

EVALUATING BII'S FINANCIAL SERVICES PORTFOLIO

Reviewing the impact of microfinance in India:

A case study of Arohan financial services



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Acronyms

AML/CFT	Anti-Money Laundering /combating The Financing Of Terrorism
AP	Andhra Pradesh
BBPS	Bharat Bill Pay System
BII	British International Investment
CAGR	Compound Annual Growth Rate
DFI	Development Finance Institution
DI	Development Impact
EBITDA	Earnings before interest, tax, depreciation, amortisation
ESG	Environmental, Social and Governance
FCDO	Foreign, Commonwealth and Development Office
FI-DI	Financial Institution-Development Impact
FY	Financial Year
ICSI	Institute Of Company Secretaries Of India
JLG	Joint Liability Group
KYC	Know-Your-Customer
MFI	Microfinance Institution
MSME	Micro, Small And Medium Enterprises
NBFC	Non-Bank Financial Company
NBFC-MFI	Non-Bank Financial Company- Microfinance Institution
NIM	Net Interest Margin
PAR	Portfolio At Risk
RBI	Reserve Bank Of India

Executive Summary

Rationale and context of the study

In 2019, the Foreign, Commonwealth & Development Office (FCDO) commissioned Genesis Analytics and IPE Global to independently evaluate British International Investment's (BII) Financial Institutions portfolio (renamed Financial Services).

The purpose of this evaluation is to better understand the development outcomes and impacts associated with BII's investments in the financial services sector. It consists of two phases, namely an evidence and portfolio-level review completed in 2020 (phase one), and a subsequent series of in-depth case studies (phase two).

The phase one review revealed that microfinance investments make up a sizable share (about 17 per cent) of BII's total investments by value.¹ Moreover, the expansion of financial inclusion remains an acute challenge across much of the developing world. In India, a sizable share of the population (42 million in 2020) is served by microfinance institutions (MFIs) that give out micro loans without requiring physical collateral from borrowers.

Therefore, the evaluation team identified microfinance as an area of interest for an in-depth study.

This report presents the findings of one in-depth case study, exploring BII's investment in Aavishkaar Goodwill India Microfinance Development Company II (AGIMDC II) which subsequently invested in Arohan Financial Services in 2012, an Indian MFI seeking to provide loans to underserved groups, particularly women. The investment was underpinned by the following development impact (DI) thesis:

Box 1: Development Impact thesis (2012)

"BII's investment will support MFIs in the Indian banking sector to reach underpenetrated states and segments at a time when there is missing confidence in the MFI sector post the AP crisis. Indicators measuring investment performance: employment growth at all underlying portfolio companies, taxes paid, total number of loans to borrowers, growth in loan portfolio, growth in number of borrowers and portfolio at risk (PAR) 202; for non-MFIs – employment growth, revenue, earnings before interest, taxes, depreciation, and amortisation (EBITDA, where applicable) and taxes paid."

In 2022, BII updated its approach to impact management and introduced the Productive, Sustainable and Inclusive (PSI) framework to inform investments covering its 2022 – 2026 strategy³ period. Though this framework was not in place at the time of the investment, the aims of the investment in Arohan remain well-aligned to the new strategy.

The objectives of the study are to understand (i) the potential of microfinance to drive financial inclusion and productivity; and (ii) the role of microfinance in supporting micro, small and medium enterprises (MSMEs) and households from a productivity point of view, such as the potential impact microfinance can have on incomes, savings and business profitability.

1  Sunderji, S., Williams, D., Fuchs, M., Wyatt, A., Verrinder, N., (2020). *Evaluating CDC's financial institutions portfolio*. Genesis Analytics and IPE Global.

2 This refers to the share of the outstanding loan portfolio that is 20 days or more overdue.

3  British International Investment. (2022). *Productive, Sustainable and Inclusive Investment 2022 – 26 Technical Strategy*.

Evaluating the impact of microfinance investments: Arohan as a case study

The study aimed to evaluate the impact of BII's investment on Aavishkaar, the impact of Aavishkaar's investment on Arohan and finally, the impact of Arohan's investment on borrowers.

The study utilised mixed methods. It used interviews with the relevant BII investment team and both Aavishkaar's and Arohan's senior management. In addition, the study made use of Arohan's internal borrower data as a first method of gauging impact at the borrower level. Finally, a survey of 1,139 Arohan borrowers was conducted to delve more deeply into any changes they have experienced as a result of Arohan's offerings.

Specifically, the study was guided by four overarching evaluation questions, presented below, along with key findings and lessons.

QUESTION 1: How has BII's investment in Aavishkaar enhanced the fund's investment capacity and processes?

Finding 1.1: The capital that BII invested in Aavishkaar allowed the fund to execute all its planned investments.

BII's \$15 million investment represented about 50 per cent of Aavishkaar's total \$30.2 million fund size. Stakeholder interviews revealed that it would not have been possible for Aavishkaar to execute all its intended investments without BII's contribution. Arohan, in turn, may not have received the funding it required.


Lesson 1.1: DFI investments have a role to play in ensuring that the funds they invest in reach critical mass.

Aavishkaar offered a strong management team with a clear vision and credible investment strategy but would have struggled to effectively execute its strategy without BII's investment. Additionality is fundamental to impact⁴. In this case, an important question for DFIs to consider when investing is: how impactful their investment is likely to be. That is to say, would appropriate investments still take place without DFI involvement, or is the investment crucial in terms of promoting the effective execution of a given fund's investment strategy? In BII's case, its strict contribution assessment for its investments includes a focus on additionality.

Finding 1.2: BII's investment in Aavishkaar was crucial given that it occurred during a period of crisis in the Indian MFI sector.

BII made its investment in Aavishkaar in 2012, during the aftermath of the 2010 Andhra Pradesh (AP) crisis. The AP crisis was caused by cross-lending by MFIs operating in AP state, which led to borrower over-indebtedness as a result of multiple MFIs lending to the same borrowers. This, in turn, resulted in borrower defaults, with some MFIs resorting to unethical collection practices in order to recover their loans. MFIs' inability to recover their loans threatened the functioning of the industry, with many MFIs either closing, merging, or downscaling.⁵ The AP crisis represented a period of substantial upheaval for the microfinance industry and made it difficult to obtain commercial capital across the sector. This extended to Arohan; it struggled to attract financing during the crisis period. It was also negatively affected by its small portfolio size of \$6.8 million⁶ at the time, which meant that it was not sufficiently attractive to bigger players to warrant acquisition.

4  British International Investment. (2022). *Our approach to investor contribution, 2022 – 26 Strategy Period*.

5  Baradi, N. and K, Reddy., (2017). *AP Microfinance Crisis & Its Impact on Microfinance Sector*. Research Journal of Finance and Accounting.

6 Source: Management interviews with Arohan

Lesson 1.2: DFIs can act as an important stabiliser by making countercyclical investments at times of crisis.

BII's willingness to invest in Aavishkaar during a crisis period provided Arohan with a lifeline and sense of stability at a time when commercial capital was not readily available. Though the MFI industry has since matured and developed substantially, any future crisis periods may once again provide the opportunity for DFIs to play a stabilising role as private capital withdraws.

Finding 1.3: Arohan's borrowers benefitted from technical assistance as well as financial assistance.


Stakeholder discussions revealed that Aavishkaar adopted BII's focus on ESG risks including corporate governance, anti-money laundering and combating the financing of terrorism (AML/CFT). This intervention had an impact that extended to the borrower level, including Arohan's.

Aavishkaar began to monitor these same topics in its portfolio companies. Over time, corporate governance has become one of Arohan's strengths. The literature reports linkages between good MFI corporate governance and improved credit ratings, as well as improved investment performance.^{7,8} Arohan was recognised by the Institute of Company Secretaries of India (ICSI) for its strong corporate governance in 2020 and carries an A- credit rating from India-based credit rating agency CareEdge Ratings. Though not explicitly stated, it is possible that Arohan's strong corporate governance could have acted as a driver in its retention of a strong credit rating. In addition, stakeholder interviews credited Arohan's strong credit rating with its ability to raise funding more affordably. This had an impact on its borrowers. Though the Indian microfinance sector has recently undergone some de-regulation, it has traditionally been under tight regulatory control by the Reserve Bank of India (RBI). Amongst other topics, the RBI's regulations covered the maximum allowable interest rates, with Arohan's maximum interest rate limited to its cost of funding plus a 10 per cent margin. As a result of its strong credit rating, Arohan was able to reduce its cost of funding by 2 per cent between 2017 and 2018⁹, with this benefit subsequently passed on to its borrowers. The focus on corporate governance as part of BII's technical assistance to Aavishkaar therefore eventually filtered down to Arohan's borrowers enabling them to access more affordable loans and making it easier and more sustainable to take loans and repay them.

