The Critical Success Factors for Microfinance Institutions in India

* Ms. Shagufta Sheikh

Abstract

Present study attempts to provide a deep understanding of factors contributing to financial success of micro-finance institutions (MFIs) in India and how MFIs in developing country might learn from the successful MFIs. It analyzes the financial performance of various microfinance institutions operating in India. Data has been collected and analyzed for 86 MFIs and a regression model is proposed. Results suggest that outreach, scale of operations and target market are the significant factors for success of MFIs. The practical implication of the study is for national/international development agent which wants to set up a sustainable MFI to assist the poor and alleviating poverty.

Key Words: Microfinance, Financial Performance, Success Factors.

INTRODUCTION

In a country like India, poverty remains to be one of the biggest policy concerns. Amongst various measures to eradicate it, Microfinance, of late, has provided a ray of hope. Both NABARD (National Agricultural and Rural Board of India) and the RBI (Reserve Bank of India) define microfinance as the "provision of thrift, credit and other financial services and products of very small amounts to the poor enabling them to raise their income levels and improve living standards" (NABARD, 2000; RBI, 1999). Two broad approaches characterise the microfinance sector in India — Self-Help Group (SHG)-bank Linkage (SBL) and Micro- Finance Institutions (MFIs). Speaking first of the SHG model, MFIs or banks render financial services to a group of 10-20 people (essentially women in Indian context) and the loan taken is collective liability of the entire group. Even if one member of the group defaults, the entire group is deemed to have defaulted. Under the SHG-bank linkage model, an NGO promotes a group and gets banks to extend loans to the group. SHGs are usually assisted by NGOs in initial periods to make them aware of the entire process. The second operating model which is widely used is the JLG (Joint Liability Group) model. In this model also the loans are lent to people who are the part of a group but unlike SHG model, here the liability rests with the individual who has taken the loan and not with the group as a whole. The most important example of MFI using JLG model is noble prize winning Grameen Bank of Bangladesh. The SBL used to be the larger model and is unique in India but internationally more established MFI model is the one that appears to be the increasingly favoured route. The problem with SBL is that it is largely a government "pushed" model and has, therefore, suffered from all the infirmities of any bureaucratic programme. All manner of government officials have been asked to form SHGs, including anganwadi workers and forest guards. These people have badly failed to do their jobs properly. As a result, the impressive figures of the fast growth of the SBL model hide a lot of poor quality work (Basu and Srivastava, 2005, p.1754). The other side of the problem is the attitude of bankers towards SHGs and partly because of bad experiences of poorly run SHGs owing to the bureaucratic insensitivity that characterises banking in India (both public and private). The newly emerging (and internationally more established) MFI model is a different ball-game altogether. Here the sponsor is a profit-oriented venture capitalist, who sees the rural

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* Research Scholar, Indian Institute of Management, Indore, Madhya Pradesh, India

credit market as a fresh business opportunity. The MFI apparently brings great professionalism, innovation and technology to its enterprise. It also ventures to provide loans that banks do not. MFIs differ according to their type (NGOs, cooperatives, non banking financial institutions, banks), their status (regulated or non regulated), their activities (systems of savings and credit, direct credit institutions, development projects including credit), their methods (group lending, individual loans, dynamic incentives) and their sources of financing (resources from deposits or external financing) etc. In this way there is a lot of scope for MFIs to choose the suitable business model according to the customer requirements.

STATUS OF MICROFINANCE IN INDIA

The NABARD's report on Status of Micro Finance in India 2009-2010 discusses the overall progress under the two models mentioned above:

(INSERT TABLE 1 HERE)

The report shows that during last years total loan distributed to MFIs have significantly increased but at the same time the bank loan outstanding with MFIs have also increased. The report clearly indicates that MFI model is becoming more and more popular in India also. The loan distributed to SHGs has declined gradually indicating the loss of confidence among investors in this model.

In numerous studies done across the world, it was generally believed that various microfinance initiatives have been able to make a difference in the target population's lives. However, increasing doubts have been raised over the financial sustainability of microfinance institutions (Annim, 2009; Reddy, 2005). MFIs need to be economically viable and sustainable in the long run but economic implications of long term sustainability are not being considered (Srinivasan et al., 2006). At least in India, there does not seem to be any working model of analyzing the financial performance and thereby sustainability of microfinance institutions. This problem is compounded by the absence of a dedicated legislation on working and management of microfinance institutions. The lack of a regulatory

mechanism for financial disclosures by microfinance institutions also abets the problem. Morduch (1999) as cited by Crabb (2008) describes the need for more empirical work on the sustainability of MFIs. He pointed out, Empirical understandings of microfinance will also be aided by studies that quantify the roles of the various mechanisms in driving microfinance performance. In this context, present study attempts to analyze and compare the financial performance of the MFIs. It is imperative that good financial performance will also lead to sustainability of the MFI.

The remaining structure of the paper is as follows. Section II presents the studies on same topic and brief review of them. Section III discusses data and the methodology of sample selection process. Section IV covers the findings and the analysis of the performance of successful versus unsuccessful MFIs. Section V concludes the paper and offers future research directions.

LITERATURE REVIEW

In the context of MFIs literature (Venkata; 2011, Thapa; 2011) shows that governance is a major influencing factor. Amarnath Samarapally and Scott Gaul (2011) in their review of RBI's microfinance framework discussed the Reserve Bank of India's (RBI) new regulations for microfinance providers, based on the conclusions of the Malegam Committee[1]. According to one of the main components of the regulation, "banks should ensure a margin cap of 12 per cent and an interest rate cap of 26 per cent for their lending to be eligible to be classified as priority sector loans." When one examines the sector as a whole, the data suggests that MFIs have been well within the prescribed 26 percent interest rate levels, although margins have crept 1 - 2 percent higher than what RBI has mandated (as in the chart below).

