

Evolving landscape of microfinance institutions in India

July 2016





Foreword from EY

Microfinance in India has come a long way. It started as an alternative source of finance to the unserved masses comprising the bottom of the socio-economic pyramid and gradually turned out to be a tool for uplifting their social standard and working their way out of poverty. The sector has helped millions of small households in the most remote areas to give life to their dreams by providing them the means to fulfil them. With sustainable growth and modest return, the sector, which initially survived just as a “not-for-profit” endeavour, has attracted several large multinational investors over the past decade.

In this remarkable journey, there have been many highs and lows. While at its peak, the industry also faced challenges which significantly impacted the business models. Although the tough times took their toll, they helped to shape the way forward for Indian microfinance by defining new milestones.

Regulators played a major role in this transformation, acknowledging the need to promote this sector wholeheartedly by providing it with a more robust and transparent framework. This has helped the sector mature and become an indispensable torchbearer of the most valued goal of our economy - financial inclusion.

However, this journey is far from complete and the goal is yet to be achieved. There are still important milestones to be achieved in order to further the goal of economic empowerment, which can only be accomplished by an increased financial discipline among the fraternity. The dynamism in the sector has just got another dimension with several large microfinance institutions (MFI) getting the licence to convert into small finance banks. When these banks with access to cheaper funds compete with MFIs, the MFIs will require to reinvent themselves. Through business reengineering they will have to find new ways to minimize their operating costs. A key variable in this equation will be technology. Besides technology, MFIs will have to establish new platforms for partnership and collaborations whereby they utilize their resources to optimum levels.

This report endeavours to throw light on some of the trends that are emerging in the microfinance industry. It also includes case studies on some of the best practices noted in the global microfinance industry.

We hope this report will help shape up the debate on the challenges that lie ahead for the Indian microfinance industry and the best way to move forward.



Foreword

I am happy to learn that ASSOCHAM in association with EY has prepared a 'Knowledge Report' for the **"National Summit on Microfinance - Servicing Trending Microfinance: Knocking at the door of aspiring entrepreneurs"**.

In India, the microfinance industry (MFI) is one of the most crucial cogs of the finance industry because this sector meets the credit needs of thousands of budding entrepreneurs. Compared to conventional modes of financing, MFI is an altogether different ballgame as it demands a different mindset and skills. Here, a potential client's capability, skills and business model, and not his assets, determine his credibility and eligibility for any loan amount.

The MFI sector has been through a roller-coaster ride in India. The sector experienced exponential growth between 2005-2010 making it one of the world's largest, it encountered a major crisis thereafter which almost destroyed this sector, but over the last few years it has slowly but surely made a solid comeback. With the evolution of a regulatory framework, the MFI sector has witnessed orderly growth and consolidation. The creation of the Micro Units Development and Refinance Agency (MUDRA) Bank as a funding vehicle for MFIs in the Union Budget 2015-16 has come as a major shot in the arm for this sector.

Going forward, the success of the MFI sector will largely depend on how well the players can blend technology and human interface in providing financial solutions to the clients. Leveraging technology to bring down operational costs and enhancing penetration and training employees to offer customised solutions to the clients will shape the future of the MFI sector.

I hope this Summit will bring to the fore new ideas and concepts that can help the MFI sector to increase its efficacy and also help in benchmarking this sector vis-a-vis its global counterparts.

Thank You,

Sunil Kanoria
President
ASSOCHAM



Foreword

ASSOCHAM representing over 4,50,000 large, medium, small and micro units is fully committed to work with vision of promoting inclusive growth drives and to create sustainable and value based entrepreneurial culture for the robust development of the micro and small enterprises.

The microfinance sector has grown up rapidly over the past few decades due to a combination of governmental support, implementation of technological enhancements and support provided by the banking sector.

In this backdrop, ASSOCHAM is organizing National Summit on microfinance to strengthen the confidence in financing small business entities and for the discussions to chalk out a feasible and effective agenda for the overall development of this sector

ASSOCHAM - with support of EY, have come out with this knowledge paper with the objective to contemplate the issues and challenges being faced by Microfinance sector and suggest measures that can be taken to optimize their contribution thereto.

We hope that this study would help the regulators, market participants, Government departments, and other research scholars.

Thank you,

D.S Rawat
Secretary General
ASSOCHAM

Contents

1. Financial inclusion: unfinished agenda.....	8
2. Growth of MFIs over the years.....	12
3. Recent trends in MFI lending	16
4. Best practices from global microfinance	23



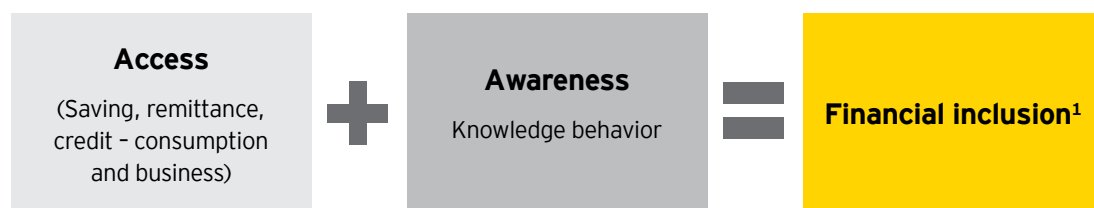




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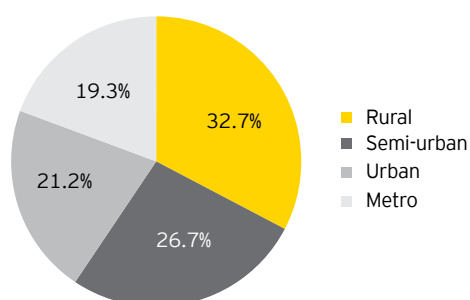
Financial inclusion: unfinished agenda

Financial exclusion can be a debilitating experience for the poor. The main objective of financial inclusion is to ensure access to formal credit for people who depend on informal sources for fulfilling their financial needs, at an affordable cost in a fair and transparent manner, and to promote financial education.



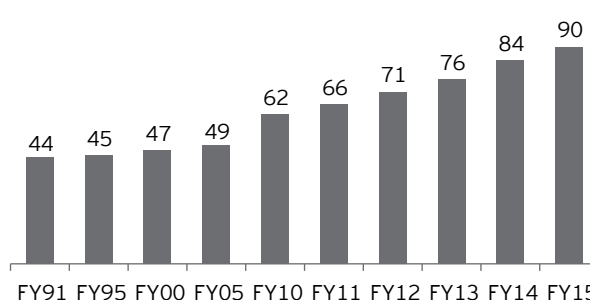
India has a substantial network of institutional credit, i.e., credit offered by financial institutions such as banks. Scheduled commercial banks, particularly public sector banks (PSBs) have a tremendous domestic presence with wide spread distribution networks. PSBs have aggressively expanded their branch network over the last decade with around 90,000 points of presence as of March 2015 from around 49,000 points of presence as of March 2005. Moreover, in terms of network distribution, PSBs have around 60% of their branches in rural and semi-urban areas.

Public Sector Banks network spread (as of March 15)



Source: RBI: Database of Indian Economy

Distribution network of PSBs (in '000)



Source: RBI: Database of Indian Economy

It is widely recognized that poor people could improve their lives significantly if they have easy access to even basic financial services such as savings accounts, loans and insurance. However, despite this rationale and a strong institutional credit network, India's financial services ecosystem lags in terms of physical infrastructure and has failed to reach the poor. The country still has 233 million people (more than 19% of the population), who are unbanked or financially excluded².

