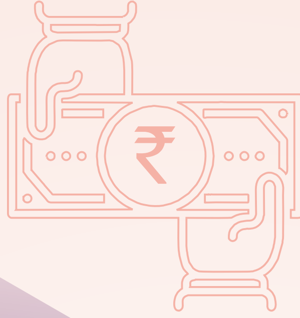
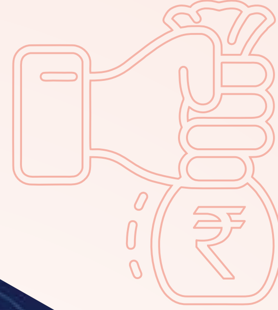
Creating Partnership with the Needy





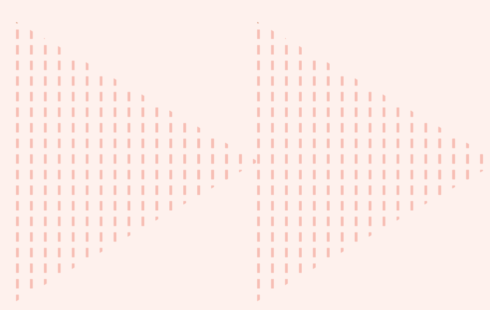
Financial Year
2020-21

SECTOR REPORT

BASED ON

PEARLS-Sahulat Ratio Analysis of Sahulat Affiliated IFCCS

www.sahulat.org



ABBREVIATION & ACRONYM

PEARLS — ***Protection, Effective Financial Structure, Assets Quality, Rates of Return & Costs, Liquidity, Signs of Growth***

WOCCU — ***World Council of Credit Unions***

RBI — ***Reserve Bank of India***

IFCCS — ***Interest-free Cooperative Credit Society***

OVERALL MEDIAN — ***The overall median has been arrived at by arranging ratios of all 25 IFCCS in ascending order (smallest to highest number) and the middle ratio has been taken as the overall median of the sector.***

OBJECTIVE OF SECTOR REPORT

Financial activities in India are generally governed by the existing laws and regulated by the regulatory bodies like Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI) Insurance Regulatory and Development Authority of India (IRDAI) etc. These regulatory bodies monitor the progress of their respective sectors and also devise the financial benchmark for their sustainable growth. Financial activities that are not directly regulated by the regulatory bodies have been allowed to self-regulate and hence microfinance activities in India have been recognized as a unique financial model by RBI and allowed self-regulation under its watch.

Interest Free financial sector is a unique model compared to existing conventional financial sector however, they are currently only governed by the country's existing laws and there is no specific regulatory body or Self-Regulatory Organization (SRO) to regulate this sector. Interest Free financial activities in India have not attracted the attention of the policy makers primarily due to its nascent stage and miniscule size in the existing economy. In the above backdrop self-regulation of Interest free financial activities becomes inevitable so as to provide financial benchmarks customized specific to unique model and to advocate its case before the policy makers and regulatory bodies.

Sahulat Microfinance Society as a Cooperative Development Organization (CDO) trying to fill the vacuum through benchmarking, monitoring and support services to the Interest Free Credit Cooperative Society (IFCCS) sector. Sahulat as a CDO and SRO has been undertaking several initiatives to strengthen the IFCCS sector which includes benchmarking, shariah audit and compliance, operational support to IFCCS, software support, advisories and advocacy on government changing regulations etc.

The current report is an effort by Sahulat to provide broad highlights of the sector to all the stakeholders. The objective of this report is to highlight the strength of this sector and also identify the weaknesses so that corrective measures are taken at the earliest.

Sahulat believes that it is inevitable for IFCCS sector to undertake critical assessments periodically to ensure sustainable and healthy growth. The assessment of critical nature not only boosts the morale of people associated with the sector but also provides a roadmap for future corrections and actions thereby leading to a healthy growth. IFCCS sector's foundational structure is built upon equity and deposit from the members and hence it becomes equally more important to educate the equity and deposit holders about the safety and security of their funds. In this backdrop this report is second in series highlighting the overall health of this sector with the recommendation of remedial action.