Lesson 1.3: Technical assistance is important in ensuring effective uptake of financial assistance.

Though the funding provided by BII was important in ensuring Arohan's survival and eventual expansion, the technical assistance support it provided was similarly able to drive impact at all levels, from the fund level down to the experience of end borrowers. It may be tempting for DFIs to prioritise capital investment above technical assistance – capital may be perceived as concrete and quantifiable, while tracking the impact of technical assistance may be more difficult. However, the provision of technical assistance to Aavishkaar and its subsequent impacts highlights the importance of DFIs providing technical assistance.

7  Beisland, L., Mersland, R., Randøy, T. (2014). *The Association between Microfinance Rating Scores and Corporate Governance: A Global Survey*. International Review of Financial Analysis.

8  Iqbal, S., Nawaz, A., Ehsan, E., (2018), *Financial performance and corporate governance in microfinance: Evidence from Asia*. Department of Management Sciences, COMSATS Institute of Information Technology.

9  Arohan. (2019). *Making it Happen, 2018-19 Annual Report*.

QUESTION 2: How are BII's investments reaching micro, small and medium enterprises (MSMEs) and what types of MSMEs are being reached, disaggregated by size, sector, income and gender?¹⁰

Finding 2.1: More than 75 per cent of Arohan's borrowers are groups that are traditionally underserved by formal financial services, such as women, people from rural communities, and small business owners. Their incomes largely align with BII's definition of "low income".

The borrower survey highlighted that most of Arohan's borrowers are women (77 per cent of respondents) and rural (79 per cent). These borrowers are mostly involved in agriculture or animal husbandry and in most cases, are the only employees in their business. They are generally financially excluded beyond microfinance. They fund their business and day-to-day activities through either their own business profits, or through MFI loans, with little usage of other formal credit. 75 per cent of survey respondents earn less than 15,000 rupees per month (about \$202, which equates to about \$6.73 per day, in USD market rates). BII use a poverty line of daily individual consumption of \$6.85/day, as defined by the World Bank, based on 2017 purchasing power parities (this was previously \$5.50/day based on 2011 PPP).¹¹

Lesson 2.1: Microfinance (as practiced in India) remains an effective tool for groups that are traditionally underserved by formal financial services.

Though Arohan's expansion took some time, the growth in the company's borrower base suggests that BII's initial investment of \$15 million in Avishkaar, of which \$7.1 million was subsequently reinvested in Arohan, has been effective in aiding the expansion of financial services to low-income, and rural individuals. Considering the size of the investment made, it was very effective in increasing outreach.

QUESTION 3: Has Aavishkaar's investment enabled an increase in access to finance for MSMEs and households?

Finding 3.1: Aavishkaar's investment fuelled Arohan's growth, allowing Arohan to increase the number of active borrowers it served to more than two million. Changes in the industry may offer chances to cast the net wider and reach even more excluded individuals.

Aavishkaar's investment in Arohan came at a crucial time for the company. Since the date of Aavishkaar's investment, Arohan's growth has been impressive. As shown in the table below, Arohan has increased in size across all metrics, including number of active borrowers, size of branch network and number of employees, and has generally outgrown the industry average growth rate.

¹⁰ In this context, there is no meaningful distinction between MSMEs (businesses) and individual borrowers, since Arohan's clientele mostly comprise individuals (primarily women) who engage in income-generating activities.


¹¹  British International Investment. (2023). Understanding who we reach: a deep dive into our portfolio in India

Table 1: Arohan's key metrics, 2012 versus 2021

Metric	FY 2012	FY 2018	FY 2021	Annual growth rate	Industry annual growth rate
Active borrowers	84,370	1,137,868	2,063,000	43%	1%
Number of states/territories served	3	11	17 ¹²	21%	Not available
Number of branches	93	435	737	26%	6%
Number of employees	500	3,318	6,790	34%	7%

Source:  Various annual reports, Arohan, AGII Fund Report, September 2012

At the time of the investment, Arohan's portfolio totalled \$6.8 million, making it a small player in an industry with a gross loan portfolio of \$2.9 billion. By 2015¹³ Arohan's \$54 million portfolio gave it nearly a 1 per cent market share of an industry with a gross loan portfolio of \$5.8 billion across 156 MFIs, and an average portfolio size of \$37.3 million per MFI. By 2015, Arohan had therefore become larger than the average Indian MFI. From 2015 to 2021, Arohan grew faster than the industry. Its 2021 portfolio of \$627 million gives it a 5 per cent market share of the industry's 2021 portfolio, which totalled \$11.8 billion. As Arohan has grown, its place in the industry has become larger than most other MFIs.

Lesson 3.1: There may be room for DFIs to back the Indian microfinance sector's transition towards digitalisation.

The highly standardised Indian microfinance sector is changing. A gradual process of digitalisation is taking place in the traditionally high-touch industry, particularly around back-office processing and know-your-customer (KYC) processes. This, coupled with a gradual loosening of regulations, may bring innovative, smaller players with different models to the fore.

Given the changes in digitalisation and regulatory environment currently taking place in microfinance in India, there may be room for DFIs to help fund this transition, for instance, by backing innovative, smaller players with alternative approaches to serving the financially excluded in a country with growing digital inclusion.¹⁴ This may lead to a more diverse industry, and could lead to the development of new products that better serve the needs of borrowers, particularly those that are currently excluded from the traditional microfinance model, which, in Arohan's case, was highly reliant on a single product.

Lesson 3.2: DFIs should remain cognisant of the best time to exit their investments in order to redeploy their capital more effectively.

An alternative lesson may relate to the timing of existing investments. Arohan has undoubtedly displayed strong growth and is able to raise funding either through public or private means, well-supported by its size, track record and strong credit rating. A question exists around at what point DFIs are better served by redeploying their investment capital into new investments, in other words, whether investment in MFIs, such as Arohan, have reached maturity. This links to the previous lesson around backing the Indian microfinance sector's digital transition, particularly as small players enter the market with new innovations.

¹² This includes the states of Maharashtra, Telangana, Gujarat and Karnataka, which form part of the MSME loan portfolio only and remained on the Arohan book after the company sold off the vertical to Ashv Finance (an NBFC under Aavishkaar, lending to MSME).

¹³ The chosen points in time reflect data availability.

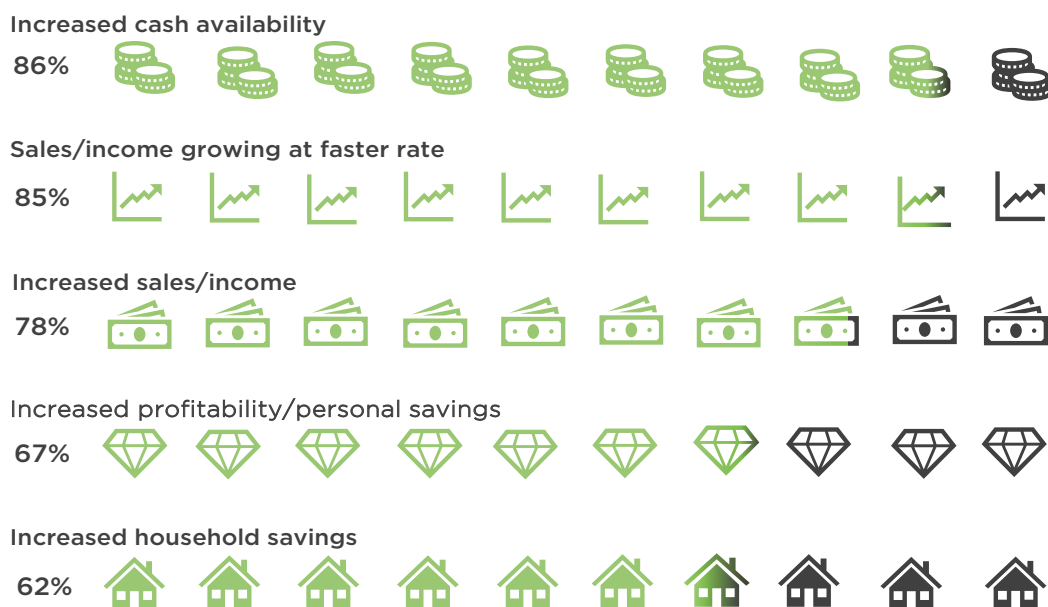
¹⁴ 41 per cent of survey respondents reported owning a smartphone, while 74 per cent had access to a smartphone through someone in their household.