¹ "Financial Inclusion - the Indian Model - Challenges & Prospects", Dr Deepali Pant Joshi, Executive Director, RBI

² "MFI's 'are key' to financial inclusion", Business Line, 12 June 2016

A significant portion of the rural population does not have access to the banking system

Census 2011 data (in m)	Rural	Urban	Total
Total households	168	79	247
Households without access to banking facilities	77	25	102
As a % of total households in respective segments	46%	32%	41%
As a % of total households in the country without access to banking facilities	75%	25%	-

Source: India Census

India lags vis-à-vis other countries in terms of performance on financial inclusion parameters

Indicator	India	Brazil	Russia	China#	South Africa
Commercial bank branches per 100,000 adults	13.04	47.32	36.98	8.06	10.94
ATMs per 100,000 adults	18.07	129.25	184.70	55.03	66.20
Outstanding deposits from commercial banks (% of GDP)	62.87	36.39	43.05	137.28	41.03

■ Highest on the indicator ■ Lowest on the indicator

#Mainland China

Source: IMF Financial Access Survey Data, 2015



Over the years, Government and the Reserve Bank of India (RBI) has made several concentrated efforts to promote financial inclusion. These efforts include launch of co-operative banks and regional rural banks, introduction of mandated priority sector lending targets, formation of self-help groups, appointment of business correspondents by banks to provide door-step delivery of banking services. These initiatives helped to bring in a large section of the unbanked population under the formal financial credit system. However, a significant portion of India's population still remains devoid of access to basic formal credit facilities mainly due to lack of last mile connectivity. Hence, the Government, with RBI's support, continues to introduce various new initiatives to fulfil its objective of achieving 100% financial inclusion.

Various initiatives taken in the past few years in respect of financial inclusion

Pradhan Mantri Jan Dhan Yojana (PMJDY):

- ▶ A major scheme aimed toward financial inclusion, Pradhan Mantri Jan Dhan Yojana, was launched on 28 August 2014, to provide every household with a bank account and basic insurance cover. This scheme received considerable response and around 15m accounts were opened on the day of its launch. As of 22 June 2016, 221.8 million accounts (with total balance of INR391.53 billion) have been opened under this scheme.

Launch of specialized banks – payments banks and small finance banks:

- ▶ The RBI granted licenses for 11 payments banks in August 2015 and 10 small finance banks in September 2015. These specialized banks are expected to become operational during 2016-17. These banks will provide further push in terms of accessibility to formal finance channels and in turn contribute to inclusive growth.

Launch of MUDRA Bank:

- ▶ Micro Unit Development and Refinance Agency (MUDRA) was launched in April 2015 to fund and promote microfinance institutions (MFI), which will, in turn, provide loans to small businesses. The MUDRA scheme refinances collateral-free loans of up to INR1m given by lending institutions to small, non-corporate borrowers, for income-generating activities in the non-farm segment. As of December 2015, MUDRA loans amounted to INR713.12b, which had been disbursed to 17.3m borrowers.

With the continued need for financial inclusion, MFI, which have emerged as an alternative to provide financial service to low-income clients will continue to play an important role. Moreover, MFIs are taking their rightful place in the financial inclusion scenario as is evidenced by the fact that out of the 10 entities granted Small Finance Bank (SFB) licenses in September 2015, 8 were MFIs³.

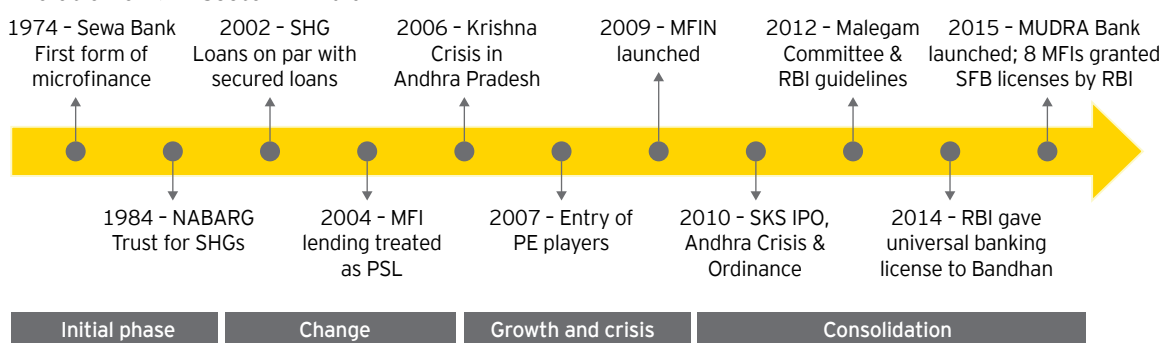
A vibrant, colorful textile market stall. The image shows various fabrics, including a prominent pink and blue patterned fabric with tassels, and other colorful textiles in shades of green, orange, and blue. The background is slightly blurred, emphasizing the textures and colors of the fabrics in the foreground.

2

Growth of MFIs over the years

The microfinance sector started in India in 1970s with the emergence of informal self-help groups (SHG) to provide access to much-needed savings and credit services. The sector witnessed strong growth following the liberalization of the Indian economy in 1991, since private sector organizations increasingly extended credit to microfinance companies. During 2005-2010, the microfinance sector reported strong growth supported by strong demand for loans from borrowers neglected by the banking system and investors eager to invest funds in the high growth industry. However, in 2010, the sector was severely impacted by the Andhra Pradesh crisis and the State Government promulgating an ordinance to curb the activities of microfinance companies. The crisis triggered a strong response from the RBI and in the years that followed, the sector has registered a turnaround and has evolved into a more mature market. Moreover, the Government as well as the RBI have tried to create a conducive policy and regulatory environment for MFIs to expand the financial inclusion agenda in India⁴.

Evolution of MFI sector in India



Evolution of MFI sector in India happened mainly in four phases:

Initial period

- ▶ **1974:** Shri Mahila Sewa Sahakari Bank owned and managed by women to provide financial services to women in the unorganized sector.
- ▶ **1984:** NABARD advocated SHG linkage as an important tool for poverty alleviation. Other government agencies followed.

Change

- ▶ **2002:** The provisioning norm for the unsecured lending to SHG brought on par with other secured loans.
- ▶ **2004:** The RBI included MFI lending within the priority sector and recognized MFIs as a tool for financial inclusion.
- ▶ **2006:** The Government shut down branches of some microfinance companies due to allegations of high interest rates, unethical recovery practices and poaching clients from SHGs.

Growth and crisis

- ▶ **2007:** Favorable regulations, economies of scale and significant growth drew PE players into the market. MFI loan book stood at INR35b.
- ▶ **2009:** Microfinance Institutions Network (MFIN) was started, all NBFC-MFIs are eligible for membership.
- ▶ **2010:** Andhra crisis unfolded – allegedly coercive debt collection practices led poor borrowers to suicide. This led to an Ordinance from the Government and significant clamp down on MFI activities.