Who can benefit from this report?

We believe that all the stakeholders associated with interest free microfinance sector be they IFCCS Board Members, IFCCS Employees, IFCCS Members, Regulators, Researchers, Students and Community at large in India and abroad can benefit from this report.

Preface

Sahulat Microfinance Society, New Delhi is a registered society under the Societies Registration Act of 1860. The Society was established in 2010 to promote interest-free microfinance cooperative institutions in self-sustaining mode to serve the people belonging to disadvantaged sections of society, meaning thereby whose daily or weekly earnings enable them to operate thrift deposit accounts and who need microfinance to enhance their earnings. On the initiative of the Sahulat, some existing interest-free cooperative credit societies were affiliated and some new cooperative credit societies were created under the state cooperative society acts (both old and new liberal acts) or the Multi-State Cooperative Society Act 2002.

As of date, altogether 52 registered interest-free cooperatives with 101 branches operating in different parts of the country are affiliated with Sahulat. Out of these 52 cooperatives, only 25 have been selected for assessment under PEARLS indicators because at least three years' data from Balance Sheet are required for comparative assessment. Some of our affiliated cooperatives are either in existence for less than 3 years or their 3-year Balance Sheets are not available with us.

This is the 2nd ratio analysis report of interest-free cooperative credit societies working in different parts of India. PEARLS indicators are tools designed for objective monitoring of financial performance and management guidance for credit institutions. These indicators take into account only the audited statements of accounts data for generating different ratios under the heads of (1) Protection, (2) Effective Financial Structure, (3) Asset Quality, (4) Rates of Return & Costs, (5) Liquidity, and (6) Signs of Growth.

One indicator of RBI has also been included in the report to know the microfinance status of our affiliates by determining the average loan size. Qualitative Shariah Compliance Performance has been assessed on four different indicators. In total 17 indicators have been assessed in the above-mentioned three categories.

We express our sincere gratitude to our affiliates who have been very participative in the development of this report by providing their audit reports and related information.

We are thankful to Mr. M.H. Khatkhatay, Mr. M. S. Khan, Mr. Arshad Ajmal, CA. S. S. Quadri and Mr. Fahad Ahmad for their expert input and constant engagement during the development of the PEARLS Sahulat Ratio Analysis tool.

Research Desk
Research and Training Department

PEARLS Standards

World Council of Credit Unions (WOCCU) has created a comprehensive tool named PEARLS to measure the financial health of credit unions. There are 45 financial ratios to measure the performance in key areas and set a path to improvement.

The financial ratios or indicators of PEARLS can be used to evaluate the health of cooperative credit institutions. While ratios provide an objective appraisal, they are not a guarantee of financial stability. Key reasons why this might be the case include, firstly, that there may be practices in a cooperative credit institution that hide important financial weaknesses, for example, there may be understating of weak loans by continuous rescheduling and making them look like they are performing better than they actually are; and secondly, that even strongly performing entity with good financial ratios can be subjected to shocks such as a sudden collapse in the value of the investments, buildings, high inflationary trend, an economic crisis or fraud. Thus, while ratios can provide a good indication of the financial health of a cooperative credit society, it is important not to rely exclusively on ratio analysis. Some other aspects of assessment include on-site examination covering the key elements of loan book appraisal, internal controls, and governance. The list of selective indicators and their significance are given below.

There are 13 key indicators under the six broader heads of PEARLS out of which, we have selected 5 key indicators and also some other indicators of PEARLS which act as key indicators for interest-free operations hence in total with 7 key indicators and 1 microfinance indicator we analyze 13 indicators in this report. The selection of indicators has been made mainly due to two reasons: (1) some of the indicators are not relevant to interest-free credit institutions, and (2) our affiliates presently do not maintain some of the accounting data required for deriving some key ratios of PEARLS, e.g., loan delinquency. Selected PEARLS and derived indicators of this report present a comprehensive objective status of our affiliates and would help in better understanding the status of the IFCCS sector which is still in a nascent stage in India.

