Scaling up the Experience

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In India there is a diversity of approaches to microfinance, involving banks, government agencies, NGOs and cooperatives. There were specialized microfinance institutions (MFIs), many still registered as NGOs or cooperatives, a few 'transformed' into Non-Banking Finance Companies or Section 25 Companies. This case study examines the scaling-up experiences of Sarv Vikas Sansthan, a microfinance institution working in Gujarat. The institute was in MFI sector since 2005. The NGO was analyzing the financial performance on the basis of their trend of financial operations. The case highlights the meeting conducted between the Directors and the financial advisor to work out the financial fraud noticed and the preventive measures taken by the authorities.

This case has been drafted to study the different type of financial fraud prevailing in Microfinance sector and to work out the probable solutions for the same.

Key Words: Microfinance, financial performance, risk mitigation, financial fraud, preventive control, detective control

Sarv Vikas Sansthan was a non-banking finance organisation, regulated by the Reserve Bank of India with the mission to eradicate poverty by providing financial services to the poor. It interpreted that much poverty can be alleviated by providing financial services to low-income households. The growth in microfinance in India - and elsewhere in the world - was most probably due in large part to mechanisms that were financially sustainable, or on track to being sustainable. SVS served with the social goals in microfinance including serving poor people, serving people otherwise excluded from formal financial services, providing appropriate financial services, contributing to employment, contributing to positive change for clients and their households, contributing to poverty reduction and being socially responsible.

Sarv Vikas Sansthan worked on the model that can cover its costs and could grow to serve more clients in more areas. Sarv Vikas Sansthan practiced a standardised process of delivering and recovering loans, which enabled them to reach out to the most customers cost effectively. They were able to expand the business to reach further villages by charging a small interest rate, one that clients are willing to pay in order to avoid starvation, poor money management, or government loan sharks.

Mr. Vikas Mehta, Mr. Alok Rathva and Mr. Sujit Patel were the founders of the organisations, The Managerial team; Sarv Vikas Sansthan had organized the meeting to discuss the financial projection of the organisation in the presence of Mr.Manoj Mahirshi, the financial advisor of the organisation. They were planning to diversify the organisation in more efficient financial service model. Mr. Sujit Patel, the manager, finance briefed the operational model of Sarv Vikas Sansthan and explained the future objectives for development. The vision of the organisation was clear, which main focus on the following objectives.

1. To reduce the poverty in Sabarkantha, Banaskantha and Godhara district of the Gujarat, by carrying on the business of providing Microfinance services to large number of poor men and women directly or indirectly, and thus to help them and their families out of poverty and improve their standard of living.
2. To facilitate the beneficiaries with sustainable financing development activities by providing the Micro Finance in the areas of

   Agriculture development

   Industrial development – like SME ventures, Integrated market development

3. To improve the standard of living of the poor families by providing collateral free credit to poor men and women for the enhancement of their living conditions based on their needs, skills and traditional livelihood occupations.
4. To carry on and undertake the business of insurance, including life and general insurance as intermediary or agent of other insurance companies, subject to the rules and regulations prescribed by the Insurance Regulatory and Development Authority and/or Reserve Bank of India, Non-Banking Finance Companies Rules, as applicable to insurance business.

Overall Need for Microfinance

Assuming the entire poor population of India as potential microfinance clientele, the market size for microfinance in India was in the range of 58 to 77 million clients. This translated to an annual credit demand of USD5.7 to 19.1 billion (INR 230 to 773 billion) assuming loan sizes between USD100 and 250. If it was assumed that the low-income but economically active population including small and marginal farmers, landless agricultural laborers, and micro-entrepreneurs, were also potential microfinance clients, the annual credit demand went further up to an estimated 245.7 million individuals and USD51.4 billion (INR 2.1 trillion) in annual on-lending requirements.

Operations:

Started in 2005 as a cooperative society in the form of an NGO, Sarv Vikas Sansthan went on to transform itself into a leading MFI in Gujarat. The Sansthan reached to 3 lacs of poor women as SHGs for the NGO. Sarv Vikas Sansthan followed the Joint Liability Group (JLG) model. The methodology involved lending to individual women, utilising five member groups where groups served as the ultimate guarantor for each member. Social collateral replaced asset collateral and such a system worked because India was still a highly community-centric society. Indian psychological zone had grown with the concept of honour and respect within society and it was deeply rooted.

In Indian rural society the need is not only limited up to financial support, they also required to be taken care of other functional aspects like livelihood training, social and health inputs. Traditional microfinance usually targeted poor and upper poor Populations, but had not been able to reach ultra poor.

Table 1: Category of the beneficiaries identified by Sarv Vikas Sansthan

Category	Criteria
Category A	Have some assets
Category B	Have no assets but can work
Category C	Extreme poverty

Table 2 : Highlights of the Operations of SVS for last 5 years

Particulars	2007	2008	2009	2010	2011
No. of branches	27	77	135	202	237
No. of districts	10	29	37	54	78
No. of employees	238	681	1281	2115	2273
No. of borrowers (In Hundreds)	604	1879	3953	6780	7307
Disbursements (Rs. In Lacs)	452	1680	4485	7618	7831

Table 3 : Highlights of Financial Performance of SVS for last 5 years

Particulars	2007	2008	2009	2010	2011
Incremental borrowing* (Rs. in Lacs)	277	1063	3762	5132	5338
Total revenue (Rs. in Lacs)	46	170	554	959	1270
Profit After Tax (Rs. in Lacs)	3.67	16.65	80.22	173.95	111.63
Total assets (Rs. in Lacs)	335	1089	3039	4047	4300
Return on average asset	1.69%	2.34%	3.89%	4.91%	2.40%
Return on average equity	8.54%	11.71%	18.29%	21.54%	7.50%

* Amount of sanctions received from banks and financial institutions

Sarv Vikas Sansthan had a unique Ultra Poor programme for the weakest section of society. Under the programme, the beneficiaries received training to run an income-generating enterprise and financial education. Over an 18-month period these beneficiaries were trained to become self-sufficient and graduate into regular microfinance. The first phase of the training programme conducted at the doorstep of the ultra poor people and then gradually they were being merged with general trainees group.