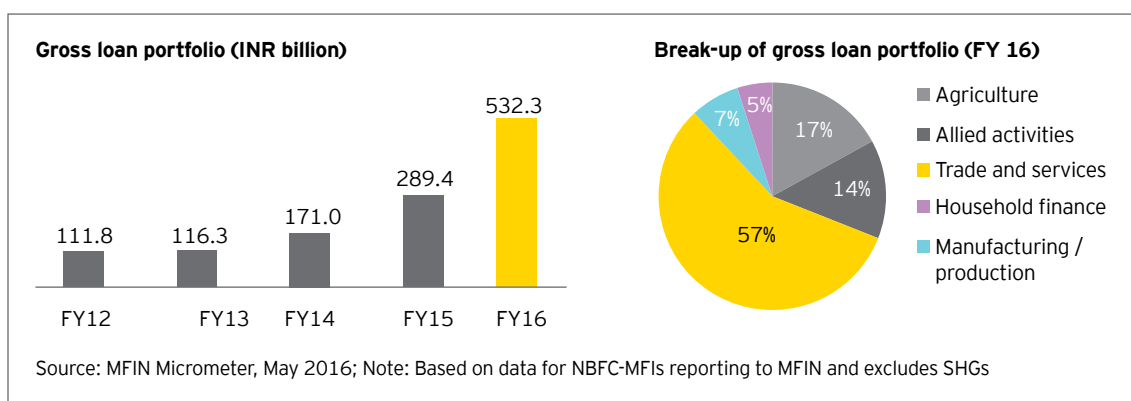
Consolidation and maturity

- ▶ **2012:** The Malegam committee recommended significant changes in the sector and the RBI issued final notifications. The MFI loan book reduced to INR209b from INR216b.
- ▶ **2014:** The RBI issued universal banking license to Bandhan, the largest microlender in India in terms of assets. MFIN was formally recognized by the RBI as a self regulatory organization (SRO).
- ▶ **2015:** The Government launched MUDRA Bank to help finance small businesses.

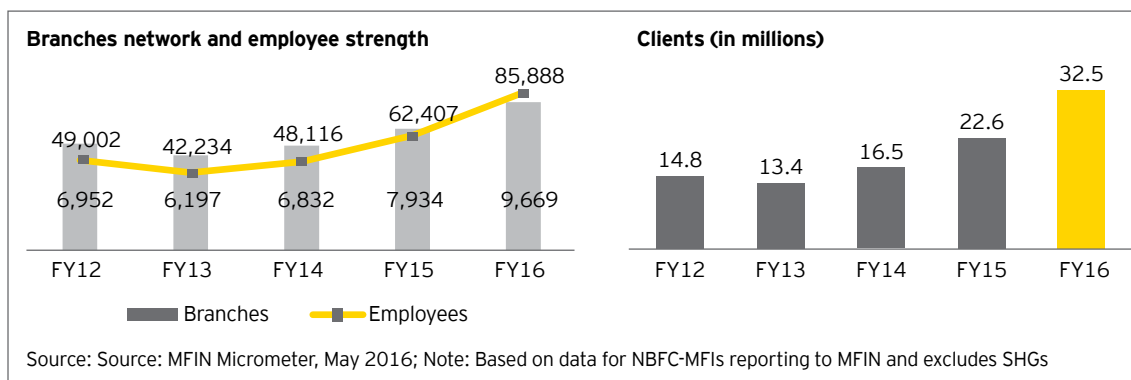
⁴ The Bharat Microfinance Report 2015; "MFIs dominate small finance bank licenses", Business Standard, 17 September 2015; "Microfinance: To hell and back", Mint, 19 October 2014

Sector continues to witness strong growth

The Indian microfinance industry is dominated by NBFC MFIs with an 88% market share⁵. According to data from MFIN, there are 12 small MFIs (loan book less than INR1b), another 22 medium-sized MFIs (loan book between INR1b and INR5b) and 22 large MFIs (loan book above INR5b). Large MFIs account for ~90% of the industry's gross loan portfolio (GLP), client base and debt funding. During FY12-16, the gross loan portfolio (GLP) of MFIs grew at a CAGR of 48% to reach INR532.3b and the number of clients benefited crossed 32.5m (as of March 2016). Notably, the sector reported a significant surge of 84% in GLP from INR289.4b in FY15 to INR532.3b in FY16, since MFIs indulged in issuing large loans to clients after the RBI relaxed indebted exposure to single borrower from INR50,000 to INR100,000. 60% of the GLP was attributed to the rural sector while the remaining 40% was from metros, urban and semi-urban areas (as of March 2016). In terms of regional breakup, south India had the highest share at 35% of GLP followed by west and north India at 25% share each. 31% of the loans were given for agriculture and allied activities while 64% were given for non-agriculture and 5% for household finance as of March 2016. Large MFIs, some of which are in the process of converting to small finance banks, reported the highest surge in their loan books⁶.



After 2010, MFIs consolidated their operations, since the sector faced more stringent regulatory requirements. Number of MFIs declined from ~70 in pre-2010 to 56 in early-2016⁷. Growth slowed after FY11 and in FY13, there was a decline in both branch network and employee base. However, following the initial consolidation, microfinance companies started aggressively expanding operations. From FY13 to FY16, branch network expanded at a CAGR of 16% while the employee base increased at a CAGR of 27%. Of the total base of 85,888 employees, 63% are loan officers who provide door-to-door credit as on March 2016.



⁵ "Microfinance industry is out of an unprecedented crisis, thanks to regulations, diligent borrowers", The Economic Times, 19 April 2016

⁶ "MFIs gross loan portfolio jumped 84 pc in Q4: MFIN", The Times of India, 18 May 2016; MFIN Micrometer, May 2016

⁷ "Microfinance industry is out of an unprecedented crisis, thanks to regulations, diligent borrowers", The Economic Times, 19 April 2016



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A man is shown from the side, focused on operating a large, traditional wooden loom. The loom is made of dark wood and has many horizontal threads stretched across it. The man is wearing a dark long-sleeved shirt. The background is bright, suggesting a window or an open area. The overall scene is one of traditional craftsmanship.

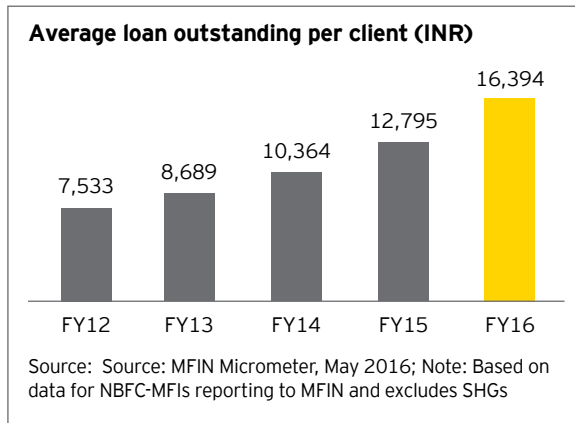
3

Recent trends in MFI lending

MFIs have started extending larger loans to their clients⁸

Initially, MFIs typically provided small-ticket income generation loans to their new customers. As customers mature over multiple loan cycles, focus moves from income-generating loans to consumption loans as well as large ticket-size loans. During the past two years, MFIs have reported a 58% jump in average loan size per customer from INR10,364 in FY14 to INR16,394 in FY16, since during the same period gross loan portfolio has increased 3X while client base has only increased 2X.

Some industry experts have ascertained the high growth pattern to the rise in clients, increase in general income levels and ease of lending rules by the RBI. In April 2015, the RBI raised the cap on indebtedness to a borrower from INR50,000 to INR100,000. However, according to others, increased lending to same clients may be risky for MFIs, since they serve vulnerable segments, which entails increased underlying risk.