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[1]The Reserve Bank of India has appointed the Malegam Committee to regulate microfinance institutions (MFIs). This committee examined major issues such as reported suicides by borrowers in Andhra Pradesh, crass overlending (many borrowers have up to 10 simultaneous loans from different MFIs), high interest rates (typically 30% or more) and coercive recovery methods.
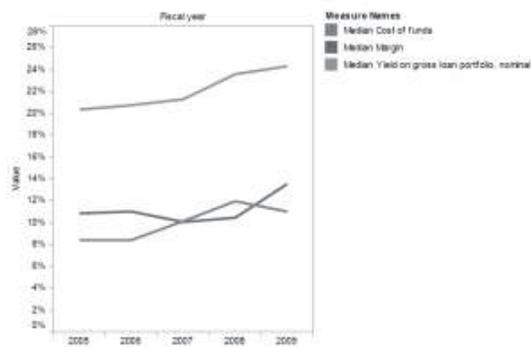
Source: Amarnath Samarapally, Scott Gaul (2011)

Practitioners have expressed concerns that small MFIs will not be able to meet the regulations. It should come as no surprise that large MFIs generally have access to cheaper funds than small MFIs, although there is little difference overall. Large and small MFIs have both increased lending rates, although lending rates have been higher for large MFIs. Consequently, large MFIs have earned higher profit margins than small MFIs and will thus be more affected by the new regulations. The following chart compare yield, cost of funds and margin metrics for small and large MFIs:
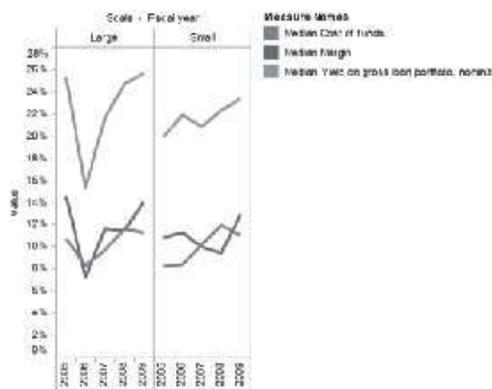
Source: Amarnath Samarapally, Scott Gaul (2011)

Marion Mbogo and Caroline Ashika (2011) investigated the factors that influence product innovation in microfinance institutions, including the legal environment, competitive pressure and organizational factors such as leverage, liquidity and risk management challenges, distribution and human resource challenges.

Analysis of the data confirmed that legal environment, competitive pressure and liquidity and risk management challenges are important in influencing MFI innovation. Lack of leverage and risk management are negatively correlated with product innovation which was agreed by Alarcon (2008), Moussa (2007), and Brugger (2004) who confirmed that limited sources of finance and high costs of doing business hinder product innovation. Liquidity management and human resource challenges are positively correlated with product innovation and agreed by Deshpande (2007) and Gupta (2008), who respectively argued that higher standards of liquidity management are required to ensure safety of liquid deposits and that MFIs require to have leaders with vision and managerial capacity.

Pankaj K. Agarwal and S.K. Sinha (2010) concluded that most of the best performing firms are following different business models in India. They seem to be following their own time tested way of doing business which has sustained itself over the years. However the managerial capability as reflected in productivity parameters is different as it is possible that management of different MFIs are at different stages of the learning curve. The limitation of the study is that it has been conducted on the 5-star rated (rated by mixmarket.org, on the basis of level of disclosure) performers. This is possible that the similarities observed in various parameters emanates from their belonging to the elite group of firms with strong ethics of disclosure.

Purna Chandra Parida and Anushree Sinha (2010) survey results on performance of SHGs suggested that all-female SHGs perform better than other types of SHGs. All-female SHGs reportedly have higher rates of savings per member than other types of SHGs. They also reported better performance in terms of loan recovery. The all-female SHGs were sustainable because they were more focused and united, adhere to basic objectives of groups, utilized borrowed funds for different productive activities, and were highly concerned about the well-being of their children and family members. Further, female SHG members took membership in the group as a means to educate themselves and confront social, political, and economic problems. On the other hand, members of all-male SHGs have ego problems, work for their own interest, and do not follow the basic objectives

and goals of group formation. As a result, they are most irregular in loan repayments and perform badly in economic and managerial activities.

Rubach, Michael J., Bradley, Don B., III and Brown, Justin Eric (2010) having experience of operations of MFIs in Iraq and the US conclude that it supports the theory that a factor in the success of microlending is the presence of free markets (Crabb, 2008). Despite the prior lack of government interest and support for microlending in the US, government support for microlending in Iraq stands in sharp contrast. Structural differences in markets are not the only answer. US regulation of financial lending institutions severely restricts microlending. The need for regulatory reform is great (Robertson, 2009). The current recession should provide opportunities for microlenders as the declines in the job market have forced many laid-off individuals to seek self-employment as a solution. However, the operational and regulatory structures of the US MFI industry have impeded its efficiency and effectiveness.

Christian Ahlin, Jocelyn Lin and Michael Maio(2009) presented evidence for complementarity between MFI performance and the broader economy. For example, MFIs are more likely to cover costs when growth is stronger; and MFIs in financially deeper economies have lower default and operating costs, and charge lower interest rates. There is also evidence suggesting substitutability or rivalry. For example, more manufacturing and higher workforce participation are associated with slower growth in MFI outreach. Overall, the country context appears to be an important determinant of MFI performance; MFI performance should be handicapped for the environment in which it was achieved.

Joséphat Mboya Kiweu (2009) in modelling the various relationships of the 33 predictors with success in commercialisation found support for the hypothesis that any MFI's mission and its overall sustainability (profitability and liquidity) strategy, growth prospects coupled with adequate disclosure of financial reports is associated with successful commercialisation. Association among economic and social variables will play a minimal role in differentiating who gets funded and who does not attract commercial capital. The results suggest that investors and funding agencies will value superior earnings on invested capital in the microfinance industry and prefer MFIs that operate in an environment which supports growth opportunities and low inflation trends.

Samuel Kobina Annim (2009) found that Institutional character based on regulation and source of funds both had a significant and hefty impact on household poverty scores. Characterisation based on regulation and licensing (formal) showed an effect of reaching extremely poor clients by 1.765 in the case of a formal MFI. On the other hand, categorising institutions based on source of funds showed that institutional funding reached less poor clients. Both observations were consistent with a priori expectations; as in the case of the latter, the general expectation was that institutions tend to be much more circumspect in dispensing their own mobilised funds relative to government and donor funding.

Petra Dacheva (2007) proved that there is no association between the commercialization factors and loans sizes. The exception, and a very interesting finding, was the significance of women borrowers as predictors of loans size. There is negative correlation that suggests – the bigger percentage of women borrowers in a microfinance institution, the smaller the average loan size per borrower.