List of Selected PEARLS & RBI Indicators

S.No.	Indicator	Ratio	Formula	Goal
			P: PROTECTION	
01	Protection Level of Members' Savings and Share Capital	P6A	[(Total Assets+Reserves+Surplus) -(Delinquent loan>12m+0.35 (Assumed)x Delinquent loan 1-12 m (Assumed)+ Total Liabilities)]/ (Total Deposits)	Min 125%
			E: EFFECTIVE FINANCIAL STRUCTURE	
02	Ratio of Loan Portfolio in Total Assets.	E1	(Total Gross Loans Outstanding-Total Allowance for loan losses)/Total Assets	70-75%
03	Ratio of Savings Deposit against Total Assets.	E5	Total Deposit/Total Assets	75-85%
04	Ratio of Total Members Shares against Total Asset	E7	Total Share Capital/Total Assets	Max 15%
05	Ratio of Institutional Capital against Total Assets	E8	Total Institutional Capital/Total Assets	5% Min
			A: ASSETS QUALITY	
06	Percentage of Non-earning Assets excluding Cash and Bank	A2B	Asset in Liquidation + Non-Earning Fixed Asset +Prepaid Expenses + Refundable Advances) / Total Assets	<=5%
07	Net Zero Cost Fund against Non-Earning Assets	A3	(Net Institutional Capital +Transitory Capital + Interest free Liabilities)/Non-Earning Asset	>=100%
			R: RATE OF RETURNS & COSTS	
08	Demand loan Income against Demand loan expense	RS1	(Yield on Demand Loan)/C Y Demand Loan+P Y Demand Loan/2)	100%
09	Business Loan Income against Operating Expenses	RS2	(Yield on Business Loan)/C Y Business Loan+P Y Business Loan/2)	140%
10	Operating Cost Ratio against Average Total Loan Asset	R9	(Total Operating Expenses - Provisions for loan losses)/ [(Total Loan Assets of current year-end + Total Loan Assets of last year-end)/2]	<=10%
			L: LIQUIDITY	
11	Adequacy of Liquid Cash Reserves	L1	Total Earning Liquid Investments + Total Non-Earning Liquid Assets - Short-term Payables / Savings Deposits	Min 22%
			S: SIGNS OF GROWTH	
12	Growth rate in Total Asset	S11	(Total Asset at current year-end/Total Asset at last year-end)-1	>Inflation + 10% (16%)
			MICROFINANCE	
13	Loan Size	LS	Total Loan Disbursed /No of Borrowers	< 120,000

Due to the interest-free nature of IFCCS, many ratios were not applicable and some ratios have been either tweaked in their formula or in goal and some have been derived by Sahulat to assess the interest-free aspect of IFCCS. Below are the details of the kind of changes made in the respective ratios.

PEARLS Ratios: R9, S11 ratio has been used without any modification in the formula and goal;

PEARLS Tweaked Ratios: P6, E1, E5, E7, E8, A2B, A3, L1 ratios have been either tweaked in their formulas or the goal has been revised to complement IFCCS unique requirements;

Sahulat derived PEARLS Ratios: RS1, and RS2 ratios have been derived to measure the rate of return from the interest-free perspective and accordingly goals have been fixed.

Sector's Overall Health (indicator-wise)

S.N.	Ratio	Goal	Sector's Median Ratios
1	P6	Min 125%	116.62
2	E1	70-75%	70.78
3	E5	75-85%	84.57
4	E7	Max. 15%	11.27
6	E8	5% Min	2.23
5	A2B	<=5%	1.72
7	A3	>=100%	152.29
8	RS1	100%	85.41
9	R9	<10%	9.19
10	RS2	140%	83.84
11	L1	Min 22%	28.09%
12	S11	>Inflation + 10% (16%)	29.54%
13	LS	<120,000	55,843
14	Intent to be compliant	30	30
15	Initial Shariah Audit done – 14(a) Demand Loan	30	15
	Initial Shariah Audit done – 14 (b) Business Loan	30	0
16	Implementation	30	0
17	Implementation Complete	30	0

Constraints

The data collection is the biggest constraint faced by the Research and Training Department as we receive the audited balance sheet with significant delays. We humbly request our affiliates to complete the audit of financial statements and share the same on a priority basis. There are other four constraints as listed below in preparation for this report;

The first constraint faced by the Research and Training Department of Sahulat was that it could select only those vital indicators from PEARLS for which our interest-free cooperative credit societies maintain the relevant data except the key indicators of “Protection” (P1 & P2) for which we do not have data.