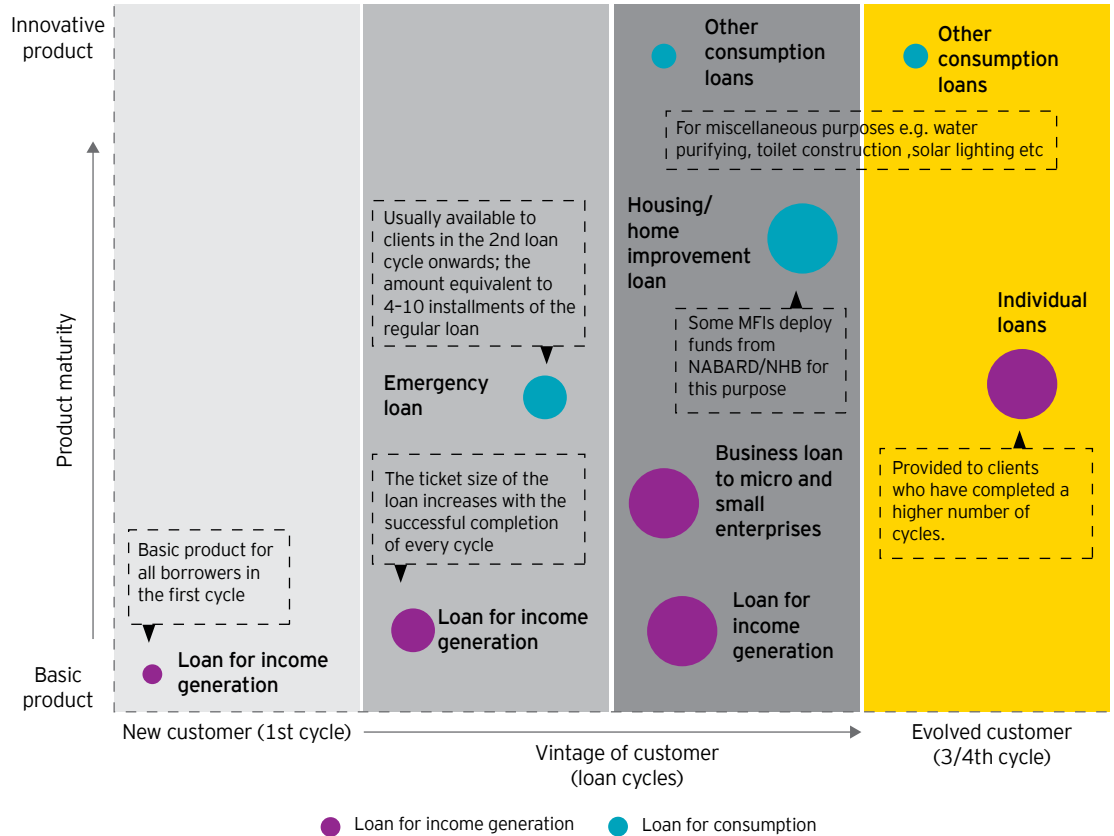
The microfinance product lifecycle:

The RBI has been relentlessly pursuing a structured approach and has focused on inclusive growth through policies such as selective credit control, priority sector lending norms, lending to weaker sections of the society, financial literacy initiatives, etc. Microfinance institutions also form a key part of the RBI's inclusion drive. As banks hesitate to expand in remote areas due to high operational costs involved, MFIs have emerged as an alternative to provide financial services to low-income clients, who are otherwise excluded from formal credit channels.



⁸ "Rapid growth of MFIs' gross loan portfolio sets alarm bells ringing," Mint, 29 June 2016

Microfinance credit life cycle

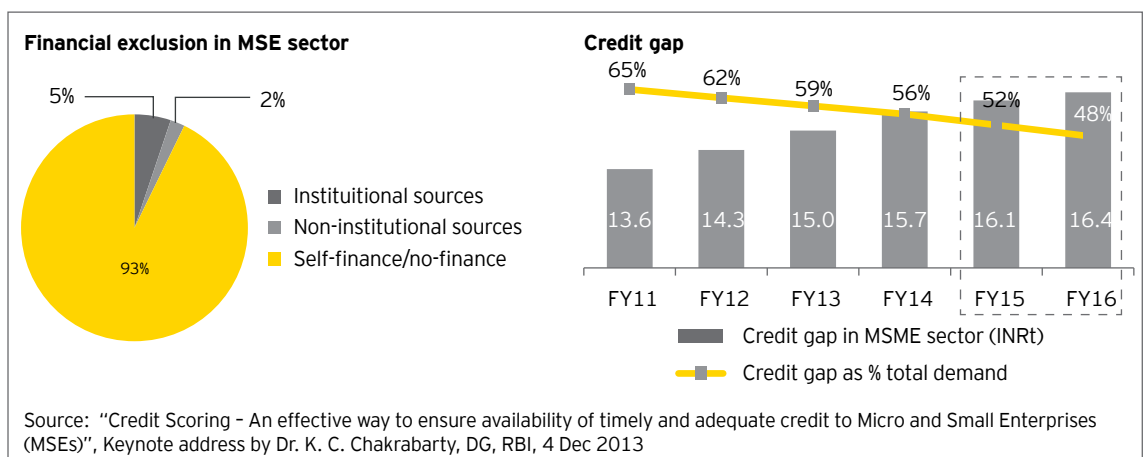


Size of bubbles depicts ticket size of the loan and is indicative * Product set is representative

Source: EY Analysis

Lending to micro-enterprises:

In India, the extent of financial inclusion in the MSE sector is very low. According to the Fourth Census of the MSME sector, around 93% of MSME units in India did not have any access to finance and depended on self-finance. According to the 12th five year plan, credit gap as a percentage of total demand was estimated at 56% in FY14 for the MSME sector. In absolute terms, this gap is estimated to be more than INR16t in FY17.

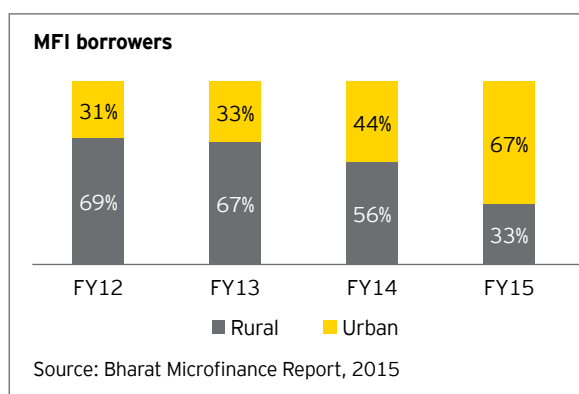


Given their role in job creation and ability to foster entrepreneurship, micro and small enterprises (MSEs) are considered vital to the economy and MFIs can play a key role in fulfilling the funding gap in this sector, which seems to have begun based on the recent trends in average loan tickets extended by MFIs. MFIs have disbursed around 35% of the total loans extended by MUDRA Banks. The significant disbursement of MUDRA loans by micro-lenders reflects the maturity of MFIs' credit delivery models, reach and last mile connectivity, particularly in rural areas⁹.

Evolving base of borrowers¹⁰

Since its inception, the Indian MFI sector has been perceived as a predominantly rural-focused sector, largely different from the MFI sector in Latin America as well as parts of America and Africa. However, recently, MFIs have shifted their focus from rural hinterlands to urban pockets.

The industry's outreach to urban clients was increasing every year and in FY15, for the first time in its history, Indian MFIs reported more urban clients than rural ones. The share of rural customers has drastically declined from 69% in FY12 to 33% in FY15. This shift in the customer base of MFIs has been due to several factors – strong growth of urban focused MFIs; shift in business model of many MFIs and reluctance of banks to lend to small borrowers.



A large number of MFIs have shifted to an urban-centric business model to cut-down operating costs and maximize operational efficiency. Many banks lend to small borrowers through MFIs in order to meet their priority sector lending targets. MFIs cannot charge more than 10% over the cost of loans taken from banks while fixing the loan price for small borrowers and hence, profitability of MFIs depends heavily on their operational efficiency.

The rise in urban clients of MFIs also underlines reluctance of banks to lend to small borrowers. In spite of the presence of banking infrastructure in urban areas, there is a strong demand from the unorganized sector and migrants for microfinance loans.