Rusdy Hartungi (2007) in his case based article investigating the success factors contributing to a micro-finance institution (MFI) in a developing country, e.g. Bank Rakyat Indonesia (BRI) found one of the factors contributes to the success of BRI is the decision to keep adapting its practice with environmental changing. Also BRI is very innovative in choosing collaterals, so on one hand, the credit is still interesting for lower class community, but at the same time they work as compensation in case the clients fail to repay their credit and thus ensuring the sustainability of the MFI. Well-trained and dedicated staffs operating a simple, transparent system, clear incentives to staffs and clients, tight internal supervision and audit capacities and financial procedures and sound financial risk management contributes to its success as well.

Imène Berguiga (2007) talked about determinants of a profitable institution. Generally speaking, for an institution to be profitable over one period, its resources should at least cover its expenditure. A transaction will take place through a process of identification, meeting and negotiation between the partners that are concerned (Howitt, 1985). Thus it generates costs, which should be specified according to their nature and origin (Diamond, 1987). Some MFIs increase progressively the number of agents with the increase of customers and the opening of local agencies, without evaluating beforehand short and medium term profitability of their operations (Lelart, 2006). MFIs need to be financially autonomous by carrying out a financial margin i.e. a sufficient positive differential between the rate paid by MFIs to access funds and the rate earned on loans, so as to cover both direct and indirect costs related to the activity (Labie, 1996). The debtor interest rates must be generally established in order to allow the supply of long lasting financial services to a very great number of customers. However, these debtor rates are criticized on the grounds of the capacity of poor to meet such levels. It shrinks profits and investment, and thus the activity of micro-entrepreneurs (Acclassato, 2006). Raising the interest rate is not the best strategy to reach financial balance: It can be achieved by lowering the interest rate and by adopting other possibilities provided by microfinance such as an effective management of subsidies, a re-incorporation of output returns in own capital stocks and good governance (Hamed, 2004).

Christian Ahlin and Jocelyn Lin (2006) conclude that growth has a significant and salutary impact on MFI performance, both in terms of financial sustainability and default rates. However, the degree of formalization and industrialization of the economy appears to adversely affect MFI's, particularly their rate of growth in outreach. Additional tests hints negative effect from inflation and that growth affects the ability to cover costs, not just to paid profit margins; and reverse causality is an unlikely explanation for the growth effect. Overall, the results suggest that the macroeconomy is an important determinant of MFI performance, though not more than institution-specific factors. MFI performance should be handicapped for the macroeconomic environment in which it was achieved.

Peter R. Crabb (2006) diagnosed at the relationship between the success of microfinance institutions and the degree of economic freedom in their host countries. Many microfinance institutions are currently not self-sustaining and research suggests that the economic environment in which the institution operates is an important factor in the ability of the institution to reach this goal, furthering its mission of outreach to the poor. The sustainability of the microlending institutions is analyzed here using a large cross-section of institutions and countries. The results show that microfinance institutions operate primarily in countries with a relatively low degree of overall economic freedom and that various economic policy factors are important to its sustainability.

Rajesh Chakrabarti (2004) found that the state-wise distribution of SHGs linked with banks shows considerable variation in the share of total SHGs. Andhra Pradesh has a disproportionately large share of over 42% of all linked SHGs. Tamil Nadu and Uttar Pradesh (including Uttaranchal) follow with about 12% and 11% share respectively. Karnataka come next with about 9%. The rest of country thus accounts for about a quarter of the total SHGs combined. From an all-India perspective the SHG-bank linkage experience has been very strongly biased towards the South and has not provided a balanced access to credit facility for the poor in India.

Hassan Zaman (2004) suggested that strategic donor investments in a handful of well-managed institutions that offers simple, easily-replicable financial product could lead to large gains in access to finance for the poor. However, this approach could sacrifice other objectives of financial sector development, such as product and institutional diversity, which could be promoted after the initial expansion has taken place. Governments can also have a crucial role in promoting access to microfinance by ensuring macro-economic stability, enforcing a simple regulatory structure and developing communication networks that reduce transaction costs. Another lesson is that while visionary leadership cannot simply be franchised, the internal management systems that led to the scaling up can be replicated in other settings.

Jonathan Morduch and Stuart Rutherford (2003) talked about the lessons from Bangladesh and Indonesia that provide guidelines as to what better solutions should look like. Necessary steps include: raising interest rates well above "cheap credit" levels (no matter what one's view on subsidy); clear targeting customer groups (whether by product design, location, or explicit eligibility criteria); judiciously providing (or not providing) non-financial inputs; and managing and rewarding staff according to clear, performance-based criteria. Creating diverse, responsive institutions will also mean avoiding an exclusive focus on credit, or on "microenterprise credit", or on group-based solutions.

Richard h. Patten, Jay K. Rosengard and Don E. Johnston, Jr. (2001) discussed the success factors of Bank Raykat Indonesia during the East Asian crisis. The performance of the BRI units during the East Asian crisis demonstrates quite dramatically essential features in the design of a sustainable microfinance institution; ability to repay, willingness to repay and willingness to save. The organization must design loan delivery systems that are adapted to local market conditions and clientele, in order to identify market opportunities, cope with market failures, and distinguish fair cases of customer inability to repay versus unwillingness to repay. Development of a long-term banking relationship with borrowers, characterized by mutual respect and adherence to pre-agreed loan terms and conditions is also necessary. Savings products that offer security, access, and a fair return, gives customers both a financial cushion during hard times, and an incentive to keep their funds in the bank during periods of economic uncertainty. Products that differentiate between "savings" and "investments," passbook accounts versus time deposits. Savings tend to be relatively stable and long-term, and are used primarily for lumpy payments or family emergencies; investments are usually more volatile, speculative, and "hot," and chase the highest short-term return.

Ruth Goodwin-Groen (1998) based on their research, and corroborated by other studies, found following to be key success factors for microfinance in commercial banks:
* Create a small specialised bank or a separate microfinance unit within a large commercial bank.
* Treat savings as equally important to lending.
* Charge interest rates to cover all the costs of the lending products.
* Ensure excellent MIS and portfolio management.
* Recruit staff from outside the bank and/or give staff specialist training.
* Find a champion or visionary who will see the program through to success.