QUESTION 4: What is the impact of the finance provided by Arohan on MSMEs and households?

Finding 4.1: Arohan's borrowers have reported positive effects on their cash availability, sales and income, profitability, personal savings, and household savings.

There were several findings related to the impact of Arohan's products on its borrowers. The survey explored several core metrics, which are shown in **Figure 1** below.

Figure 1: Share of survey respondents answering affirmatively to selected questions (per cent of total respondents)



Source: Arohan borrower survey, 2021

Respondents reported an increase in cash availability (86 per cent), faster growth in their sales/income (85 per cent) and a higher sales/income overall (78 per cent). Also, most borrowers reported increases in profitability/personal savings (67 per cent) and household savings (62 per cent). In most cases, there were no statistically significant differences in the shares of women reporting positive impacts on these five metrics compared to men, nor for rural respondents compared to urban respondents.

Lesson 4.1: The impacts of microfinance may include higher productivity and are therefore more diverse than the impacts reported in some literature.

Although some literature has found that microfinance does not lead to changes in household income or business profitability, the survey findings suggest that respondents have effectively used their microfinance loans for productive purposes, with positive impacts on their business' sales, incomes and profitability. These findings are surprising given that some literature found that microfinance does not lead to changes in household income or business profitability at least over the time horizon of one to three years post-intervention¹⁵.

In practice, given that most borrowers are the only employees within their businesses, it may be somewhat difficult to disentangle the businesses from their owners. Regardless, survey respondents highlighting increased sales and income are encouraging in terms of microfinance's ultimate impact at borrower level from a productivity perspective.

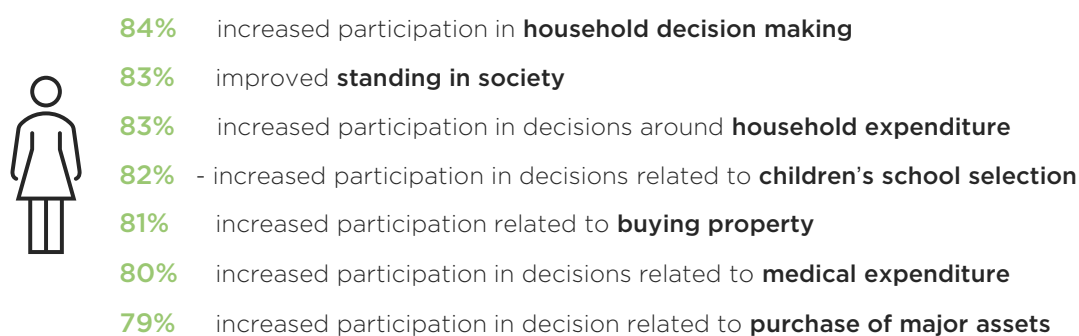
15 Cai, J., Meki, M., Quinn, S. (2023). Microfinance. VoxDevLit. 3(2).

Finding 4.2: Survey respondents, including female entrepreneurs, reported an improvement in their quality of life, in addition to positive productivity impacts.

Survey respondents highlighted increased welfare, including the ability to save more, access to better quality education and a general increase in income, as well as access to more nutritious food. Around 64 per cent of respondents also reported that Arohan's products helped them access more institutional credit sources, though only 42 per cent were certain that they would take out loans in the future.

The survey included a section dedicated to female entrepreneurs, defined as women who own a business and who reported running it themselves or in conjunction with a man. There were 34 per cent (388 out of 1139 Arohan borrowers) such respondents in the sample. As shown in the figure below, these women reported several positive impacts relating to their decision making (84 per cent), management of household expenses (83 per cent) and decisions around buying major assets (79 per cent).

Figure 2: Female entrepreneurs, responses to questions targeted specifically at them



Source: Arohan borrower survey, 2021

Lesson 4.2: In addition to positively affecting productivity, microfinance investments should also be viewed in terms of their ability to drive overall well-being.

Respondents were asked a set of questions about changes in their household well-being, with the option to select multiple choices, as having improved due to their use of Arohan's products, such as increased savings, better education for children, more disposable income, access to more/better nutritious food, improved living conditions, improved access to healthcare etc.

The finding that respondents, including female entrepreneurs, reported improvements in their well-being represents an additional form of impact that goes beyond the reported productivity gains. These additional impacts may be more difficult to quantify than productive impacts. They are subjective in nature, rather than concrete, but being cognisant of them may allow DFIs a more comprehensive view of the borrower-level impact that their investments can have.

1 | Introduction

1.1 Study rationale

In 2019, the Foreign, Commonwealth & Development Office (FCDO) commissioned Genesis Analytics and IPE Global to independently evaluate British International Investment's (BII) Financial Institutions portfolio (renamed Financial Services).

The purpose of this evaluation is to better understand the development outcomes and impacts associated with BII's investments in the financial services sector. It consists of two phases, namely an evidence and portfolio-level review completed in 2020 (phase one), and a subsequent series of in-depth case studies (phase two).

The phase one review revealed that microfinance investments make up a sizable share (about 17 per cent) of BII's total investments by value.¹⁶ Moreover, the expansion of financial inclusion remains an acute challenge across much of the developing world. In India, for example, a sizable share of the population (42 million in 2020) is served by microfinance institutions (MFIs) that give out micro loans without requiring physical collateral from borrowers.

On this basis, the evaluation team identified microfinance as an area of interest for an in-depth study and selected the investment in Arohan Financial Services (Arohan), an Indian MFI, as a case study. The objectives of the study are to understand (i) the potential of microfinance to drive financial inclusion and productivity; and (ii) the role of microfinance in supporting micro, small and medium enterprises (MSMEs) and households from a productivity point of view, such as the potential impact microfinance can have on incomes, savings and business profitability. Given that some literature found that microfinance did not lead to changes in household income or business profitability, the study is contributing to the evidence base around microfinance's productive uses.¹⁷

At the time of the investment, BII (formerly Commonwealth Development Corporation) used the Financial institution-development impact (FI-DI) framework (see more on this in Section 2.3). In 2022, BII updated its approach to impact management and introduced the Productive, Sustainable, and Inclusive (PSI) framework to inform investments covering its 2022 - 2026 strategy period.

Box 2: BII's current approach to investment

Through its investments BII aims to support development that is:

Productive - helping the productivity of an economy to ensure a decent standard of living for all.

Sustainable - helping to transform the economy, reducing emissions and protecting the environment while allowing for adaptation to climate change.

Inclusive - allowing the gains from productivity and sustainability to be shared with poor, marginalised sections of society.

This framework allows BII and FCDO to ensure that investments remain aligned to strategic priorities. Each of the above strands contributes to an overarching Impact Score for each investment. Within each strand, BII focuses on several underlying sub-criteria. These are detailed in its latest Investment Policy¹⁸, which spans 2022 to 2026.

16  Sunderji, S., Williams, D., Fuchs, M., Wyatt, A., Verrinder, N., (2020). *Evaluating CDC's financial institutions portfolio*. Genesis Analytics and IPE Global

17  J-PAL. (2023). *Microcredit: Impacts and promising innovations*.

18  British International Investment. (2021). *Investment Policy for the period from 1 January 2022 to 31 December 2026*.

1.2 Context

While there are well-documented benefits associated with household access to payments, savings, credit and insurance services, developing markets trail their wealthier counterparts with respect to formal financial services. India has made substantial progress in reversing this trend with the share of individuals older than 15 that have access to an account with a formal financial institution growing rapidly from 2011 (35 per cent) to 2021 (78 per cent).¹⁹ Still, the sheer size of the Indian population implies that a vast number of people still have no access to formal financial products. Having access to financial services is important, as financial services are instrumental in allowing individuals and microenterprises to smooth their consumption, invest in areas such as education and healthcare and otherwise plan their long-term futures²⁰.

Though India has a developing financial services sector, including capital markets and commercial banks, a substantial portion of its citizens are served by smaller, non-bank financial companies (NBFCs). Specifically, micro-finance institutions (MFIs), which offer small loans to consumers and owners of microenterprises using social rather than formal, physical collateral, play an important role. The NBFC-MFI sector served more than 42 million borrowers in 2020.²¹

In 2010, the Indian MFI industry was shaken by the Andhra Pradesh (AP) crisis. The AP crisis was caused by cross-lending amongst MFIs operating in AP state, which led to borrower over-indebtedness as a result of multiple MFIs lending to the same borrowers. This in turn resulted in borrower defaults, with some MFIs resorting to unethical collection practices to recover their loans. MFIs' inability to recover their loans threatened the functioning of the industry, with many MFIs either closing, merging, or downscaling.²² Subsequently, the MFI industry became subject to a stringent set of regulations, covering areas such as interest rates and loan length.