Diversification of funding¹¹

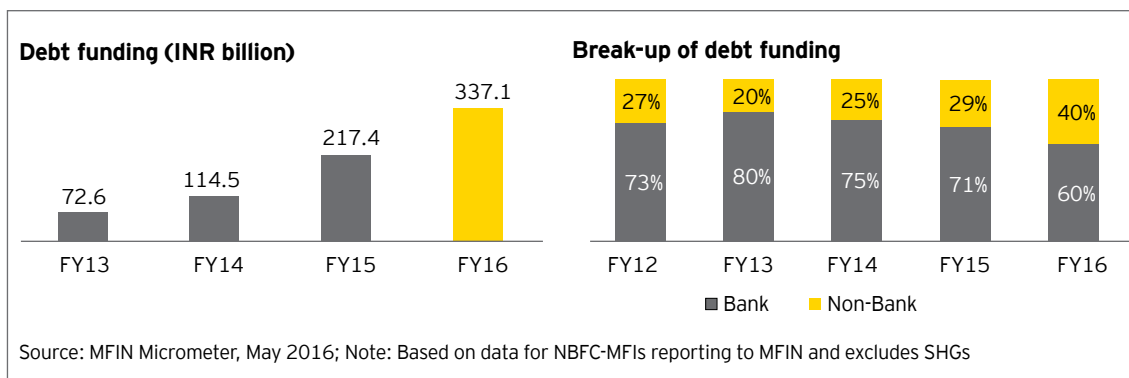
Debt funding for MFIs has increased at a CAGR of 67% from FY13 to FY16. However, microfinance companies have started tapping non-bank financing sources such as mutual funds with the aim to diversify their funding sources. Share of non-bank funding has doubled from 20% in FY13 to 40% in FY16¹². During FY15-16, several large MFIs have raised funds by issuing non-convertible debentures to mutual fund houses. Debt instruments by mutual funds has emerged as an important source of funding for MFIs and a new investment avenue for mutual fund houses. Typically, mutual funds offer funds at fixed rate of interest while banks primarily offer floating rate loans.

9 "MFIs have disbursed 35% of MUDRA loans since April 2015", Business Line, 3 June 2016

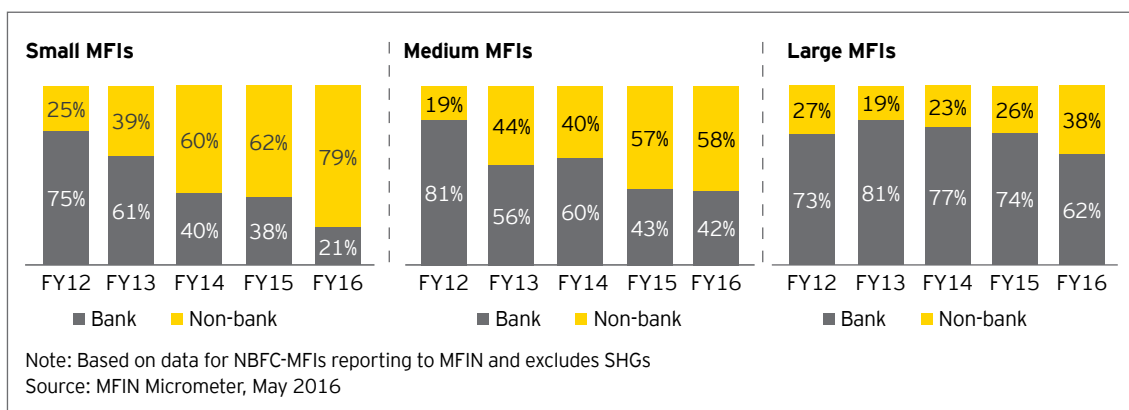
10 "Urban MFI borrowers outstrip rural counterparts", Mint, 9 October 2015; "Indian microfinance institutions have just busted a myth", Mint, 19 October 2015

11 "Microfinance institutions tap MFIs to raise money", Business Standard, 16 June 2015; MFIN Micrometer, May 2016

12 MFIN Micrometer, May 2016



Further, large MFIs accounted for 89% of total debt funding received in FY16 while medium MFIs and small MFIs accounted for just 9% and 2% respectively. Given bank's reluctance to fund small and medium sized MFIs, these entities have become more reliant on non-bank funding vis-à-vis large MFIs.



However, with the microfinance sector showing steady traction backed by a more stable regulatory environment and large MFIs converting to banks (e.g., the largest MFI, Bandhan, has converted into an universal bank and 8 other MFIs are on the verge of becoming small finance banks), commercial banks have recently become more liberal in providing funds to small and medium MFIs. Hence, funding structures of small and medium MFIs may become more reliant on bank funding going forward¹³.

Furthermore, NBFCs and Banks are acquiring equity stakes in MFIs to establish a strong presence in the microfinance segment, since MFIs' distribution network gives huge cross-selling opportunities.

- ▶ In February 2015, Kerala-based gold loan NBFC Manappuram Finance acquired a 71% stake in Asirvad Microfinance. The acquisition was part of Manappuram's business diversification to become a financial services company offering a wide range of products and services¹⁴.
- ▶ In 2016, two private sector banks – IDFC and DCB – purchased direct equity in MFIs. In January 2016, newly launched IDFC Bank acquired a 9.99% stake in ASA International India Microfinance, with a footprint predominantly in the Northeast to help expand lending operations, while, in March 2016, DCB Bank acquired a 5.81% equity stake in its business partner Annapurna Microfinance, a growing MFI focused primarily on the rural locations of Odisha, Chhattisgarh and Madhya Pradesh¹⁵.

13 "Micro finance companies get funds from banks," The Economic Times, 25 March 2016

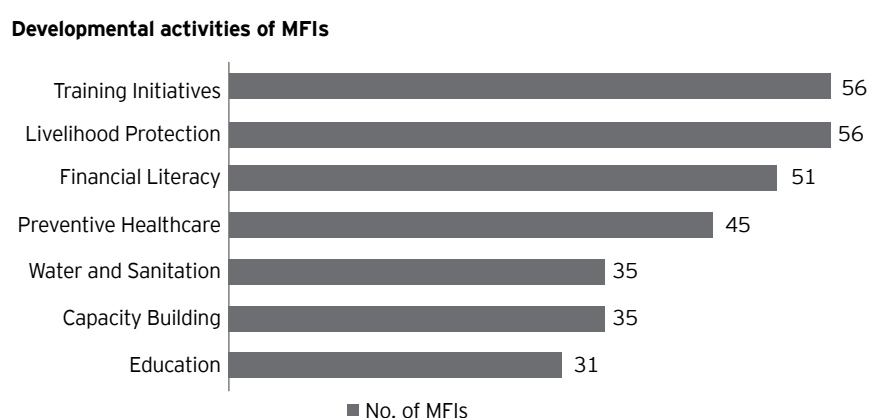
14 "Manappuram takes over Asirvad Micro Finance," Business Standard, 16 February 2015

15 "IDFC Bank buys 10 per cent stake in ASA International India for Rs 8.5 crore", The Economic Times, 12 January 2016; "DCB Bank acquires 5.81% stake in Annapurna Microfinance", Mint, 5 March 2016

Moreover, with the microfinance sector demonstrating strong growth potential, more corporate organizations and banks may look to partner MFIs.

Developmental activities of MFIs in India¹⁶

Apart from providing microcredit, micro-savings, micro-insurance and micro-pension, MFIs in India also undertake various other developmental services such as financial literacy, empowerment of community (mainly with a focus on women), capacity building, etc.