Piyush Tiwari and S.M. Fahad in HDFC's concept paper also raise the issue of Microfinance institutions versus business-like NGOs that can offer commercial banks ways of funding microentrepreneurs at low cost and risk. There are many on-going researches on this line but context specific research is needed to identify the most appropriate model. In this context, following institutional issues related to micro-finance arise.

* Is there a need for a new institution?
* Should it operate all India or in a state?
* Where should it be located?
* Who can lead an institution of this sort?
* What will its contextual interconnections be?
* Who will be its beneficiaries?

Some valuable lessons can be drawn from the experience of successful Microfinance operation. Deposit mobilization is the major means for microfinance institutions to expand outreach by leveraging equity (Sacay et al 1996). In order to be sustainable, microfinance lending should be grounded on market principles because large scale lending cannot be accomplished through subsidies. The challenge lies in finding the level of flexibility in the credit instrument that could make it match the multiple credit requirements of the low income borrowers without imposing unbearably high cost of monitoring its end-use upon the lenders. A promising solution is to provide multi-purpose loans or composite credit for income generation, housing improvement and consumption support.

M. S. Sriram and Rajesh S. Upadhyayula (2002) examined five significant issues that trigger the transformation of NGOs into MFOs: Size, Diversity, Sustainability, Focus and Taxation.

Transformation experiences in India are few. To move to the mainstream, non-governmental organizations

(NGOs) choose from three popular forms of organizations: non-banking finance companies (NBFCs), banks, and cooperatives. It appears that there is no ideal path for spin-off. Regulatory changes are needed to allow MFOs to graduate to other legal forms as they grow organically. NGOs must be permitted to invest in the equity of MFOs, as is the case in Bolivia and Africa. Norms for setting up MFOs under current legal forms should not be eased. Regulations should ensure that they help genuine MFOs and not others masquerading as MFOs.

Literature shows that there is some work done exploring the success factors of MFIs, however it still needs to be understood why a particular MFI is performing better and getting more benefits out of financial outreach than others. Sustainability of MFIs is critical because many MFIs are unable to keep on functioning in the long term. Some of the factors causing this are mismanagement of money borrowed from the bank and lack of accountability and commitment toward expanding the group activities. On the basis of literature, some factors determining the success of MFIs were found to be; location, financial intermediation, profit status, regulation, age, scale, administrative expenses, staff payment, lending only or deposits as well, women borrowers, lending technique (individual /collective), outreach, targeting to poor only or broad customer base, source of funding etc. In this paper we are trying to explore whether these factors are really success determinants of MFIs in India and collectively upto which extent they contribute into success of a MFI. The paper explores these critical issues of MFIs from a holistic perspective, and identifies best practices to help in improving MFIs sustainability.

DATA AND METHODOLOGY

Data Collection

Meyer (2002) indicated measuring financial sustainability requires that MFIs maintain good financial accounts and follow recognized accounting practices that provide full transparency for income, expenses, loan recovery, and potential losses. One of the biggest problems in conducting this kind of study with MFIs in India is for the need of mandatory disclosure requirements and lack of dedicated legislation governing MFIs; it is very difficult to get reliable and actionable data on the financials. The data used for this study is purely secondary taken from the MIX Market Inc. website (www.mixmarket.org) and from the websites of the microfinance institutions. The Mix Market is a not-for profit initiative that works for the dissemination of information among the MFIs institutions. It provides information to sector actors and the public at large on Microfinance Institutions (MFIs) worldwide, public and private funds that invest in microfinance, MFI networks, raters/external evaluators, advisory firms, and governmental and regulatory agencies.

Sample Selection

The data reported by the MFIs is irregular, moreover most of them have reported from 2001 onwards. I have used 2009 data for the purpose of analysis because maximum MFIs reporting were seen for this year. Even if the data has some missing points, I left it as it is because in averaging, SPSS will take care of the missed data. There are in total 141 MFIs currently reporting to Mix Market in India. For year 2009 total number of MFIs reporting comes out to be 86. The data for location, lending technique and sources of fund have been collected from the websites of these 86 MFIs.

Methodology

The financial overall performance of 86 MFIs have been compared to capture the holistic picture. It covers three ratios viz. Return on Assets, Return on Equity and Operational Self-Sufficiency. I have used Return on Assets as a proxy for capturing the overall success of MFIs. On the basis of literature the factors determining the success of MFIs were location, financial intermediation, profit status, regulation, age, scale, administrative expenses, staff payment, lending only or deposits as well, women borrowers, lending technique (individual/collective), outreach, targeting to poor only or broad customer base and source of funding etc. Outreach here is defined by CGAP, 2003 (loan size/GNIpc). These variables were operationalized as follows:

(INSERT TABLE 2 HERE)

For staff pay and administrative expenses the benchmark values 1.74 and 4.44% respectively are considered as mean values and on this basis, successful and poor performing MFIs have been classified in groups. The methodology used is difference of means test for the purpose of comparing the performance of the star and poor performers. After this, Linear Regression is used to propose a model for success of MFIs.

FINDINGS AND ANALYSIS

The difference of means t-test has been performed on legal status, profit status, administrative expenses, staff pay, deposits taking, regulation, sustainability, target market and women borrowers. The test shows following results:

(INSERT TABLE 3 HERE)

The Analysis of Variance tests at 95% confidence interval for financial intermediation, age, scale, source of fund, lending technique, outreach and location shows following results:

(INSERT TABLE 4 HERE)

The results show that target market, scale and outreach are the significant factors at 5% confidence level. On the basis of these results I regress this model for the profitability of a microfinance institution:

ROA= a + b1 target market + b2 scale + b3 outreach + e .... (I)

The multiple regression gives following results:

ROA= -0.371 - 0.055 target market + 0.11 scale – 0.229 outreach ....(II)

The F-value of the model comes out to be 14.166 with a significance value of 0.002. The R^2 is 0.413 with an adjusted R^2 of 0.374. The results show that overall the model is significant in explaining the profitability of the microfinance institution.

