
Tiffin Expenses	37,500	-
Professional Tax	250	-
Donations	49,760	17,550
Contingencies	32,698	50,133
Utensils	-	1,946
Miscellaneous	-	3,630
	683,543	**598,755**

	2002 Rupees	2001 Rupees
16. Social Development Expenses		
Scholarship	13,885	7,062
Cultural Activities	148,955	30,826
Education	2,408	1,905
Supplementary Nutrition	17,113	16,918
Social Work & Relief	201,978	116,092
Road Development	-	196,889
Other Development	327,246	364,990
	711,585	**734,682**

VSSU can consider that future investments in local infrastructure, such as the construction of roads or schools, are investments in "goodwill assets," and therefore a balance sheet activity; the expense would then be amortized over a reasonable number of years, to avoid understating income in any one year.

17. Other Income

	2002 Rupees	2001 Rupees
Received		
Sale of Uddyan Card	1,800	23,850
Grants - WBSWAB	18,480	18,480
Grants - SIDBI	42,500	-
Donations	24,996	57,778
Ambulance/car Income	4,330	16,345
Drama	2,500	-
Guest House	7,363	-
Miscellaneous	15,764	8,557
Contribution of Local People	-	50,000
Advertisement	-	6,000
NEAC	-	350
	117,733	**181,360**
Receivable		
Grant (committed) from SIDBI	42,500	-
	160,233	**181,360**

Appendix

Terms of Reference (copied from ***MicroSave*** document)

MicroSave

Market-led solutions for financial services

Shelter Afrique House, Mamlaka Road
P.O. Box 76436, Yaya 00508, Nairobi, Kenya
Tel: 254 20 2724801 / 2724806
Fax: 254 20 2720133
Email: info@MicroSave.org
Website: www.MicroSave.org

Attachment A

Terms of Reference

For Innovative Approaches to Delivering MicroFinance Services

Specific Background

Much of the microfinance industry has been confined to pursuing Grameen Bank and FINCA models of delivering financial services. Indeed many commentators have come to regard the predominance of these models as a significant impediment to making progress towards offering financial services to poor people worldwide – not least of all since there is a growing body of evidence that these models have limited transferability to different socio-economic, geographic and demographic environments.

This series of studies looks at approaches to providing financial services that are not attempts to replicate Grameen Bank or FINCA models but use very different delivery mechanisms and systems designed to serve poor populations.

Systems/MFIs under consideration for study in the series are:

Managed ASCAs in Central Kenya

VSSU in India

SAGA Finance in Kenya

Equity Building Society in Kenya

CARE's MDD programme with ASCAs in Niger

Provident Financial in South Africa

Keys Matrix in South Africa

I. Description of the Required Services

The consultant will:

1. Study the operations and management systems of the MFI

- the existing level of client outreach and the profile of clients, in particular to assess the geographic location and socio-economic characteristics of existing users

the range of services provided and their relation to clients needs

the profitability of the organisations offering the service and of the MFIs themselves - in particular the way in which delinquency and default is managed

client satisfaction and the impact of the services being provided

- management and governance systems of the MFIs

2. To assess the opportunities and constraints facing:

- the improvement of products and services offered by the model and the organisational support that would be required to achieve this (including a SWOT analysis) and
- the replication of the MFI's system elsewhere

3. Share the findings of the fieldwork for each organisation with the management and staff of that organisation in a day-long workshop, which will feed back findings and undertake analysis of opportunities and constraints and consider organisational needs.

II. Duration and Timing

The work will take place in February – April 2002. The report is deliverable by 30th April 2002, but ideally before then.

III. Monitoring/Progress Control

The progress of implementation will be monitored by the ***MicroSave*** Programme Director.

IV. Definition of Expected Outputs/Results

The consultant will deliver the report (of maximum 30 pages with an executive summary of 2-4 pages) in Word 97/2000 format in Times New Roman 12pt with top, bottom and side margin settings of 0.8" and a left gutter setting of 0.2". The report will follow the outline attached as Annex A

Annex A

1. INTRODUCTION

1.1 The Context

1.2 The Local Financial Landscape

2. VSSU's MODEL

2.1 Products and Services

2.2 Organisational Structure: Ownership, Governance and Management

2.3 Administrative and Operating Systems

2.4 Financial Management

3. ANALYSING PERFORMANCE

3.1 Outreach: Breadth and Depth

3.2 Financial Performance

4. EXPLAINING PERFORMANCE

4.1 Clients' Perceptions of the MFI and its Services

4.2 Achievements of, and Challenges Facing the Model

5. CONCLUSIONS

5.1 Strengths and Weakness of the Model

5.2 Lessons for Mainstream MFIs

5.3 Recommendations for Donors