The second constraint in the assessment is related to the lack of a uniform system of accounting and reporting and translation of statutory audit reports of societies of Maharashtra. However, we have tried to derive authentic data from the audit reports of respective IFCCS.

The third constraint is related to short age group of our 52 affiliates and the non-availability of the required three-year audit reports. IFCCS with only two years of existence have not been included in the comparative trend assessment. It is to be noted that at least three years of accounting data is required for the comparative assessment of PEARLS indicators.

The fourth major constraint is the lack of required data for three key indicators (P1, P2, & A1) out of 13 key PEARLS indicators. These left-out indicators are related to maintenance of Loan Delinquency>12 months & Delinquency<12 months &>30 days for which provisions should be made in our credit societies for the protection of Liabilities.

Sector Report - Strong Areas of the Sector

1. Growth Story of the Sector:

The growth of the sector is measured by comparing the current year's total assets to the previous year's total assets size. The goal for this indicator is growth greater than the inflation rate (i.e., 6%) + 10%.

It is satisfying to note that the IFCCS (Interest-free Credit Cooperative Society) sector has grown more than WOCCU's prescribed goal i.e., greater than the inflation rate + 10%. The median growth (in total assets) of the sector is 29.54% which is if adjusted with an annual inflation rate of 6%, the inflation-adjusted median growth of the sector would be 23.54%.

However, there are eight IFCCS that are pulling back the sector median with 4 IFCCS having negative growth and 4 IFCCS having insignificant growth as highlighted in the below chart.

Growth of the Sector Range	<0%	>0%-16%	>16%
No. of IFCCS	4	4	17
Remarks	IFCCS are making negative growth which is further aggravated due to inflation	IFCCS are making growth which is able to cover inflation and some additional growth	IFCCS are making significant growth thereby expanding their asset size

All the IFCCS having negative growth and insignificant growth need to improve their weak indicators, such as deposit mobilization, share capital, loan, etc. The positive growth in their respective indicators shall reflect in their growth story.

2. ALS (Average Loan Size):

The ALS indicator is measured by dividing the total loan disbursed during the year and the number of new borrowers who were extended loan during the year. The goal for this indicator is less than Rs. 120,000 loan size for each borrower.

The average loan size of the sector is exceedingly well and within the erstwhile RBI microfinance guidelines i.e., Rs. 120,000. The ALS is on target as the entire sector disbursed the loan in the range of Rs. 16,000 to Rs. 120,000 and the median of the sector is Rs. 55,843. All IFCCS are doing good in this indicator.

3. Non-Earning Assets:

The non-Earning Assets indicator measures the Percentage of Non-earning Assets (Fixed Assets and other assets that do not make earnings excluding cash and bank) in total assets. The goal for this ratio is less than or equal to 5% non-earning assets against the total assets.

Non-Earning Assets Range	<5%	5%-10%	>10%
No. of IFCCS	22	2	1
Remarks	IFCCS are in the healthy range	IFCCS are slightly exceeding the healthy range	Excessive non-earning assets are a burden on IFCCS and need to be liquidated

Non-Earning Asset is on target with 22 out of 25 IFCCS maintaining a ratio lower than 5%. Three IFCCS are the outliers as one has huge historical assets i.e., premises, properties and the other two have their fixed assets in the range of 5% - 10%.

The IFCCS which have higher fixed assets need to liquidate its assets and infuse the liquid fund into loaning activity which shall increase its loan portfolio and also the earning thereby improving the institutional capital

4. Operational Cost:

The Operational Cost indicator is measured by dividing the total operational cost during the year and the average loan outstanding ((opening loan outstanding + closing loan outstanding)/2) during the year. The goal for this indicator is less than or equal to 10% of operational cost against the average loan outstanding.