Source: Bharat Microfinance Report, 2015

Credit Bureaus are evolving to support the MFI sector¹⁷

India's first credit bureau (CB) for MFIs, CRIF High Mark Credit Information Services, started in 2010 with an aim to gather credit data on microfinance borrowers and bridge the lack of information a lender faces while evaluating a prospective borrower. Since then, the MFI industry is making good use of credit bureaus to check delinquent borrowers, reduce NPAs, restrict over lending and comply better with regulatory guidelines. CBs help MFIs keep a tab on RBI's "two-lender rule", i.e., a borrower should not get loans from more than two MFIs¹⁸. Most MFIs are reporting to CBs and have integrated credit bureau check in their loan appraisal systems. The KYC data quality from MFIs improved by more than 100% between 2011 and 2014, as an outcome of joint efforts of MFIs, associations and CBs. Going forward, the MFI industry can derive improved benefits by leveraging CB platforms for comprehensive pre-acquisition and post-acquisition risk management.

¹⁶ The Bharat Microfinance Report, 2015

¹⁷ The Bharat Microfinance Report, 2015

¹⁸ "Microfinance industry is out of an unprecedented crisis, thanks to regulations, diligent borrowers", The Economic Times, 19 April 2016



4

Best practices from global microfinance

Best practices emerging in the global microfinance industry can provide useful reference point for the Indian MFIs in the backdrop of the recent trends noted above.

Risk management

Risk management is essential for any financial services institution. Like other FIs, microfinance companies also need to effectively and efficiently manage risks. Moreover, risk management may be seen as more important for MFIs vis-à-vis other FIs, since MFIs cater to vulnerable and underserved sections of society and are more likely to suffer from borrower defaults. Over the years, microfinance companies have devised innovative risk management strategies such as group lending. In case of group lending, borrowers are grouped together and given loans sequentially. If one member of the group defaults, the entire group suffers. Hence, this creates incentives for group members to monitor each other and also aids in careful selection of group members, which in turn leads to reduction of credit risk for MFIs¹⁹.

A flexible risk management system helps MFIs to ensure long-term stability and growth. The following points need to be carefully considered while developing a flexible risk management system:

<p>Decentralization</p>	<ul style="list-style-type: none"> ▶ Involves developing a culture, which encourages internal controls with delegated authority that allows loan officers to be responsive to client needs ▶ Requires establishing a culture of trust between management, financial intermediaries and borrowers ▶ Helps reduce cost of internal controls
<p>Effective support system</p>	<ul style="list-style-type: none"> ▶ Requires an effective support system of information technology and sound MIS ▶ Risk-monitoring activities must be supported by systems that provide senior managers and directors with timely and accurate reports on the financial condition, operating performance and risk exposure ▶ Risk monitoring and MIS should be consistent with MFI's operations
<p>Culture of training</p>	<ul style="list-style-type: none"> ▶ Entails a need for a culture of providing regular training to build a competent and loyal employee base ▶ Improves efficiency and help reduce cost
<p>Openness and client centered approach</p>	<ul style="list-style-type: none"> ▶ Client-centered approach helps design products according to the needs of the customer ▶ Helps manage financial/cash flow risk more effectively as resources can be allocated on components that help maximize profits

¹⁹ The problems (and promise) of microfinance", 15 April 2014, <http://economicstudents.com/2014/04/the-problems-and-promise-of-microfinance/>

Case study: The Caja Model of Risk Management²⁰

Peru's Caja municipalities benefited from a flexible risk management system and successfully survived even during the financial crisis.

The Caja municipalities (savings-and-credit “cash shops”) are MFIs owned by municipal government throughout Peru. They were established in early 1980s to widen access to credit to people with limited economic means, especially outside the capital city of Lima. Cajas are considered to be centres of excellence in the MFI industry. The Cajas network has grown consistently in Peru since early 1980s weathering domestic and international economic crises. Initially, Cajas only offered pawn-secured loans but over the years their offerings expanded to providing credit to micro-and small-enterprises, savings accounts as well as a diverse range of banking services. According to a research study conducted in 2013, there were 13 Cajas in Peru controlling more than 91% of the lending and 73% of savings outside Lima. Risk management flexibility and prudential measures are key to Cajas' success story.

← Pillars of the Caja Risk Management Model →

Openness and client-centric approach	Decentralization and loss control	Strong support system
<ul style="list-style-type: none"> ▶ Cajas follow graduated expansion model that focuses on building complex operations, such as accepting deposits and providing financial advice in a phased manner. ▶ It starts complex operations only after fulfilling certain capital and risk-provision requirements. ▶ Cajas' credit evaluation methods rely on cash-flow analysis of customers' repayment capacity rather than guarantees or collaterals. ▶ Cajas follow a client-focused approach that includes conducting appraisals of clients' family and overall social setting. 	<ul style="list-style-type: none"> ▶ Cajas ensured balance between internal control and delegation of authority to loan officers so that they are responsive to clients and reduce risk in a decentralized manner. ▶ Products were designed in such a manner that it integrated loss control. For instance, pawn loan products were offered at deep discount in loan-to-value to protect against principal risk. ▶ Products were designed to suit the needs of local market conditions. ▶ Cajas used industry-specific risk controls for niche products. 	<ul style="list-style-type: none"> ▶ Strong support system such as information technology and MIS is core to Cajas' risk management system. ▶ Cajas developed and gradually enhanced their IT software packages to support its risk-monitoring systems including factors relating to cash-flow analysis. ▶ They provided training to build competent and loyal employee base. ▶ Cajas extended advice to clients on how to scale up their businesses and to assess risk in business models periodically.

²⁰ “Peruvian Microfinance's Caja Municipal Model”, ella.practicalaction.org/knowledge-brief/peruvian-microfinance-s-caja-municipal-model, 15 April 2013

► Funding of liabilities

Sourcing capital is a critical element of MFIs' goal to provide financial services to the underserved. Globally, MFIs have explored several innovative strategies for generating funds to support their growth and operations.

Linkages with informal community savings groups

The under-privileged sections of the society have themselves devised ways to fill credit gaps left by formal financing bodies, such as banks. Community-based savings groups are a common platform through which members deposit a fixed amount on a regular basis (usually weekly or monthly) and pay out the pooled savings to a different member each period. These informal groups have emerged due to several factors such as reluctance of formal institutions to serve poor people, especially in remote areas; high interest rates charged by banks; non-availability of proper documentation; cumbersome formal account opening process and lack of financial literacy and awareness about financial products. Linking of well-constructed savings groups to formal microfinance institutions benefits both parties:

Benefits for savings groups

- Improved profitability and return on savings
- Better management practices within groups
- Group cohesion and self-esteem
- Improved internal loan repayment rates
- Change in amount of savings within groups

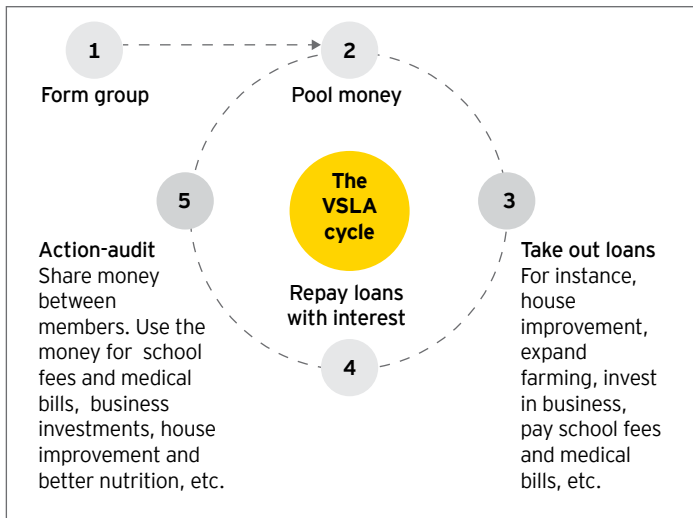
Benefits for MFIs

- Access to group's savings record in terms of frequency and amount before initiating credit relationship
- Increased penetration among poorer sections without significant cost outlay
- Low default rates due to ability to monitor group's savings to credit ratio

Case study: The Village Savings and Loan Association (VSLA) microfinance model help reduce poverty by financially empowering the poor in Africa²¹

The Village Savings and Loan Associations (VSLA) Model is one of the most effective microfinance models, facilitating formation of informal savings groups and allowing members to save flexibly, access loans to invest in small businesses and build a social fund for support without any external cash injection. The VSLA model is "savings-led" – members save money each week, and use the funds that accumulate to finance small loans to each other. Members also contribute a small sum to a compulsory insurance fund, which can be used to provide grants or no-cost loans to members in distress. The cycle of savings and lending is time bound. At the end of an agreed period the accumulated savings and interest earnings are shared out among the members. To ensure cost-effectiveness and scalability, strong members of the community are often selected and trained as community-based trainers or village agents, who supervise a portfolio of groups on a fee-for-service basis.