DISCUSSION

Operational self-sufficiency is the desired factor for the success of microfinance institutions, relying on subsidies and grants makes them handicap. Also, they have to follow the instructions of the donating bodies which brings the inefficiency in the organization. Theoretically, the effect of subsidies on the efficiency of microfinance can be positive and negative. The arguments for negative impact on subsidies rest on the effects of soft budget constraints where donor funded bailouts of poorly performing MFIs reduce the incentive for cost cutting and hence decrease the efficiency (Dewatripont and Maskin, 1995; Kornai et al., 2003). Moreover, the moral hazard argument where staff of the MFIs takes advantage of the lack of costly monitoring by donors to shirk, gather perks or extract wage rent. Thus, it results in decreased efficiency due to higher costs. On the other hand, subsidies may contribute to efficiency by increasing opportunities for the MFIs to invest in capacity building, develop and expand the infrastructure and quality of services. However in this study, we did not found any significant impact of funding source on performance of MFIs. This also might be because the sample consists of the companies having a mixed source of financing viz. Grants and equity, grants and loan, loan and equity etc. This might have balanced the individual effect of a particular funding source.

The effect of subsidization on the staff cost ultimately impacts staff productivity. That effect relates to the impact of subsidization on the incentives for effort and innovation by managers and staff, as well as availability of funds to finance key investment on human resource and physical assets (Hudon and Traca, 2008). Hence, the staff pay as measured by average salary GNI per capita also acts as a predictor of profitability of microfinance institution. Generally, people working with MFIs have a dedication to serve the society though they also need pay for performance however the study does not find any significant difference in the profitability on the basis of staff pay.

The results also lend support to the trade off between outreach and productivity. Here, Lower outreach (increase in the loan size) is associated with lower staff productivity because fewer clients can afford to borrow larger loans and in return clients demand higher attention and better level of services from the institution which also results in higher costs as well. Also, as expected the results suggest the scale benefits for MFIs

also. In agree with Samarapally and Gaul (2011) the ROA will be more for large scale MFIs. The learning effect and capability to cope with changing legislation accounts for the success of MFIs, as Hartungi (2007) also pointed about the adaptability of the institution with the changing environment was the key success factor for the Bank Indonesia.

CONCLUSION

This article aims at contributing in the ongoing debate on the sustainability issues in microfinance in the wake of increasing commercialization. The empirical evidence lends support to the importance of efficiency in determining the profitability of microfinance Institutions. On the social efficiency front, delivering credit to the poor in small sizes tend to be costly with higher transaction cost. Thus, indues MFIs to charge higher interest rates to poor borrowers with small loan sizes. From the financial efficiency perspective, increase in both the administrative cost and cost of acquiring loanable funds induce MFIs to raise interest rates on loans to the borrowers. On the other hand, increase in the administrative cost reduces the profitabilty. Further, the regression results supports the trade off between sustainability and outreach, where lending in small loan sizes (greater outreach) to relatively more poor borrowers leads to an increase in the profitability and sustainability of MFIs with lowering the subsidy dependence and increasing the ROA. However, lending to women borrowers does not explain any variation in the profitability of MFI. The evidence about the determinants of efficiency and productivity of microfinance are by and large, in line with the theory. The fact that more the MFIs cater to well off clients with large loan sizes, the more their costs rise, suggests that MFIs having customers with larger loans require better and high level of services.

The findings in this paper have policy implications and there are lessons to be learned for those having stake in microfinance. It is high time for practitioners and social investors to realize that cost efficiencies as a result of good governance and management can significantly contribute towards expanding the outreach to poor. Whereas, lending to well off clients in larger loan sizes, and thus gradually deviating from their social mission in

anticipation of reaping exorbitant profits, can not guarantee profitability because it ultimately leads to the increase in costs. Resultantly MFI´s subsidy dependence increases and the Return on Asset (ROA) declines. Policies and training related to small scale income generating activities and enterprise development which in the long run can contribute to profitability of lending to women should be encouraged. This will help in increasing the profitability of MFI.

The sustainability of MFI requires not only financial viability but also a clear strategic vision and an organization that is transparent, efficient, and accepted by all the stakeholders. There is a need of continuously innovating new institutional models of MFIs which can reach the rural poor in a sustainable manner.

LIMITATIONS AND FUTURE RESEARCH DIRECTION

The paper discusses the influence of various organizational factors on the success of MFIs. However, future researchers can think upon incorporating some more factors such as; level of competition, deposit deepening, importance of nonfinancial products, or business strategies for microfinance operations (i.e., downscaling, upscaling, etc.).

The issue further can be dealt with more dynamic approach, in which changes in the unit of analysis should be assessed over time (3 or 5 years), as Schreiner suggests (2001, pp. 22). This type of analysis would be more useful in understanding MFIs' operations. Since, the results with one year data can be biased due to some economical and other company specific events therefore, a panel data analysis can be done for analyzing MFIs performance across years.

Literature also suggests that governance and government policies have significant impact over the performance of MFIs therefore the scenario can also be studied across countries and country-specific factors such as-governance and other macroeconomic policy factors can be incorporated in the model.

Finally, the ultimate objective of any MFI is serving the society therefore not only financial but also social performance of the MFIs matters. In the long run,

sustainability must be supplemented by some social performance. It can be interesting to see if the financial performance of MFI gets translated into its social performance and what can be the suitable indicators of the social performance. Earlier studies have also shown the departure of financial performance from social performance and prove the concept of microfinance schism.

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Table: 1- Overall growth under Micro-finance during the last three years

Particulars		2007-08		2008-09		% Growth (2008-09)		2009-10		% Growth (2009-10)	
		No. of SHGs	Amount	No. of SHGs	Amount	No. of SHGs	Amt.	No. of SHGs	Amount	No. of SHGs	Amt.
A. SHG - Bank linkage Model											
Savings of SHGs with banks	Total SHGs	5009794	3785.39	6121147	5545.62	22.2	46.5	6953250	6 198.71	13.6	11.8
	Out of SGSY	1203070	809.51	1505581	1563.38	25.1	93.1	1693910	12 92.62	12.5	(17.3)
Bank loans distributed to SHGs	Total SHGs	1227770	8849.26	1609586	12253.51	31.1	38.5	1586822	14453.30	(1.4)	17.9
	Out of SGSY	246649	1857.74	264653	2015.22	7.3	8.5	267403	2198.0 0	1.0	9.1
Bank Loans Outstanding With SHGs	Total SHGs	3625941	16999.91	4224338	22679.84	16.5	33.4	4851356	28038.28	14.8	23.6
	Out of SGSY	916978	4816.87	976887	5861.72	6.5	21.7	1245394	6251 .08	27.5	6.6