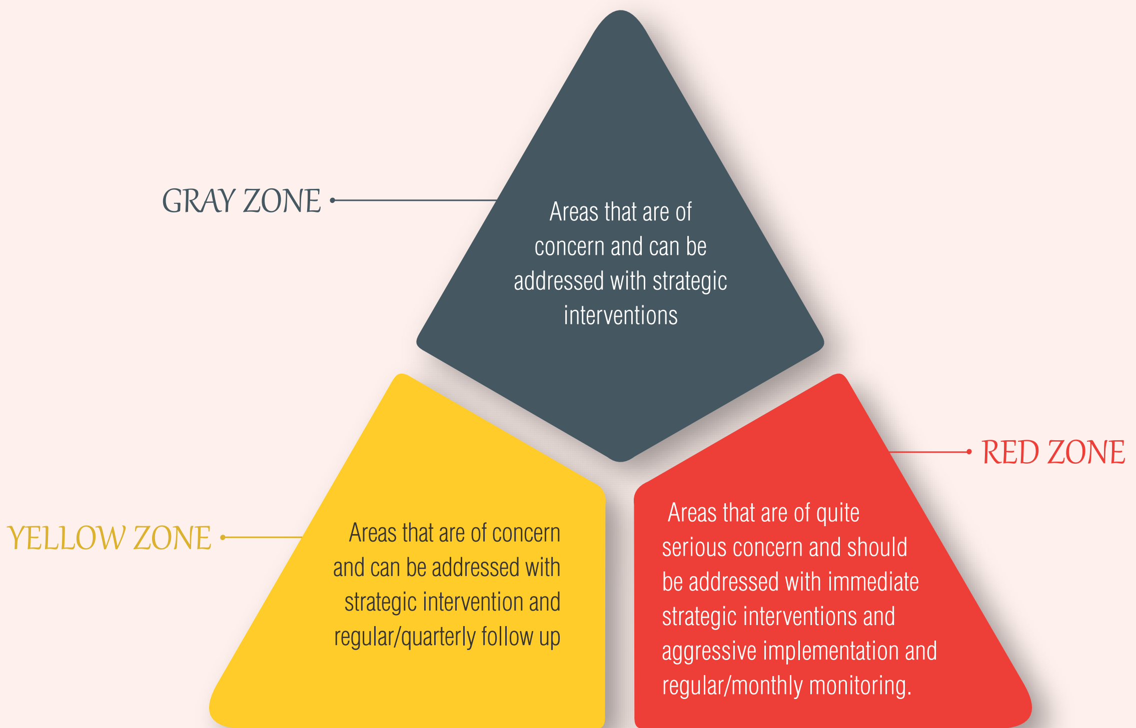
Operational Cost Range	<10%	10%-14%	>14%
No. of IFCCS	15	8	2
Remarks	IFCCS expenditure is within the permissible limit	IFCCS expenditure has exceeded the permissible limit by 4%	IFCCS expenditure has exceeded the permissible limit by nearly 8%-10%

The sector has performed well in this indicator owing to the 15 IFCCS that have achieved the goal by keeping their operational cost less than 10%. The remaining 10 IFCCS have made an operational cost more than 10%, however, there are 8 IFCCS that have operational costs in the range of more than 10% to 14% whereas there are only 2 IFCCs that have operational costs more than 15%.

IFCCS which have high operational cost need to reduce its cost by increasing their deposit and loan portfolio with the existing staff. Efficiency in the operations could also be brought through the effective use of technology and staff training.

Concern Areas of the Sector

The concern areas of the sector have been divided into three zones according to the nature of gravity.



Gray Zone

1. Loan Portfolio:

The Loan Portfolio indicator measures the ratio of total gross loans outstanding against the total assets of the sector. The goal for this ratio is 70%-75% loan portfolio against the total assets.

Loan Portfolio Range	<70%	70%-75%	>75%
No. of IFCCS	11	5	9
Remarks	Risk of making losses	Healthy position	Excessively high liquidity risk

There are 5 IFCCS that have achieved the goal of being within the 70%-75% range whereas 9 IFCCS have breached the ceiling of 75% and 11 IFCCS have a loan portfolio lower than 70% against the total assets.