21 "Village Saving and Loans Associations", CARE Uganda; "Connecting the World's Poorest People to the Global Economy", CARE February 2013 publication



Social benefits of the VSLA model:

- ▶ Women empowerment
- ▶ Improvement in household income and welfare
- ▶ Preparing for emergencies through micro-insurance
- ▶ Linkages with formal institutions such as MFIs/banks

Case study: Barclays was able to successfully link informal savings groups into formal banking channels in Africa²²

Barclays "Banking on Change" project in Kenya and Uganda

- ▶ Barclays wanted to understand the financial needs of poor communities in a market it had yet to penetrate. A pilot project "Banking on Change" was set-up by Barclays with a modest target of linking 210 savings groups in Uganda and 200 in Kenya. KYC for this project was done at a group level with three members acting as nominated signatories.
- ▶ In Kenya, Barclays launched Uwezo account, a special low-cost savings account, which allowed free withdrawals and deposits, no monthly maintenance fee, a 2.5% interest rate, and a relatively low minimum opening deposit. In Uganda, a group current account was launched, with no account set up or monthly fees and no minimum balance.
- ▶ Savings groups welcomed the fact that they can keep their funds in a safe place and they are treated as equals by the bank.
- ▶ The growing trust between groups and the bank encouraged members to request additional financial services from Barclays, particularly access to credit.

²² "Connecting the World's Poorest People to the Global Economy", CARE February 2013 publication

Financing support from corporate bodies:

In order to reduce dependence on banks for their funding needs, MFIs have also looked at raising funds from large corporations.

Case study: Grameen America gets US\$7 million support from Wells Fargo

Grameen America is a leading non-profit microfinance organization based in the US. The US-based organization's primary objective is to support poor women to build small businesses in order to create better livelihoods. The MFI seeks to empower women entrepreneurs through access to capital, savings and credit-building. Since its inception in 2008, the MFI has provided more than 197,820 microloans to 69,525 women²³. Wells Fargo launched the Diverse Community Capital program in November 2015, which aims to provide US\$75m in grants and lending capital over a three-year period to Community Development Financial Institutions serving diverse small businesses. In February 2016, Wells Fargo provided US\$7m (US\$1m in equity equivalent and US\$6m in senior debt facility) to Grameen America. Other than Wells Fargo, the microfinance organization receives strong funding support from a diverse group of American corporations such as Apple, Bank of America, Google and Morgan Stanley.

Crowd-funding in microfinance

Crowd-funding, which has emerged over the past few years, is set to revolutionize the financial services industry and is also expected to have a profound impact on the microfinance sector. Alternative lending has been booming to fill the gap left by banks and other financial institutions; however, the microloan market remains largely overlooked.

Case study: crowd-funded Kiva micro-lending platform²⁴

Kiva's micro-credit platform finances small borrowers across the world by relying on social capital rather than traditional underwriting. Since its creation in 2005, the American association has raised ~US\$832m from 1.4m lenders to finance nearly 2m people in 84 different countries. It gives loans in small increments of as little as US\$25. Lenders select borrowers on the Kiva website, who get a loan to start a business that could help lift them out of poverty. Kiva has more than 250 vetted field officers, mainly NGOs, who assess the genuineness of borrowers' claims. Borrowers funded through Kiva have a 98% repayment rate.

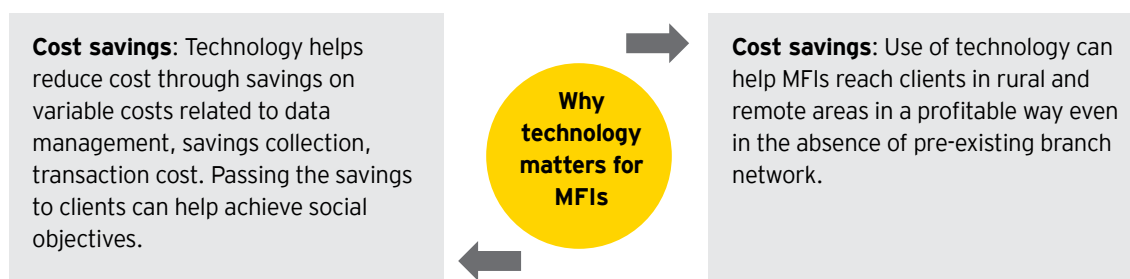
Kiva Zip was launched to fund small businesses across the US, particularly those in under-banked and underserved communities. Kiva Zip provides loans of maximum US\$10,000. Since its launch, it has helped around 60,000 individual lenders fund 1,800 small businesses for a total of US\$10m. In the US, 65% of Kiva's borrowers are ethnic minorities, and 54% are women.

23 "Firms are now looking to invest in MFIs after RBI awarded small finance bank licenses", Economic Times, 20 April 2016

24 "Kiva To Offer Its Zero-Interest Crowdfunded Loans To Small Businesses Nationwide", Forbes, 9 December 2015; "Crowdfunding development: 'Kiva's aim is to make microfinance easy'", the guardian, 10 June 2014; "Microcredits and Crowdfunding: The Dynamic Duo of Solidarity", <http://downtoearth.danone.com/2016/04/20/microcredits-and-crowdfunding-the-dynamic-duo-of-solidarity/>

► **Technology**

Earlier MFIs were focused on achieving high repayment rates and to do this they recruited a large number of field officers and set-up branches even in remote areas. Technology is transforming the microfinance space by helping to reduce costs, improve efficiency, and increase outreach.



Innovative technologies which can be leveraged by microfinance companies²⁵:

<p>Mobile device</p>	<ul style="list-style-type: none"> ► Mobile devices can be used by MFIs to provide innovative services such as cash deposit and withdrawals; transaction facilities such as micro loans borrowing and repayment, payment of utility and other bills; and money transfer between accounts. ► MFIs can draw significant benefits from low operational costs facilitated by transactions over mobile devices. This will, in turn, help them expand their operations at a reduced cost and get a strong foothold in rural markets. ► There is strong potential for mobile banking in India. India's mobile phone subscriber base crossed the 1b landmark in January 2016. Moreover, a significant part of this user base is expected to become smartphone users over the next few years. India has already become the world's second-largest smartphone market with 220 million users (second only to China, which has a smartphone user base of 500 million). MFIs can leverage India's mobile revolution in low-cost distribution of financial products/ services.
<p>Biometrics</p>	<ul style="list-style-type: none"> ► Storing biometric client information such as finger prints enables MFIs to conduct secure transactions remotely and does not need staff members to be present during authentication. ► It also helps cut down on paper records and improves efficiency in information management. ► Biometric authentication has advantage over password and personal identification methods, which can be easily forgotten.
<p>Personal Digital Assistant (PDAs)</p>	<ul style="list-style-type: none"> ► Personal Digital Assistant (PDA) is a portable computer-like platform that runs several software programs and brings the entire information system to the customer. ► This helps to standardize lending methodologies as well as assist in collection of information, conducting loan analysis and disbursement of funds, thereby, reducing time taken for each activity. This in turn, improves efficiency of loan officers.