B. MFI - Bank linkage Model

Particulars	2007-08		2008-09		% Growth (2008-09)		2009-10		% Growth (2009-10)	
	No. of MFIs	Amount	No. of MFIs	Amount	No. of MFIs %	Amt %.	No. of MFIs	Amount	No. of MFIs (%)	Amt. %
Bank loans distributed to MFIs	518	1970.15	581	3732.33	12.2	89.4	691	8062.74	18.9	116.0
Bank Loans outstanding with MFIs	1109	2748.84	1915	5009.09	72.7	82.2	1513	10147.54	(21)	102.6

Table 2: Variable Description

Variable	Indicator
Profitability	Return on Assets
Administrative cost	Administrative expense/ assets
Staff payment	Average salary/ GNI per capita
Lending only or Deposits as well	Deposits to loans (zero or otherwise)
Location	South, East, West, North
Financial Intermediation	Non-FI, Low-FI, High-FI
Profit status	Profit, Non-profit
Regulation	Regulated or Non-regulated
Age	New, Young, Mature
Scale	Small, Medium, Large
Women borrowers	Percent of women borrowers (100% or less)
Outreach	loan size/GNIpc (Small, Medium, Large)
Targeting poor only or broad customer base	Target Market (Low end or Broad)
Lending Technique	Individual, Group, Individual & group
Source of funds	Loan, Equity, Savings, Grants

Table 3: t-test results for selected variables

Factor	T-value	Significance (at 5% level)
Legal Status	0.681	0.498
Profit Status	0.300	0.765
Administrative expense/ assets	2.567	0.012
Average salary/ GNI per capita	0.071	0.944
Deposits to loans	1.842	0.069
Regulation	1.673	0.098
Percent of Women borrowers	0.129	0.898
Target Market	2.818**	0.007**

Table 4: F-test results for categorical variables

Factor	F-Value	Significance (at 5% level)
Financial Intermediation	1.829	0.167
Age	1.374	0.257
Scale	5.547**	0.006**
Outreach	5.381**	0.006**
Location	0.759	0.555
Source of fund	0.249	0.992
Lending Technique	0.325	0.807

Appendix (Data table for Sample MFIs for the year 2009)