IFCCS having the loan portfolio within the goal range indicates their healthy position whereas the IFCCS having breached the ceiling of 75% indicates their vulnerable position against the liquidity risks. The IFCCS having a lower loan portfolio against the minimum benchmark of 70% also indicates that they are not able to deploy the fund in an efficient manner thereby compromising the earning opportunity and leading to incurring losses.

It is pertinent to highlight that over-deployment leads to risking the stability of the organization whereas under-deployment reduces the income-generating capacity and both scenarios should be avoided.

2. Solvency:

Solvency (Protection) is a position of an IFCCS at any given date with the objective that in the event the organization needs to shut down its operation then the total assets should cover the total deposit including liquidation expenses. The goal for this indicator is to have a solvency ratio of 125% or more against the total deposit and liquidation expenses.

Solvency Range	<110%	110%-125%	>125%
No. of IFCCS	7	11	7
Remarks	Deposit is secure, not enough funds to cover the liquidation cost	Deposit is secure, and enough to cover the liquidation cost	Deposit and shares are secure, and enough to cover liquidation cost

The sector falls behind on the solvency (Protection) indicator. Out of twenty-five IFCCS, only 7 IFCCS have more than 125% ratio whereas 11 IFCCS have solvency ratio enough to cover the deposit and liquidation cost. The remaining 7 IFCCS have solvency ratio lower than 110% thereby risking the deposit and also lack enough fund to cover the liquidation cost.

Covid 19 pandemic and the two nationwide lockdowns can be seen as the contributing factors to the decline in solvency from the financial year 2018-19 which was at 125%. The sector has not been able to achieve its previous levels of solvency in the last 2 years.

3. Deposit Mobilization:

The deposit Mobilization indicator measures the ratio of the total deposit balance against the total assets of the IFCCS. The goal for this indicator is 75%-85% deposit mobilization against the total assets.

Deposit Mobilization Range	<75%	75%-85%	>85%
No. of IFCCS	5	8	12
Remarks	IFCCS is unable to mobilize enough deposits against its share capacity	The deposit is in a healthy position	IFCCS has mobilized deposits more than its share capital capacity thereby risking the member's deposit

Out of twenty-five IFCCS, 8 IFCCS have achieved the goal of 75% - 85% whereas 12 IFCCS have breached the ceiling of 85% and 5 IFCCS have a ratio lower than 75%.

IFCCS having the deposit mobilization portfolio within the goal range indicates their healthy position whereas the IFCCS having breached the ceiling of 85% indicates that they do not have sufficient share capital to back up the deposit mobilization. Whereas IFCCS having lower deposits against the minimum benchmark of 75% also indicates that they are not able to mobilize sufficient funds thereby underutilizing their deposit mobilizing capacity as provided by their share capital.

IFCCS which have mobilized less than 75% of deposit needs to increase its deposit ratio through the introduction of new deposit products whereas IFCCS which have mobilized deposit of more than 85% needs to mobilize more share capital so that this indicator is stabilized.

4. Net Zero Cost Fund:

The Net Zero Cost Fund indicator is measured by dividing the Net zero-cost funds (Institutional Capital + Transitory Capital) with the Non-earning assets (Fixed Assets and other assets that do not make earnings excluding cash and bank). The goal for this indicator is more than or equal to 100% net zero cost fund against the non-earning assets.

Net Zero Cost Fund Range	<50%	50%-100%	>100%
No. of IFCCS	8	2	15
Remarks	IFCCS have very poor institutional capital against their non-earnings assets	IFCCS do not have a satisfactory level of institutional capital against their non earnings assets	IFCCS have satisfactory level of institutional capital against the non-earnings.

Net zero-cost funds of 15 out of 25 IFCCS is more than 100% whereas 10 IFCCS net zero cost fund is less than 100% and most of them have a ratio less than 50% or negative. The negative net zero cost fund is owing to the losses incurred on their operations.