Against this backdrop, BII sought to support the MFI sector through an investment in the Aavishkaar Goodwill India Microfinance Development Company (Aavishkaar). The investment was underpinned by the following development impact (DI) thesis:


Box 3: Development Impact thesis (2012)


“BII’s investment will support MFIs in the Indian banking sector to reach underpenetrated states and segments at a time when there is missing confidence in the MFI sector post the AP crisis. Indicators measuring investment performance: employment growth at all underlying portfolio companies, taxes paid, total number of loans to borrowers, growth in loan portfolio, growth in number of borrowers and portfolio at risk (PAR) 20²³; for non-MFIs – employment growth, revenue, earnings before interest, taxes, depreciation, and amortisation (EBITDA, where applicable) and taxes paid.”

BII ultimately invested \$15 million in the \$30.2 million Aavishkaar fund, with the fund subsequently investing \$7.1 million into Arohan Financial Services (Arohan), an Indian MFI. The financial institution-development impact (FI-DI) framework underpinning this investment is provided in the Annex.

19  The World Bank. (2021). *Global Findex Database*.

20  Ogden, T., Wagner, NYU., (2019). *What is the impact of investing in financial systems?* British International Investment.

21  Nandi, A., Nandan, S., Koshy, S., (2020). *The Bharat Microfinance Report 2020*. Sa-Dhan.

22  Baradi, N. and K, Reddy., (2017). *AP Microfinance Crisis & Its Impact on Microfinance Sector*. Research Journal of Finance and Accounting.

23 This refers to the share of the outstanding loan portfolio that is 20 days or more overdue.

Arohan's mission is to provide under-served households with a range of financial services in a manner sustainable for all stakeholders, with an overarching vision of impacting 20 million lives by 2027.²⁴ The core of the business lies in its credit offering, which is targeted at women with an annual household income of 200,000 rupees (about \$2,700) or less in urban areas, or 125,000 rupees (about \$1,700) or less in non-urban areas, as mandated by Reserve Bank of India (RBI) regulations.^{25,26} Arohan also offers other forms of loans and insurance products. Loans are extended through a Joint Liability Group (JLG) model, where other members of the group act as a form of social collateral for a given member's loan, in the absence of physical collateral. Loan sizes are generally smaller than 50,000 rupees (\$675) and are intended for income generation purposes, with tenors of 12 to 24 months.

Given that BII's investment in Aavishkaar (and Aavishkaar's subsequent investment in Arohan) occurred in 2012, the latest Investment Policy (2022-2026), was not in effect at the time. Nevertheless, the aims of the investment remain well-aligned with BII's current strategic priorities. Arohan's microfinance loans are specifically aimed at providing loans to under-served households and micro-enterprises in a sustainable fashion, with a particular view to fostering financial inclusion by expanding access to formal credit within India.

1.3 Purpose and method

The purpose of this study is to assess the impact of BII's investment across the fund (Aavishkaar), FI (Arohan) and borrower levels. Specifically, the evaluation seeks to answer four overarching questions as shown in the table below.

Table 2: Key evaluation questions


#	Question
1	How has BII's investment in Aavishkaar enhanced the fund's investment capacity and processes?
2	How are BII's investments reaching MSMEs and what types of MSMEs are being reached eg. by size, sector, income and gender?
3	Has Aavishkaar's investment enabled an increase in access to finance for MSMEs and households?
4	What is the impact of the finance provided by Arohan on MSMEs and households?

Note: the evaluation questions are presented with a set of lessons identified from the research. The lessons are numbered and mapped to the evaluation questions that they answer. Evaluation questions were not answered in order - numbering is therefore not always sequential. The numbers assigned to lessons correspond to the numbering used in the Executive Summary.

To answer these questions, the study utilised a mix of data sources. Desktop research allowed for a thorough understanding of the Indian MFI industry and its regulatory environment, as well as the context and performance of Arohan and other sizable Indian MFIs. The study analysed Arohan's internal portfolio data to form a deeper understanding of its performance and possible impact on the lives of its borrowers. Stakeholder discussions with the BII, Aavishkaar and Arohan teams provided important insight into the underlying impact of the investment at each level.

²⁴  Arohan website. (2023).

²⁵ An exchange rate of USD/INR = 0.0135 is used throughout this report.

²⁶  As of April 2022, the RBI raised this limit to INR 300,000 (\$4,050) for all households. Source: Gaur, M. (2022). *Regulatory Framework issued by RBI for Microfinance Loans*. Adda247 Current Affairs.

A survey of 1,139 of Arohan's borrowers was conducted across three states, Bihar, West Bengal, and Uttar Pradesh²⁷, reflective of the number of borrowers that Arohan has in each state.^{28,29} The sample was representative at the state level at a 95 per cent confidence interval. The evaluation team partnered with a local survey partner to administer the survey via a mixture of face-to-face and telephonic interviews. Arohan assisted in contacting the required number of borrowers for their consent to take part in the survey, after which the borrowers' contact information was shared with the survey partner. The initial aim was to conduct 80 per cent of interviews via telephone, with the remainder carried out face-to-face. In practice, 935 responses (81 per cent) were collected telephonically, with the remaining 204 (19 per cent) carried out face to face.³⁰ Where relevant, survey results were tested for significance. The presented results are significant to at least the 5 per cent confidence interval, unless otherwise stated. Finally, some information was obtained from Arohan's own internal surveys of its borrower base. These are highlighted in the report where relevant.

There were certain challenges the evaluation team faced around the data sources, as follows:

- Due to a change in Arohan's loan management system implemented in 2018, the Arohan portfolio data spans only four financial years (2018 to 2021). This leaves a substantial time gap between 2012 (the investment date) and 2018 (the year of system change).
- It was not possible to ascertain the accuracy or quality of the data received from Arohan. The data is assumed to be accurate and valid.
- Not all data were fully available, such as a lack of accurate geography data for a substantial share of the borrower base in some years.³¹ Specifically, geography data was not captured for 19 per cent of borrowers in FY 19, 34 per cent in FY 20 and 32 per cent in FY 21.
- An emerging finding around gender: The survey brought to light that in some cases, though the borrower may be female, the end user of the loan is likely to be a man. These observations mean that it is possible that in certain cases, loans taken out by women are being passed on to men, possibly for use in the family business and hence suggest it may be difficult to conclusively evaluate the effects of microfinance loans on the lives of female borrowers.

Overall, these challenges were not insurmountable and do not affect the validity of the study's findings. Moreover, the methods underpinning the findings are fully described later in the report.

²⁷ Refer to the Survey response rates in the Annex.

²⁸ Assam has more Arohan borrowers than Uttar Pradesh, but the Arohan team raised the point that there had been local disturbances in the state, hence the more practical option (Uttar Pradesh) was selected.

²⁹ More information about response rates is provided in the Annex.

³⁰ Covid-19 protocols were followed during face-to-face interviews.

³¹ Arohan was maintaining operational data showing whether a branch belongs to an urban, semi-urban or rural area during this time.

2 | The outcomes of BII's investment

2.1 Changes for Aavishkaar and Arohan

Discussions with stakeholders from BII, Aavishkaar and Arohan represented an important source of information in understanding the impact of the investment in the fund. This subsection comprises findings from those discussions.

BII's investment in the Aavishkaar could be seen as a crisis response measure, given the fallout of the AP crisis and the regulatory restrictions both imposed by the AP government and the RBI. As a result, private investors perceived the sector's risk level to be unacceptable.

The AP crisis created a scarcity of funding for Arohan at the time. Arohan's business had shrunk and, though a number of larger MFIs performed due diligence on Arohan, Arohan's portfolio of around 50 crore rupees (\$6.8 million) was simply too small to justify an acquisition³². Consequently, there was a real risk of the company closing its doors. However, Intellectash, a business involved in incubating and scaling up start-up-level MFIs, was already part of the Aavishkaar Group, and was eager to expand its lending offering. Thus, it was possible for Aavishkaar to invest in Intellectash, which then merged with Arohan. Aavishkaar was then able to indirectly invest in Arohan, while also allowing the newly merged Intellectash-Arohan entity to build a more meaningful business proposition.


BII's decision to provide funding therefore played a substantial role in contributing towards stabilising the sector. Given that BII's investment was equal to approximately half the size of the Aavishkaar fund, it would not have been possible for Aavishkaar to commit to making the same size of investment without BII's funding. Though there was no specific change to the Aavishkaar investment strategy because of BII's funding, BII's contribution facilitated the implementation of their strategy.