25 "India Just Crossed 1 Billion Mobile Subscribers Milestone And The Excitement's Just Beginning", Forbes, 6 January 2016; "With 220mn users, India is now world's second-biggest smartphone market", The Hindu, 3 February 2016

Case study: The Taysir Microfinance in Tunisia incorporates a 100% mobile banking based operating model²⁶

Taysir Microfinance, which started its operations in Tunisia in June 2014, made the unique choice of going 100% cashless (fully dependent on mobile banking). Taysir and La Poste Tunisienne (responsible for post services in Tunisia) have a strategic partnership with the Tunisian mobile phone operator Ooredoo. Taysir uses a mobile payment service known as “Mobiflouss,” which was developed on the basis of a specific microfinance module. Loans are issued by bank transfer on La Poste’s banking card, which clients purchase beforehand in a post office. The clients therefore become holders of a prepaid MasterCard that can be used to manage withdrawals or purchases. For the repayment, the clients, having recharged their cards in La Poste’s cash in network (1,500 branches with 900 connected), then pay with their mobile phones. The clients do not therefore, have to visit Taysir branches. This system has proved to be very effective indeed in rural areas, where 63% of Taysir’s 2,000 clients are located (as of April 2015).

Measuring success:

- ▶ Improved operational efficiency
- ▶ Reduced transaction costs

Key requirements for success:

- ▶ Acceptance by clients
- ▶ IT infrastructure support such as an effective mobile payment system

Case study: use of PDAs²⁷

BanGente (Venezuela), Banco Solidario (Ecuador) introduced PortaCredit application for PDAs. The software was used to collect client information in the field and then upload it to a central database. The main goal of the program was to automate and standardize the credit application process and increase operational efficiency of loan officer.

Measuring success:

- ▶ Improved workflow efficiency
- ▶ Reduced operational costs
- ▶ Improved quality of information available to loan officers

Key requirements for success:

- ▶ Well developed and stable MIS system
- ▶ Quick access to MIS data from branches
- ▶ Support from top management
- ▶ High quality and trained technical staff to support MIS

26 Microfinance Barometer, 2015

27 “ACCION PortaCredit: Increasing MFI Efficiency with Technology”, May 2004

Case study: use of Biometrics²⁸

Prodem FFP (Bolivia) introduced innovative combination of biometrics and smart cards. The concept involved developing own software to integrate biometric readers and smart cards with its software platforms. Computers at the company's 54 branch offices were equipped with card readers and fingerprint scanners. Biometric readers were also installed at ATMs to facilitate secure transactions.

Measuring success:

- ▶ Improved security of client transactions
- ▶ Speedy verification without need for any staff which in turn reduced operational costs
- ▶ Increased customer satisfaction due to improved convenience and safety

Key requirements for success:

- ▶ Detailed cost-benefit analysis of software integration between card readers and central MIS
- ▶ High quality and trained technical staff to support MIS
- ▶ Reliable electrical power for card or biometric readers

Urban job creation: MFIs can help generate employment by supporting micro and small businesses through an inclusive and innovative framework

Globally, micro and small enterprises form an essential platform for job creation, innovation, entrepreneurship and social economic development. However, these small enterprises find it exceedingly difficult to get funding from formal sources, especially in developing and emerging economies. Microfinance is key to providing financial support to such small businesses.

Foster political support	<ul style="list-style-type: none"> ▶ Develop institutional framework to encourage entrepreneurship and access to finance ▶ Reduce administrative procedures for companies that hire micro businesses ▶ Encourage commitment and responsibility toward community
Increase availability of public and financial resources	<ul style="list-style-type: none"> ▶ Encourage development of specialized institutions with the help of government, commercial banks and private companies ▶ Utilize public resources to develop a fund to provide loans and guarantees to MFIs
Encourage entrepreneurial initiative	<ul style="list-style-type: none"> ▶ Educate population regarding benefits of entrepreneurship ▶ Promote entrepreneurship in the educational system ▶ Encourage financial education programs for low, middle class and unemployed population
Cooperation between public and private institutes	<ul style="list-style-type: none"> ▶ Encourage cooperation between financial institutes, MFIs, universities, NGOs and local public authorities ▶ Encourage cooperation between regional and local government ▶ Promote agenda of financial inclusion among these institutes

About ASSOCHAM

THE KNOWLEDGE ARCHITECT OF CORPORATE INDIA

Evolution of Value Creator

ASSOCHAM initiated its endeavour of value creation for Indian industry in 1920. Having in its fold more than 400 Chambers and Trade Associations, and serving more than 4,50,000 members from all over India. It has witnessed upswings as well as upheavals of Indian Economy, and contributed significantly by playing a catalytic role in shaping up the Trade, Commerce and Industrial environment of the country.

Today, ASSOCHAM has emerged as the fountainhead of Knowledge for Indian industry, which is all set to redefine the dynamics of growth and development in the technology driven cyber age of 'Knowledge Based Economy'.

ASSOCHAM is seen as a forceful, proactive, forward looking institution equipping itself to meet the aspirations of corporate India in the new world of business. ASSOCHAM is working towards creating a conducive environment of India business to compete globally.

ASSOCHAM derives its strength from its Promoter Chambers and other Industry/Regional Chambers/Associations spread all over the country.

Vision

Empower Indian enterprise by inculcating knowledge that will be the catalyst of growth in the barrierless technology driven global market and help them upscale, align and emerge as formidable player in respective business segments.

Mission

As a representative organ of Corporate India, ASSOCHAM articulates the genuine, legitimate needs and interests of its members. Its mission is to impact the policy and legislative environment so as to foster balanced economic, industrial and social development. We believe education, IT, BT, Health, Corporate Social responsibility and environment to be the critical success factors.

Members - our strength

ASSOCHAM represents the interests of more than 4,50,000 direct and indirect members across the country. Through its heterogeneous membership, ASSOCHAM combines the entrepreneurial spirit and business acumen of owners with management skills and expertise of professionals to set itself apart as a Chamber with a difference.

Currently, ASSOCHAM has more than 100 National Councils covering the entire gamut of economic activities in India. It has been especially acknowledged as a significant voice of Indian industry in the field of Corporate Social Responsibility, Environment & Safety, HR & Labour Affairs, Corporate Governance, Information Technology, Biotechnology, Telecom, Banking & Finance, Company Law, Corporate Finance, Economic and International Affairs, Mergers & Acquisitions, Tourism, Civil Aviation, Infrastructure, Energy & Power, Education, Legal Reforms, Real Estate and Rural Development, Competency Building & Skill Development to mention a few.

Insight into 'New Business Models'

ASSOCHAM has been a significant contributory factor in the emergence of new-age Indian Corporates, characterized by a new mindset and global ambition for dominating the international business. The Chamber has addressed itself to the key areas like India as Investment Destination, Achieving International Competitiveness, Promoting International Trade, Corporate Strategies for Enhancing Stakeholders Value, Government Policies in sustaining India's Development, Infrastructure Development for enhancing India's Competitiveness, Building Indian MNCs, Role of Financial Sector the Catalyst for India's Transformation.

ASSOCHAM derives its strengths from the following Promoter Chambers: Bombay Chamber of Commerce & Industry, Mumbai; Cochin Chambers of Commerce & Industry, Cochin; Indian Merchant's Chamber, Mumbai; The Madras Chamber of Commerce and Industry, Chennai; PHD Chamber of Commerce and Industry, New Delhi.

Together, we can make a significant difference to the burden that our nation carries and bring in a bright, new tomorrow for our nation.

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