IFCCS which have less than 100% net zero cost fund need to improve their institutional capital so that this indicator could be improved.

Yellow Zone

1. Liquidity:

The liquidity indicator measures the ratio of the total liquid funds (cash and bank excluding the expenditure of less than 30 days) against the total deposit balance of the IFCCS. The goal for this indicator is 22% liquidity against the total deposit balance.

Liquidity Range	<15%	15%-22%	>22%
No. of IFCCS	6	4	15
Remarks	IFCCS risking the liquidity crisis	IFCCS liquidity is in a healthy position	IFCCS are not fully utilizing its liquid fund for loaning activity thereby compromising their income

Out of twenty-five IFCCS, 15 IFCCS have liquidity of more than 22% whereas 10 IFCCS have liquidity of less than 22%. Out of 15 IFCCS which have more than 22% liquidity 14 IFCCS have liquidity of more than 25% whereas out of 10 IFCCS which have liquidity of less than 22%, 6 IFCCS have liquidity of less than 15%. There are only 4 IFCCS that have liquidity in the range of 15%-25%.

IFCCS having liquidity near to the goal indicates their healthy position whereas the IFCCS having breached the ceiling of 22% indicates that they have excess funds lying idle and losing the opportunity to earn by deploying the excess fund in income generating loan portfolio. Whereas IFCCS having lower liquidity position bearing the excessive risk of liquidity management which can even lead to a bank run scenario.

From the above figures it could be concluded that the sector's liquidity management is not prudent and the sector needs to amend its operations so that it could achieve the goal of 22% liquidity.

IFCCS which have less liquidity need to work on their deposit ratio and those with high liquidity need to deploy the same in their loan portfolio.

2. Institutional Capital:

The institutional Capital indicator measures the ratio of institutional capital (reserves and surplus) against the total assets of the IFCCS. The goal for this indicator is equal to or more than 5% institutional capital against the total assets.

Institutional Capital Range	<0%	>0%-5%	>5%
No. of IFCCS	4	15	6
Remarks	Less institutional capital indicates the inefficiency of the IFCCS	Institutional capital indicates the efficiency and profitability of the IFCCS	Better Institutional Capital indicates the good efficiency and profitability of the IFCCS

Out of twenty-five IFCCS, 6 IFCCS have institutional capital of more than 5% whereas 19 IFCCS have less than 5% institutional capital. Out of six IFCCS which have equal to or more than 5% institutional capital 5 IFCCS have the institutional capital in the range of 5% - 10% whereas one IFCCS has the institutional capital of 33% owing to its legacy reserves. 19 IFCCS have less than 5% institutional capital out of which 4 IFCCS have negative institutional capital and the remaining 15 IFCCS have the institutional capital in the range of 0% - 5%.

The Institutional Capital of the sector is behind the goal as only 8 IFCCS are either near to the goal or exceeding the goal. 17 IFCCS have institutional capital in the range of -8% to 4%.

Institutional capital indicates the health of an IFCCS and hence all efforts should be made to achieve the goal of 5% by all the lagging IFCCS.

3. Share Capital:

The share Capital indicator measures the ratio of share capital against the total assets of the sector. The goal for this ratio is 15% share capital against the total assets.

Share Capital Range	<5%	5%-15%	>15%
No. of IFCCS	10	6	9
Remarks	Less Share Capital means the deposit of members is at risk	Healthy Share Capital which protects the member's deposit	The potential of deposit mobilization is not being fully utilized

Out of 25 IFCCS, only 6 IFCCS have a share capital in the range of 5% to 15% whereas there are 9 IFCCS that have a share capital of more than 15%. The reaming 10 IFCCS have a share capital of less than 5%.

The 15 IFCCS have a share capital more than 10% whereas 10 IFCCS have a share capital of less than 5%. The IFCCS which have a share capital of more than 15% needs to mobilize more deposits whereas the IFCCS which has less than 5% share capital needs to mobilize more share capital to stabilize the ratio of the sector.