In addition to providing funding, BII brought a strong focus on corporate governance; environmental, social and governance (ESG) principles; as well as anti-money laundering/combatting the financing of terrorism (AML/CFT). BII also provided training to Aavishkaar on these topics. The fund subsequently began monitoring these aspects in its own portfolio companies, including Arohan.

Arohan benefitted from the Aavishkaar investment in two ways. Firstly, the investment opened Arohan's access to additional funding from local creditors, as Arohan's creditworthiness was strengthened by Aavishkaar's investment. Secondly, Aavishkaar's focus on strengthening corporate governance within Arohan created a virtuous self-perpetuating cycle of growth, making third-party investment easier to attract, resulting in further growth and so on. Research over the past decade has found linkages at a global level between microfinance corporate governance and higher credit ratings.³³ In addition, a two-way relationship has been found in Asia between corporate governance and MFI performance.³⁴

³² Source: Management interviews

³³  Beisland, L., Mersland, R., Randøy, T. (2014). *The Association between Microfinance Rating Scores and Corporate Governance: A Global Survey*. International Review of Financial Analysis.

³⁴  Iqbal, S., Nawaz, A., Ehsan, E., (2018). *Financial performance and corporate governance in microfinance: Evidence from Asia*. Department of Management Sciences, COMSATS Institute of Information Technology.

Arohan has received a credit rating of “A-“ from CareEdge Ratings, an Indian ratings agency. Arohan directly credits its ability to raise funding more affordably to its strong credit rating.³⁵ Subsequently, it was able to pass a reduction in funding costs of 2 per cent to its borrowers, thus making its loans more affordable³⁶. Arohan’s current observance of corporate governance standards is seen as a core strength, with the company being recognised by the Institute of Company Secretaries of India (ICSI).³⁷

Table 3: Lessons: investing in Aavishkaar and Arohan

QUESTION 1: How has BII’s investment in Aavishkaar enhanced the fund’s investment capacity and processes?

Lesson 1.1: DFI investments have a role to play in ensuring that the funds they invest in reach critical mass

Aavishkaar offered a strong management team with a clear vision and fund strategy. However, it would not have been able to give full expression to its strategy without BII’s investment, given that BII represented 50 per cent of the fund’s final capital pool. Therefore, there is value in BII and other DFIs actively seeking to identify such funds, where DFI contributions would not merely be additive in an already sizable funding pool, but transformative in allowing investment to be executed and impact to be realised. In BII’s case, strict contribution assessment prior to committing to investments includes a focus on additionality.

Lesson 1.2: DFIs can act as an important stabiliser by making countercyclical investments at times of crisis

BII and other DFIs are willing to act as a countercyclical stabiliser during crisis periods. The AP crisis created a vacuum for the Indian microfinance industry as far as access to capital was concerned. Most commercial investors were unwilling to invest in Arohan, partly due to the upheaval faced by the microfinance industry and partly because its portfolio had shrunk to \$6.8 million³⁸. BII and Aavishkaar’s willingness to enter the Indian microfinance space and invest in Arohan against this backdrop therefore acted as a source of stability and a lifeline during a crisis period. The industry has since matured, but future crisis periods may once again require DFIs to be willing to act as a source of stability.

Lesson 1.3: Technical assistance is equally important as financial assistance

A third lesson was unearthed by the finding that Arohan’s borrowers ultimately benefitted from BII’s focus on corporate governance. Arohan’s strong corporate governance has placed it on a stronger footing when raising financing, and borrowers benefitted from lower borrowing costs. This highlights the potential impact of DFI technical assistance, not only at the fund level, but for the underlying companies and borrowers.

Crucially, these interventions take time to materialise. BII first invested in Aavishkaar in 2012, but the ultimate impact on Arohan’s borrowers only came to light a decade later. These interventions are therefore worth pursuing, and DFIs should remain cognisant that their ability to drive impact goes beyond only providing capital.

³⁵  Arohan website. (2023).

³⁶ Ibid.

³⁷ APN News. (2021). *Arohan wins the prestigious ICSI National Awards, 2020 for Corporate Governance*.

³⁸ Source: Management interviews

2.2 Arohan and its borrowers

2.2.1 A closer view of Arohan

As seen above, the investment from Aavishkaar was crucial to Arohan at a time when its portfolio size and the effects of the AP crisis made it difficult for the company to attract new investors. Since then, however, Arohan has established itself as one of the leading MFIs in India, showing strong growth across a variety of metrics, including in the number of active borrowers it serves, its outreach as measured by the number of its branches and the number of people it employs.

Table 4: Arohan's key metrics, 2012 versus 2021

Metric	FY 2012	FY 2018	FY 2021	Annual growth rate	Industry annual growth rate
Active borrowers	84,370	1,137,868	2,063,000	43%	1%
Number of states/territories served	3	11	17 ³⁹	21%	Not available
Number of branches	93	435	737	26%	6%
Number of employees	500	3,318	6,790	34%	7%

Source:  Various annual reports, Arohan, AGII Fund Report, September 2012

At the time of the investment, Arohan's portfolio totaled \$6.8 million, making it a small player considering the industry's gross loan portfolio of \$2.9 billion. By 2015⁴⁰ Arohan's \$54 million portfolio gave it nearly a 1 per cent market share of an industry with a gross loan portfolio of \$5.8 billion across 156 MFIs. This suggests an average portfolio of \$37.3 million per MFI. Arohan had therefore become slightly larger than the average Indian MFI. From 2015 to 2021, Arohan grew faster than the industry. Its 2021 portfolio of \$627 million gave it a 5 per cent market share of the industry's 2021 portfolio, which totalled \$11.8 billion.

Portfolio data provided by Arohan spanning its 2018 to 2021 financial years (FY18 to FY21) allowed for further analysis of how the company has changed, as well as providing some indications of the impact on its borrowers.⁴¹ As shown in the figure below, the number and value of loans disbursed by financial year grew strongly between FY18 and FY19, with a slowdown in FY20 and a reduction in FY21 reflecting the impact of the Covid-19 pandemic. Notably, however, the total number and value of loans disbursed in FY21 remained some 26 per cent and 49 per cent higher respectively than in FY18.

³⁹ This includes the states of Maharashtra, Telangana, Gujarat and Karnataka, which form part of the MSME loan portfolio only and remained on the Arohan book after the company sold off the vertical to Ashv Finance (an NBFC under Aavishkaar, lending to MSME).

⁴⁰ The chosen points in time reflect data availability.

⁴¹ Arohan's financial year runs from 1 April to 31 March.

Figure 3: Number of loans disbursed by FY and state (Thousands, FY 18 - FY 21)

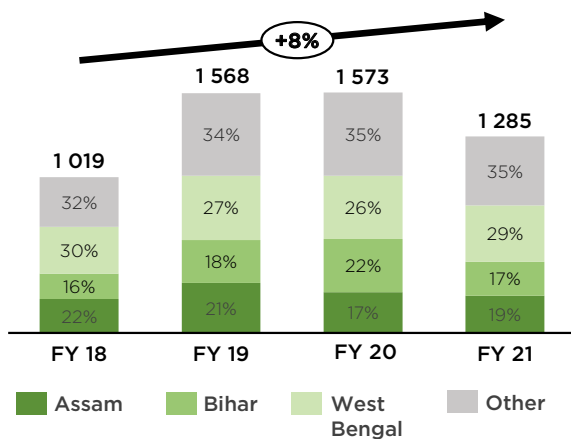
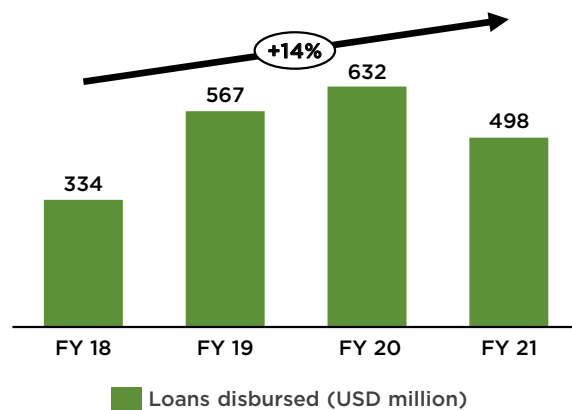


Figure 4: Value of loans disbursed by FY (\$million, FY 18 - FY 21)