Operational features of Sarv Vikas Sansthan working model

Operational Features	SHG
The 'model'	10-20 member groups save regularly: group loans to members from savings; jointly liable for external loans – from MFI or bank
Main clients	Women
Targeting	'The poor'– broadly described as the weaker sections or 'BPL'- Category C population
Service focus	Savings and Credit
Transactions	Monthly meeting
Saving deposits	Rs. 20 – 100 per month
Interest on Savings	Bank rate (4.25%) + profit share
Initial loan size	Rs 5000 to Rs. 10,000
Effective interest rate (usual range)	24-28%
Insurance	At a preliminary stage: usually loan linked with national companies
Mode of Accepting Deposit and Disbursing Loans	Cash

Employee Frauds- A Major Concern

As the organization was working for poor and ultra poor people, it was required to carry out majority of its transactions in cash because such people were financial excluded by banks. As majority transactions were taken place in cash, there was an inherent risk of fraud. It could be observed that the cases of frauds by employees were increase multifold (See Table 4).

Mr. Sujit Patel had drawn the attention of the management and financial advisor to the fact that despite the increase in number of branches and increase in number of borrowers (See Table 2), there was a drastic decrease in profit (See Table 3). There were number of reasons for decrease in profit over past year, however, Mr. Sujit Patel iwas asking help of Mr. Manoj Mahirshi, financial advisor by drawing his attention towards the increasing number of financial frauds by employees of the organization by way of cash embezzlement and by giving loans to non-existent borrowers by employees.

Table 4 : Summary of Reported frauds from Annual Report

(Amount is in Lacs)

Type of Fraud Reported	2007	2008	2009	2010	2011
Cash Embezzlements by Employees of the company					
No. of Cases Reported	5	21	31	82	156
Amount Involved	1.51	12.90	50.80	100.24	160.18
Amount Recovered from Employees	0.00	1.24	11.64	12.26	53.42
Amount Recovered from Insurance Co.	0.00	0.00	5.39	11.35	10.42
Amount Written Off	1.51	11.66	33.77	76.63	96.34
Loans given to non-existent borrowers on the basis of fictitious documents created by the employees of the company					
No. of Cases Reported	1	2	18	61	205
Amount Involved	0.65	9.54	46.46	106.45	451.77
Amount Recovered from Employees	0.00	1.28	3.93	5.76	65.11
Amount Recovered from Insurance Co.	0.00	0.00	0.00	10.39	32.49
Amount Written Off	0.65	8.26	42.53	90.30	354.17

Sujit Patel highlighted various preventive and detective controls exercised by the orgnisation currently and asked for better Internal Control Mechanism to minimize the financial frauds by the employees of the organisation.

PREVENTIVE CONTROLS

(1) Company was procuring an indemnity bond from every field staff, with personal guarantee of a third person.

(2) Every bank transaction (deposit/ withdrawal) was to be executed by minimum of 2 staff comprising a bank signatory and a confirmed staff.

(3) The cash safe at every branch was controlled by two keys and the keys were held by two employees in the branch.

(4) Surprise visits were conducted by managerial level staff, at the time of carrying out cash/ bank transactions by field-level staff.

(5) Minimized the cash balances at various branches to the lowest level possible (Rs 50,000 + next day disbursement).

(6) All the loans disbursed had a maker/ checker control, wherein all the loans processed by SHG managers were approved by branch managers/ assistant branch managers.

(7) The SHG managers were not deployed in their home towns, so as to prevent collusion with local people.

(8) Employee rotation took place every six months, wherein the SHG managers handles different centres at the end of six months.

(9) SHG manager/ branch manager were transferred to different branches in a span of 9 to 12 months.

(10) Developed internal processes to restrict the loan disbursements to inactive members.

(11) The branch managerial staff performed thorough screening of the loan applications and the groups by physically visiting the centre.

DETECTIVE CONTROLS

(1) Staff wise daily reconciliations of cash balances by the managerial level staff at each branch.

(2) Frequent surprise visits by accountants and the internal auditors, which covered verification of physical cash and bank balances.

(3) The branch managerial staff performed a loan utilization check for every loan disbursed.

(4) The internal audit staff, on a test basis, verified the loan documents and performed a loan utilization check for the loans disbursed.

(5) The branch managerial staff performed a loan utilization check for every loan disbursed.

<u>Questions</u>:

(1) Do you think that the Internal Control Mechanism as currently practiced is sufficient looking to the size and nature of operation of the organization?

(2) If answer to (1) above is yes, why frauds have increased multifold over past year?

(3) If answer to (1) above is no, what additional control mechanisms do you advice to minimize the frauds by the employees of the organization?