S. No.	MFI name	lending technique	source of fund	Head Office	Financial Intermedi ation	Outreach	Sustainab ility	Target Market	Average salary/ GNI per capita	Deposits to loans	Percent of women borrowers	Return on assets	Administr ative expense/ assets	Return on equity	Profit status	Regulated	Age	Scale
1	Adhikar	group	grant, equity	Orrisa	Non FI	Large	OSS	Low end	1.67	-	1	0.0266	0.0347	0.2651	Profit	yes	Mature	Large
2	AML	both	loan, equity	AP	Non FI	Large	OSS	Broad	2.91	-	1	0.0431	0.0192	0.4007	Profit	yes	Mature	Large
3	Arohan	both	loan, equity	KOLKATA	Non FI	Large	OSS	Low end	2.05	-	0.9294	0.0201	0.0502	0.1301	Profit	yes	Young	Large
4	ASA India	both	equity	KOLKATA	Low FI	Large	OSS	Low end	1.24	0.13	0.9964	0.0545	0.0322	0.1195	Profit	yes	New	Large
5	Asirvad	group	grant, loan	CHENNAI	Non FI	Large	OSS	Large	2.23	-	1	0.074	0.0497	0.282	Profit	yes	New	Large
6	Asomi	both	grant, loan	ASSAM	Low FI	Large	Non-OSS	Low end	1.41	0.25	0.9734	-0.0165	0.1272	-0.0304	Profit	yes	Mature	Medium
7	AWS	group	loan	AP	Low FI	Medium	OSS	Low end	6.09	0.02	1	0.0037	0.0059	0.0266	Non-profit	no	Mature	Medium
8	Bandhan	NA	loan	KOLKATA	Low FI	Large	OSS	Low end	1.32	0.16	1	0.0352	0.0169	0.3821	Profit	yes	Young	Large
9	BASIX	group	loan, equity	AP	Low FI	Large	OSS	Low end	1.57	0.17	0.6636	0.0312	0.0631	0.2329	Profit	yes	Mature	Large
10	BFL	group	loan	TAMILNADU	Non FI	Large	OSS	Low end	1.26	-	0.85	0.0097	0.0144	0.072	Profit	yes	Mature	Large
11	BISWA	group	grant, loan	Orrisa	Non FI	Large	OSS	Low end	0.05	-	0.9885	0.0558	0.0388	0.2881	Non-profit	no	Mature	Large
12	BJS	NA	loan	KOLKATA	Non FI	Small	OSS	Low end	1.56	-	1	0.0156	0.0687	0.3527	Non-profit	no	Young	Small
13	BWDC	group	grant, loan	TAMILNADU	Low FI	Medium	OSS	Low end	1.19	0.18	0.9791	0.031	0.0186	0.3337	Non-profit	yes	Mature	Small
14	Cashpor MC	NA	grant, loan, e	VARANASI	Non FI	Large	OSS	Low end	2.25	-	1	0.0399	0.0368	1.4703	Non-profit	no	Mature	Large
15	Chaitanya	group	NA	KARNATAKA	Non FI	Small	Non-OSS	Low end		-	0.997	-0.1113	0.1389	-0.1141	Profit	yes	New	Small
16	CReSA	NA	loan	AP	Non FI	Large	OSS	Low end	2.2	-	1	0.0154	0.0493	0.0909	Profit	yes	Mature	Medium
17	Disha	NA	grant, loan, e	SAHARANPUR	Non FI	Small	Non-OSS	Low end	1.35	-	0.9776	-0.0327	0.0911	-0.3796	Non-profit	no	Young	Small
18	Equitas	group	loan, equity	TAMILNADU	Non FI	Large	OSS	Low end	3.75	-	1	0.045	0.0292	0.1238	Profit	yes	New	Large
19	ESAF	group	grant, loan, e	KERALA	Non FI	Large	OSS	Low end	1.75	-	0.9922	0.0025	0.0462	0.0144	Non-profit	no	Mature	Large
20	FFSL	group	loan	AP	Non FI	Large	OSS	Broad	2.54	-	1	0.0704	0.0143	0.4577	Profit	yes	Mature	Large
21	GK	NA	NA		Non FI	Large	OSS	Broad	2.32	-	0.9939	0.004	0.0539	0.0256	Profit	yes	Mature	Large
22	Grameen Sahar	NA	NA	ASSAM		Small		Low end										Small
23	GSGSK	group	loan	KERALA	Non FI	Large	Non-OSS	Low end		-	0.4002	-0.0044	0.0079	-0.0647	Non-profit	yes	Mature	Medium
24	GTFS	group	loan	AP	Non FI	Small	OSS	Low end		-	1	0.0044	0.0886	0.0156	Profit	yes	New	Small
25	GU	group	grant, loan	Orrisa	High FI	Large	OSS	Low end	1.28	0.44	1	0.0016	0.0181	0.0368	Non-profit	no	Mature	Large
26	GV	NA	NA		Non FI	Large	OSS	Low end	2.79	-	1	0.0365	0.0453	0.2547	Profit	yes	Mature	Large
27	HIH	group	grant, loan	TAMILNADU	Non FI	Large	Non-OSS	Low end	0.98	-	1	-0.3372	0.2141	-1.1541	Non-profit	yes	Young	Large
28	ICNW	group	grant, loan, sa	TAMILNADU	High FI	Large	OSS	Low end		0.52	1	0.0243	0.0558	0.0683	Non-profit	yes	Mature	Medium
29	India's Capital T	individual	loan	DELHI	Non FI	Medium	OSS	Low end	2.04	-	1	0.0184	0.1297	0.0308	Profit	yes	New	Medium
30	Indur MACS	NA	loan	HYDERABAD	Non FI	Medium	Non-OSS	Low end	1.74	-	1	-0.0076	0.0106	-0.0455	Non-profit	no	Mature	Medium
31	Initiatives for DI	NA	NA		Non FI	Large	OSS	Low end	0.52	-	0.9997	0.0293	0.0391	0.1576	Profit	yes	Mature	Large
32	Janalakshmi	both	loan, equity	KARNATAKA	Low FI	Large	Non-OSS	Low end		0.13	1	-0.0305	0.077	-0.0874	Profit	yes	New	Large
33	Janodaya	NA	grant, loan, sa	KARNATAKA	Non FI	Small	OSS	Low end	1.64	-	0.9978	0.0087	0.0486	0.0724	Non-profit	no	Mature	Small
34	KAS	NA	NA		Low FI	Large	OSS	Low end		0.11	0.6758	0.0056	0.024	0.0714	Non-profit	no	Young	Medium
35	KBSLAB	both	loan, saving, e	AP	High FI	Large	OSS	Broad	3.14	0.95	0.5805	0.0112	0.0444	0.1041	Profit	yes	Mature	Large
36	KOPSA	NA	loan	KARNATAKA	Non FI	Small	Non-OSS	Low end	2.11	-	1	-0.3856	0.104	-0.5496	Non-profit	yes	Mature	Small
37	Kotalipara	NA	grant, loan	KOLKATA	High FI	Large	OSS	Low end		0.26	1	0.0941	0.0518	0.5479	Non-profit	no	Mature	Medium
38	Mahasemam -	group	grant, loan, sa	TAMILNADU	High FI	Large	OSS	Low end	3.1	0.37	1	0.0078	0.1508	0.1054	Profit	yes	Mature	Large
39	Mahashakti	both	loan	KALAHANDI	Low FI	Medium	OSS	Low end	1.32	0.02	0.9792	0.003	0.0262	0.0448	Non-profit	no	Young	Medium
40	MFI	NA	NA		Non FI	Large	OSS	Low end	0.25	-	1	0.0441	0.0111	0.1589	Profit	yes	Young	Large
41	Mimo Finance	both	loan, equity	DELHI	Non FI	Large	OSS	Low end	2.82	-	0.9949	0.0136	0.0493	0.0814	Profit	yes	New	Medium
42	Nano	NA	loan	AP	Non FI	Small	OSS	Broad		-	1	0.0631	0.0974	0.099	Profit	yes	Mature	Medium