Source: Arohan internal data, 2021

There are two points worth noting on loan disbursement. First, Arohan’s disbursement of loans remains concentrated in its three original states, Assam, Bihar and West Bengal, which make up between 65 per cent and 68 per cent of loans disbursed in a given year, as highlighted in **Figure 3**. From an impact perspective, the three largest states are all classified as “A” states in BII’s Development Impact Grid⁴², where “A” is representing the most challenging states to invest in.^{43, 44} In fact, of the 13 states for which data were provided, 12 are classified as “A” states, with Tripura (a “C” state representing less than two per cent of the portfolio by loans disbursed) being the exception.⁴⁵ Secondly, the growth rate of loan value has exceeded the growth rate of loan numbers, reflecting an increase in average loan size from approximately 24,000 rupees in FY18 to 28,000 rupees in FY21 (from \$324 to \$378). The rate of loan growth has marginally exceeded inflation (6 per cent per annum versus 5 per cent), though lower loan sizes in the wake of Covid-19 closed this gap (pre-Covid, average loan sizes grew by 11 per cent per year). Overall, the average loan size remains well below the maximum RBI upper bound (75,000 rupees for the first loan, and 125,000 rupees for subsequent loans, or \$1,013–\$1,688). In addition, the average value per loan is lower than the average for NBFC-MFIs with portfolios of larger than 2,000 crore rupees (\$270 million), which was reported at 37,113 rupees (\$478).⁴⁶

As mentioned above, the company offers a variety of products, but a clear majority of its loans come from a single product, namely its Saral Basic and Plus loans. Arohan’s flagship product, ‘Saral’, which caters to women who are residing in low-income areas and are generally involved in trade and services, continues to hold a dominant share in the organisation’s portfolio. For Saral loans, Arohan predominantly provides loans to groups consisting of three to five women, and the group’s loans are disbursed using the Joint Liability Group model. The Saral loan amounts range from 10,000 rupees to 75,000 rupees and have a term of 24 to 30 months.⁴⁷

⁴² From the 2022-26 Investment period, BII replaced the Development Impact Grid with the Impact Score.

⁴³ Investment difficulty at a state level is assessed across four factors: GDP PPP, income level, credit to the private sector relative to GDP, Doing Business rankings (from the World Bank).

⁴⁴ British International Investment. (2018). *Development Impact Grid, 2017 – 2021*.

⁴⁵ BII has subsequently adapted a new list of eligible countries as part of its 2022 – 2026 Investment Policy, which focuses on driving impact across the three strands of Productivity, Sustainability and Inclusivity. India remains an eligible country on the updated list.

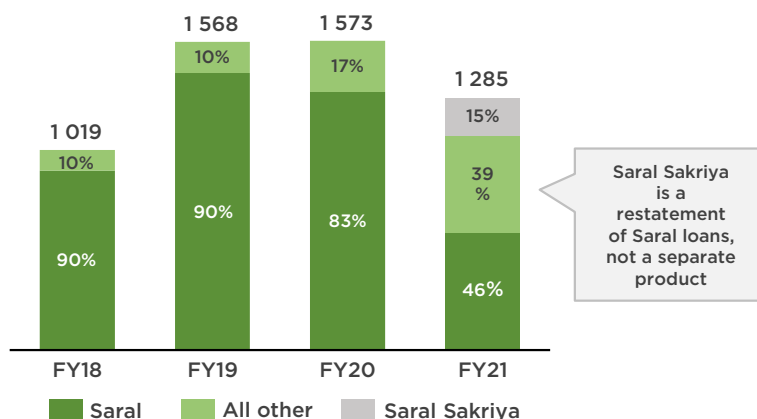
⁴⁶ Nandi, A., Nandan, S., Koshy, S., (2020). *The Bharat Microfinance Report 2020*. Sa-Dhan.

⁴⁷ Saral loans are offered to low-income women for income generating purposes. Once the borrower makes ten timely repayments, they qualify for the Plus version of loan, which allows for larger ticket sizes and longer tenors.

As shown in the **Figure 5** these loans account for most loans in any given FY. FY21 is an outlier due to the substantial loan restructuring in line with RBI Resolution Framework 1.0 that Arohan performed during the pandemic which resulted in the strong emergence of the Saral Sakriya loan product. This product was used to restructure loans that were less than 29 days overdue as of 29 February 2020 and is therefore a variation of the basic Saral product, rather than a truly new product type.

Arohan's borrower base is nearly exclusively female, with women making up 97–99 per cent of borrowers in any given year, though there is nuance around this figure, which is discussed later. The dominance of female borrowers is in line with the Indian MFI industry as a whole, which has a 98 per cent female borrower share.⁴⁸

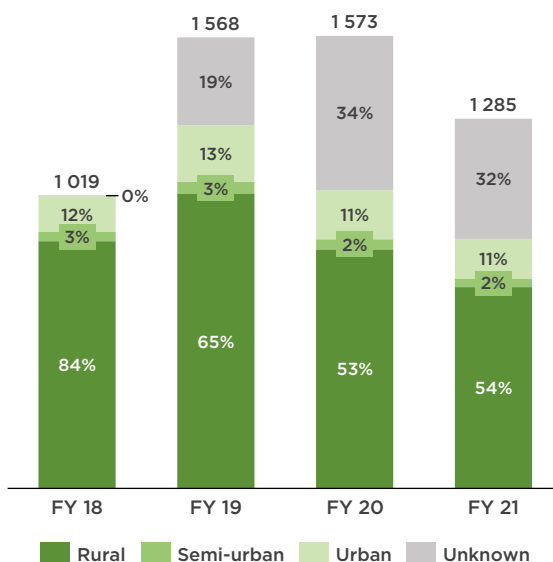
Figure 5: Loan numbers disbursed by product (per cent of total, FY 18 to FY 21)



Source: Arohan internal data, 2021

Unfortunately, for a sizable portion of loans disbursed between FY19 and FY21, information on geography was not collected, and hence not available for analysis.⁴⁹ For those loans that did have geography data available, the rural share of borrowers remained steady at around 80 per cent, as shown in the figure below. Despite the missing information, stakeholder discussions revealed that the borrowers for whom information is missing are largely located in rural areas.

Figure 6: Loan numbers disbursed by geography (per cent of total, FY 18 to FY 21)



Source: Arohan internal data, 2021

⁴⁸ Nandi, A., Nandan, S., Koshy, S., (2020). *The Bharat Microfinance Report 2020*. Sa-Dhan.

⁴⁹ Though geography data was not available for a sizable share of loans, Arohan was maintaining operational data showing whether a branch belongs to an urban, semi-urban or rural area during this time.

A final point worth exploring is the relative cost of borrowing that Arohan's borrowers have faced over time. As shown in **Figure 7**, the mean value of loans disbursed has grown every year since FY18, except in FY21. At the same time the average interest rate for loans disbursed has gradually declined, albeit marginally. Interest rates in the Indian MFI sector are tightly controlled and are quoted on a reducing balance basis, this is to say that interest is applied to the amount of the loan that remains outstanding, rather than the original loan sum. The lowest interest rate Arohan can offer its borrowers is driven by its cost of funding. A lowering of Arohan's cost of funding therefore allows borrowers to access loans more cheaply. However, it should be noted that in a tightening interest rate environment, the cost of funding for MFIs is likely to increase, which may in turn be passed on to borrowers, unless the MFIs opt to absorb a share of the rate hikes, which could theoretically occur under the new, less prescriptive regulations around interest rates.

Box 4: Alternatives to Arohan

Beyond MFIs (and commercial bank loans, which borrowers are unlikely to qualify for), individuals may obtain credit from informal moneylenders. Details around this market are somewhat scarce, though regulations do exist around the practice of moneylending. It may be that this type of moneylender is not well enforced, given the informal nature of the market. Details around interest rates are equally scarce, though there are media reports suggesting that informal money lender rates range from a figure comparable to MFIs (between 20-30 per cent) to rates of 100 per cent or more.⁵⁰

In addition to informal moneylenders, India also offers prospective borrowers the opportunity to access credit via digital lenders, who partner with banks or NBFCs to offer loans through apps.⁵¹ The loan sizes offered by these lenders appear to fluctuate dramatically, with some offering loans of up to 5,000,000 rupees (about \$67,500). Interest rates are similarly diverse, but generally range between 13-60 per cent per annum, suggesting that they could, in some instances, be more affordable for borrowers, though this is by no means guaranteed. Going forward, it is possible that Arohan will face ongoing competition from providers using new technology-driven solutions.