Red Zone

1. Income from Business Loan:

The income from Business Loan indicator measures the income received on the business loan against the expenses incurred on the business loan. The goal for this indicator is less than or equal to 140% income against the expenses on the business loan.

Income from Business Loan Range	<100%	100%-140%	>140%
No. of IFCCS	5	6	4
Remarks	IFCCS is not able to even recover the actual cost of business loans	IFCCS is able to make a decent profit in addition to recovering the actual cost	IFCCS is making high profits thereby attracting Shariah disqualification

Out of the twenty-five IFCCS in the analysis pool, only 15 IFCCS offer business loan products, therefore, the rest IFCCS have been excluded from this indicator's analysis.

5 IFCCS out of 15 IFCCS offering business loan products, have income against their expenses less than 100%. Out of 6 IFCCS that have an income in the range of 100% - 140% only 3 IFCCS are making decent profit and the rest 3 are merely recovering their cost of operation. The remaining 4 IFCCS are recovering more than 140% against their expenses on business loans.

It is evident from the above discussion that the sector is not efficient on this indicator and only 3 IFCCS is able to make the descent earnings as prescribed whereas the other 4 IFCCS is breaching the goal and 8 IFCCS are either not recovering the cost or merely recovering the cost of operations.

Incomes from business loans are a legitimate source of income (Profit) for IFCCS to build its institutional capital and help in growing its operations and expansion.

2. Qualitative analysis of Shari'ah Parameters:

The shari'ah parameter of the sector is behind the target as the median marks are 45 out of 150 marks. The sector has achieved a 30% median of the total marks. The two basic parameters, first intended to be compliant and second service charge collection lower than the actual cost have been achieved by majority of IFCCS making the sector as a whole Shari'ah complaint.

12 IFCCS have shown interest and started the implementation of the scientific costing method but no significant progress has been made. However, on business loan parameters except for one IFCCS, none have been able to work, hence these indicators seem quite skewed. The sector needs to expedite the implementation of the scientific costing method and also correct some issues in business loans (due to poor understanding) at the earliest to make this indicator healthy.

3. Cost Recovery from Demand Loan

The cost Recovery from Demand Loan indicator measures the income received on the service charge-based loan against the expenses incurred on the service charge-based loan. The goal for this indicator is less than or equal to 100% income against the expenses on the service charge-based loan.

Cost Recovery from Demand Loan Range	20%-90%	>90%-100%	>100%
No. of IFCCS	13	6	6
Remarks	IFCCS is not able to recover the cost	IFCCS is able to recover the cost	IFCCS recovering more than the cost of attracting Shariah non-compliance

Cost recovery from service charge-based loans is the most serious concern area for the sector as only 6 IFCCS have been able to recover the 90% to 100% cost of funds from the borrowers. Whereas 13 IFCCS have recovered the cost of operations in the range of 20% to 90% only. The remaining 6 IFCCS have recovered the cost of operations on-demand loans by more than 100% leading to shariah disqualification.

It is pertinent to highlight that the IFCCS breaching the goal is not willful but rather due to the slab-based collection of service charge. Most of the IFCCS having breached the goal have already conducted the Shariah audit and are in the process of making refunds to the members. The stand-alone software equipped with scientific costing method module is in implementation phase and post implementation the anomalies are hoped to be rectified.

All IFCCS under study must improve this ratio at the earliest by recovering the actual cost by instituting the scientific costing method.

4. Asset Classification (Loan Delinquency)

The balance sheet and other reports do not confirm if our IFCSS have classified their loan assets as per the level of delinquency of loans. Furthermore, Allowances for loan losses have been made by five IFCCS which are also negligible in comparison to their gross loan portfolios. Non-recognition of bad loans is a big risk for the financial institution as the management would not be able to take timely and appropriate measures to address the bad assets which may lead to large-scale default of the loan portfolio leading to even collapse of the organization.

SAHULAT
MICROFINANCE SOCIETY

E-89, Flat No- 403, Hari Kothi Lane,
Abul Fazal Enclave Part-I,
Jamia Nagar, New Delhi-110025

+91 11 2994 0031/0032

info@sahulat.org

www.sahulat.org