43	NBJK	group	grant, loan	JHARKHAND	Low FI	Small	OSS	Low end	1.8	0.13	0.7879	0.0777	0.0158	0.1381	Non-profit	no	Mature	Small
44	NCS	group	loan	KARNATAKA	Non FI	Small	OSS	Low end	2.18	-	1	0.0178	0.0569	0.7527	Non-profit	no	New	Small
45	NEED	group	grant, loan	UP	Low FI	Large	OSS	Low end	1.74	0.17	0.866	0.0247	0.0308	0.2372	Non-profit	no	Young	Medium
46	Nidan	both	grant, loan	BIHAR	Non FI	Small	Non-OSS	Low end	0	-	0.9596	-0.014	0.0051	-0.1194	Non-profit	no	Mature	Small
47	Pushtikar	NA	loan, saving, e	RAJASTHAN	High FI	Small	OSS	High end	0.21	0.89	0.2206	0.0439	0.0119	0.3179	Non-profit	no	Mature	Large
48	PWMACS	NA	loan, saving	AP	Low FI	Large	OSS	Low end	3.3	0.26	1	0.0117	0.0177	0.085	Non-profit	no	Mature	Medium
49	RASS	NA	loan	AP	Non FI	Large	OSS	Broad	1.26	-	1	0.0443	0.0075	0.3035	Non-profit	no	Mature	Large
50	RGVN	NA	grant, loan, sa	ASSAM	Low FI	Large	OSS	Low end	1.34	0.17	0.9071	0.0325	0.0229	1.0146	Non-profit	no	Mature	Large
51	RISE	NA	loan, equity		Non FI	Small	Non-OSS	Low end		-	1	-0.0961	0.0643	-0.6272	Non-profit	yes	New	Small
52	RORES	group	grant, loan, sa	KARNATAKA	Low FI	Medium	OSS	Low end		0.16	1	0.0823	0.0519	0.7053	Non-profit	yes	Young	Medium
53	Saadhana	NA	grant, loan	AP	Non FI	Large	OSS	Low end	2.39	-	1	0.0487	0.0457	0.3832	Non-profit	no	Mature	Large
54	Sahara Utsarga	group	grant, loan, e	KOLKATA	Non FI	Large	OSS	Low end	1.29	0.16	1	0.0586	0.0343	0.411	Profit	yes	Mature	Large
55	Sahayata	group	grant, loan, e	RAJASTHAN	Non FI	Large	OSS	Low end	3.61	-	1	0.0634	0.0588	0.1746	Profit	no	Young	Large
56	Samasta	group	equity	KARNATAKA	Non FI	Large	Non-OSS	Low end	1.47	-	1	-0.0238	0.0725	-0.0745	Profit	yes	New	Medium
57	Sanchetna	both	loan, equity	UP	Non FI	Small	Non-OSS	Low end	2.23	-					Profit	yes	Young	Small
58	Sanghamithra	NA	grant, loan, e	KARNATAKA	Non FI	Large	OSS	Low end	2.07	-	0.9917	0.0247	0.0179	0.1821	Non-profit	no	Mature	Large
59	Sarala	NA	grant, loan	WEST BENGA	Low FI	Large	OSS	Low end	1.27	0.17	1	0.0842	0.0265	1.1857	Non-profit	no	New	Medium
60	Sarvodaya Nano	group	loan, equity	CHENNAI	Non FI	Large	OSS	Low end	0.44	-	1	0.0018	0.0072	0.0091	Profit	yes	Mature	Large
61	SCNL	NA	loan, saving, e	DELHI	Low FI	Large	OSS	Broad	1.52	-	0.8491	0.0181	0.0526	0.1303	Profit	yes	Mature	Large
62	SEIL	both	loan	DELHI	Low FI	Large	OSS	Broad	0.64	0.25	0.2773	0.0563	0.1108	0.1378	Profit	yes	Mature	Large
63	SEWA Bank	NA	saving, equity	GUJARAT	High FI	Medium	OSS	Broad	4.08	2.25	1	0.0052	0.0315	0.0306	Profit	yes	Mature	Large
64	SEWA MACTS	group	grant, loan, e	AP	High FI	Large	Non-OSS	Low end		1.43	0.6497	-0.0557	0.0451	-0.8872	Non-profit	yes	Mature	Medium
65	SHARE	group	loan, equity	AP	Non FI	Large	OSS	Low end	3.09	-	1	0.055	0.0218	0.4518	Profit	yes	Mature	Large
66	Share MACTS	NA	loan	VISHAKAPAT	High FI	Medium	OSS	Low end		0.47	0.9778				Non-profit	no	Mature	Small
67	SKDRDP	group	grant, equity	KARNATAKA	Non FI	Large	OSS	Low end	0.78	-	0.6392	0.0129	0.0233	0.3006	Non-profit	no	Mature	Large
68	SKS	group	grant, loan, e	AP	Non FI	Large	OSS	Low end	2.57	-	1	0.0496	0.0366	0.2156	Profit	yes	Mature	Large
69	SMILE	group	loan, equity	TAMILNADU	Non FI	Large	OSS	Low end	1.21	-	1	0.0151	0.0174	0.0807	Profit		Young	Large
70	SMSS	group	loan	AP	Non FI	Medium	OSS	Low end	2.49	-	0.9956	0.0246	0.0304	0.1922	Non-profit	no	Mature	Medium
71	Sonata	group	grant, loan	UP	Non FI	Large	OSS	Low end	1.57	-	1	0.0112	0.0625	0.0328	Profit	yes	Young	Large
72	Spandana	both	loan, equity	AP	Non FI	Large	OSS	Broad	2.79	-	0.9195	0.0899	0.0133	0.5567	Profit	yes	Mature	Large
73	SSK	NA	NA		Non FI	Small	OSS	Low end		-	1	0.0009	0.0645	0.0073				Small
74	SU	individual	loan	WEST BENGA	Low FI	Large	OSS	Low end	1.32	0.18	1	0.0592	0.0387	0.6045	Non-profit	no	Mature	Medium
75	Suryoday	group	loan, equity		Non FI	Medium	Non-OSS	Low end		-	1	-0.0539	0.0672	-0.1436	Profit	yes	New	Medium
76	SVCL	group	loan, equity	HARYANA	Non FI	Small	Non-OSS	Low end		-	1	-0.6068	0.2802	-0.7848	Profit	yes	New	Small
77	SVSDF		loan, equity	GUJARAT	Non FI	Small	OSS	Low end	1.15	-	0.9964	0.0056	0.0508	0.0335	Non-profit	yes	New	Small
78	Swadhaar	both	loan, equity	MUMBAI	Non FI	Medium	Non-OSS	Low end	3.52	-	0.8857	-0.2075	0.1461	-0.3873	Profit	yes	Young	Medium
79	SWAWS	both	loan	AP	Non FI	Large	OSS	Low end	2.25	-	1	0.0745	0.0479	0.2171	Profit	yes	Mature	Large
80	Swayamshree Micro Credit S	loan, equity	Orrisa	Low FI	Large	OSS	Low end		0.14	1	0.0186	0.0096	0.4016	Profit	yes	Young	Medium
81	Trident Microfin	both	loan, equity	AP	Low FI	Large	OSS	Low end	2.68	0.03	0.9916	0.039	0.0365	0.1964	Profit	yes	Mature	Large
82	UFSPL	individual	loan	KOLKATA	Low FI	Medium	OSS	Low end	1.5	0.18	1	0.0384	0.1146	0.1952	Profit	yes	New	Small
83	Ujjivan	both	loan, equity	BANGLORE	Low FI	Large	OSS	Low end	2.99	0.16	1	0.0317	0.0622	0.0945	Profit	yes	Young	Large
84	VFS	group	loan, equity	KOLKATA	Non FI	Large	OSS	Low end	2.11	-	1	0.011	0.0583	0.0707	Profit	yes	Young	Large
85	VSSU		loan	WEST BENGA	High FI	Small	Non-OSS	Low end	1.11	0.94	0.5383	-0.0281	0.0281	-1.9016	Non-profit	yes	Mature	Small
86	WSE		loan	KERALA	Low FI	Large	OSS	Low end	0.13	0.09	0.98	0.033	0.0496	0.3457	Non-profit	no	Mature	Medium