Figure 7: Mean size per loan (\$, FY 18 – FY 21)

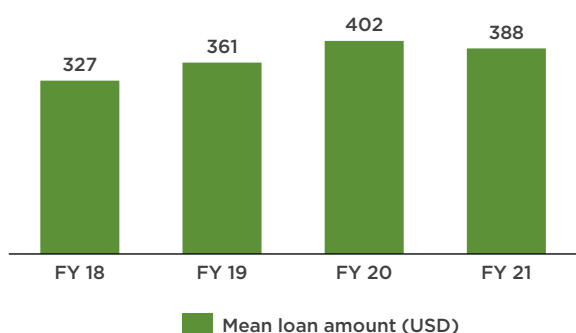
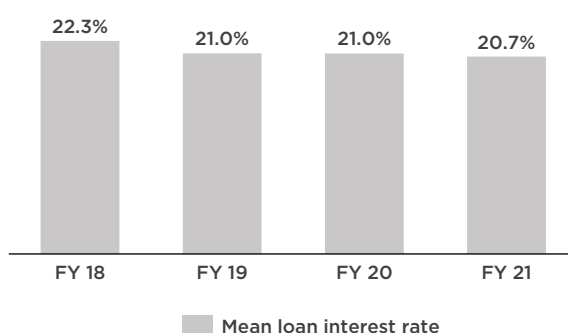


Figure 8: Mean loan interest rate (per cent, FY 18 – FY 21)



Source: Arohan internal data, 2021

50 [↓](#) Mishra, I. (2021). 120% interest on loans: moneylenders are making a killing in UP small towns. The Times of India.

51 [↓](#) Moneytap. (2023). 24 Best Instant Personal Loan Apps in India.

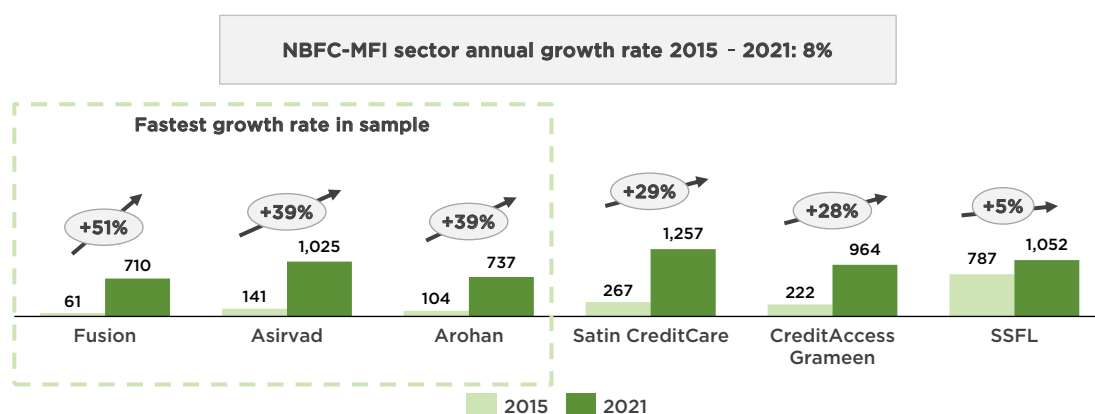
It is clear both from Arohan's publicly available and internal data that the company has reached an ever-growing number of rural women. Arohan has particularly emphasised reaching rural women in challenging states, as defined by BII's Development Impact Grid (and the current PSI framework).

Borrowers are largely served by a single, rather standard loan product, with little differentiation based on individual borrower needs. This outcome is likely driven by the prescriptive nature of the regulation of the MFI industry in India. In particular, prescriptive regulations around the maximum size of loans, repayment tenors, reliance on social rather than physical capital, and limits on the maximum interest rates that MFIs are able to charge are all factors in determining the design of products MFIs can make available to their borrowers.

Arohan and its peers

Though Arohan's growth appears impressive, it is instructive to compare Arohan to a group of other large MFIs and the MFI industry as a whole between 2015 and 2021. Peers were selected based on size (by number of borrowers) as well as ease of accessing information.⁵²

Figure 9: Selected NBFC-MFI branch networks – ordered by growth rate⁵³
(Number of branches and growth rate, 2015 and 2021)



Source: [↓](#) MFI annual reports (2015 and 2021), Bharat Microfinance reports (2015 and 2020)

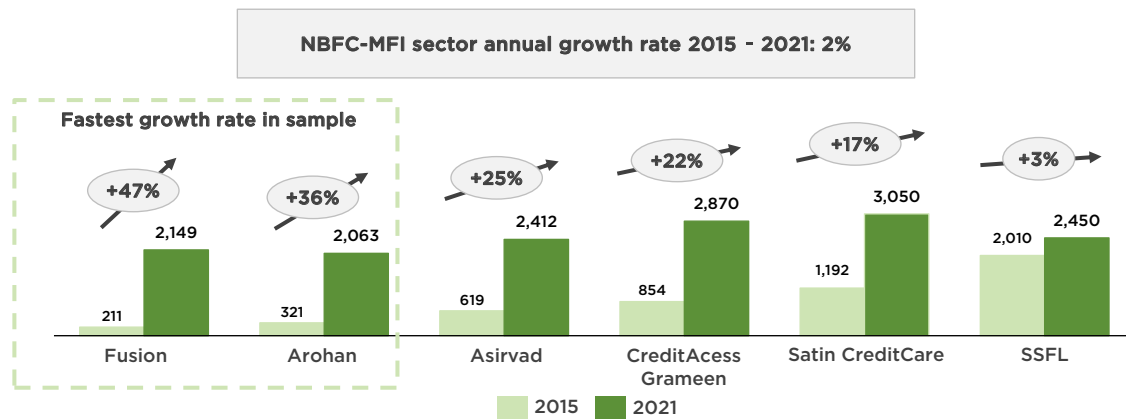
As shown in **Figure 9**, Arohan's branch network has grown far more rapidly than the industry average, and faster than all but two of its selected peers. However, this industry average includes several MFIs far smaller than Arohan, possibly making this comparison less relevant. Given that most MFIs in Arohan's peer group grew much faster than the industry average, this suggests that smaller MFIs are only growing rather slowly. Hence, while comparisons between Arohan and its peers are relevant, this group of large MFIs is not representative of the overall market.

⁵² The selected MFIs are: Asirvad Microfinance, CreditAccess Grameen, Fusion Microfinance, Satin Credit Care and Spandana Sphoorty Financial Limited (SSFL).

⁵³ 2021 industry figure was estimated based on quarterly industry reports, which lacked detail compared to whole-year industry reports.

As shown in **Figure 10**, only one peer has grown its borrower base more quickly than Arohan, though some peers retain a borrower number advantage despite their slower growth.

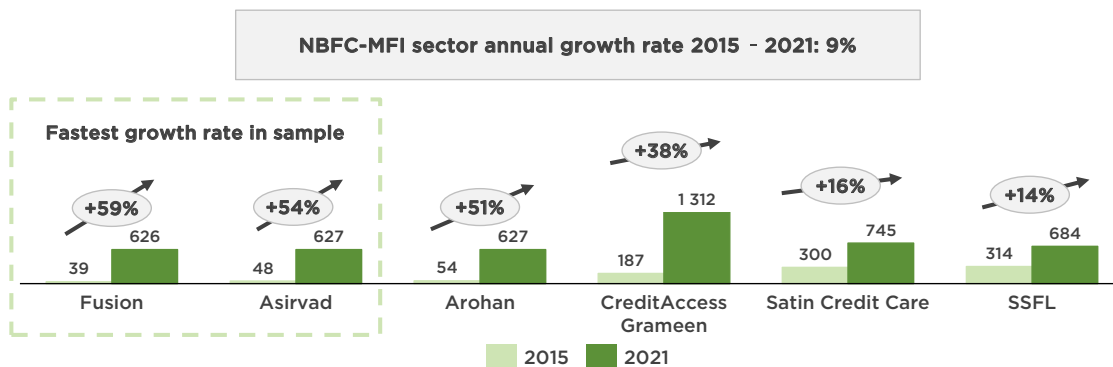
Figure 10: Selected NBFC-MFI borrower outreaches – ordered by growth rate⁵⁴
(Thousands of borrowers and growth rate, 2015 and 2021)



Source: MFI annual reports (2015 and 2021) Bharat Microfinance reports (2015 and 2020)

In addition, as shown in **Figure 11** below, Arohan’s loan portfolio has grown faster than all but two of its peers.

Figure 11: Selected NBFC-MFI loan portfolios – ordered by growth rate⁵⁵
(\$Mn and growth rate, 2015 and 2021)



Source: MFI annual reports (2015 and 2021) Bharat Microfinance reports (2015 and 2020)

Comparing Arohan to the industry and a group of selected peers suggests that the company has far outstripped the industry average in terms of its growth, though the caveat around smaller players applies, and has generally been in the top three of the group of selected peers across the metrics discussed above.

A final area of portfolio data analysis related to the income of Arohan’s borrowers. However, information collected by Arohan was not adequate to allow for an analysis of borrower income levels. This necessitated greater reliance on the findings of the survey, which are discussed in the next subsection.

⁵⁴ 2021 industry figure was estimated based on quarterly industry reports, which lacked detail compared to whole-year industry reports.

⁵⁵ Ibid.

Table 5: Lesson: the timing of exiting investments

QUESTION 3: Has Aavishkaar’s investment enabled an increase in access to finance for MSMEs and households?

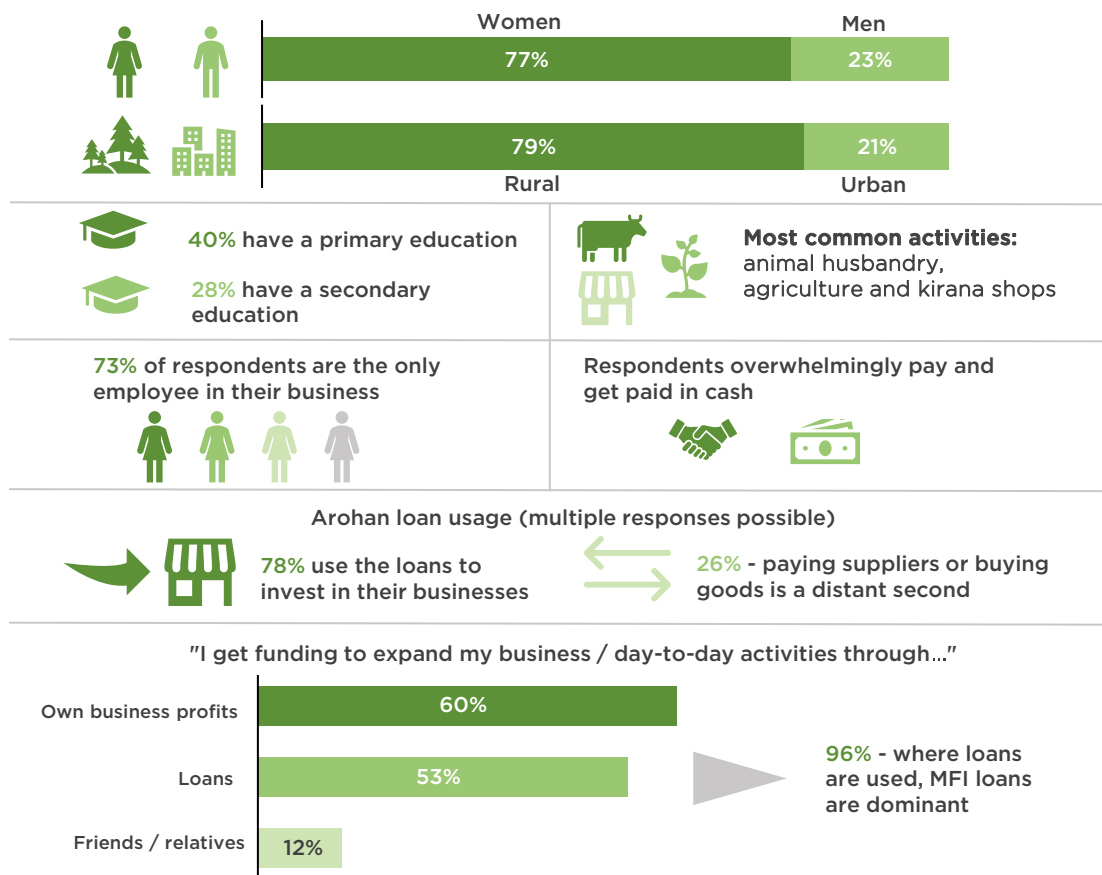
Lesson 3.2: DFIs should remain cognisant of the best time to exit their investments in order to redeploy their capital more effectively

BII’s investment in Aavishkaar and the fund’s subsequent investment in Arohan acted as a crucial lifeline for the company. Since the investment, Arohan has displayed impressive growth and is one of the largest MFIs in India by borrowers served. Therefore, it seems that the benefits of further involvement by BII in Arohan are likely to diminish in terms of development impact. The question may arise of whether BII would be better served by unlocking its capital for redeployment. Of course, given that BII’s investment was made into Aavishkaar, this would require Aavishkaar to exit its investment into Arohan to allow BII to exit..

2.2.2 A closer view of Arohan’s borrowers

We undertook a survey to form a deeper understanding of Arohan’s borrowers and the commonalities they share. It confirmed that Arohan’s borrowers are predominantly female, with 77 per cent of survey respondents being women⁵⁶.

Figure 12: A profile of Arohan’s borrowers



Source: Arohan borrower survey, 2021

⁵⁶ The survey answers revealed that in many cases, a customer was listed as female, but the survey team reached a man.

The borrowers that Arohan serves form a rather homogenous group. They are female, live in rural areas and generally have either a primary or secondary education. They run small businesses in which they are generally the only employee. They are most often involved in animal husbandry, kirana shops or agriculture, and do so on a largely cash basis, which may suggest a mixture of general exclusion from formal financial services (beyond Arohan) and/or a general preference for the concrete nature and familiarity of cash. In addition, borrowers' use of Arohan's loans was found to be uncomplicated. Borrowed funds are largely reinvested in the business. In addition, when they take out loans, this is overwhelmingly (96 per cent) from MFIs. A survey conducted by Arohan in November 2020 across 2,861 borrowers suggested a similarly high (99 per cent) share.⁵⁷

Table 6: Lesson: microfinance's ability to reach underserved individuals

QUESTION 2: How are BII's investments reaching micro, small and medium enterprises (MSMEs) and what types of MSMEs are being reached e.g. by size, sector, income and gender?

Lesson 2.1: Microfinance (as practiced in India) remains an effective tool for reaching financially under-served individuals

Though Arohan's expansion took some time, the growth in the company's borrower base suggests that BII's initial investment of \$15 million has been effective in aiding the expansion of financial services to low-income, and rural individuals. Considering the size of the investment made, it was very effective in increasing outreach.

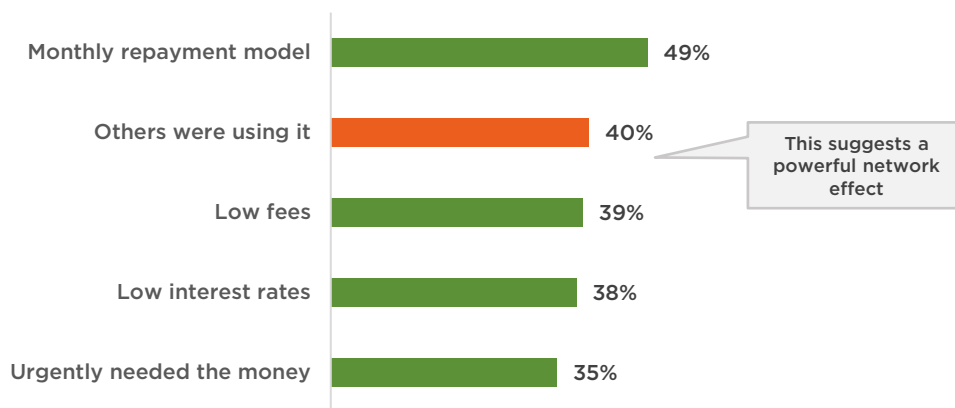
Why borrowers choose Arohan

Arohan's scale appears to have created powerful network effects making it easier to attract new borrowers. 80 per cent of survey respondents stated that they first came to hear about Arohan's products and services from friends or relatives. As elsewhere in the financial sector this points to the importance of size and reputation: it is easier to attract new borrowers if there is already a sizable pool of borrowers who can vouch for the provider.

The results of the survey reinforce this observation. Survey respondents were asked why they chose Arohan. As shown in the figure below, the most common reason mentioned was Arohan's monthly repayment model. This model allows borrowers to better manage their liquidity with smaller repayments over time, which may arguably be a more important factor to them than interest rates and fees. This monthly repayment model is not unique amongst MFIs. The RBI mandates a weekly, fortnightly, or monthly repayment model, to be selected by the borrower. However, the second most selected reason was that others were using Arohan products, highlighting again the effect of word-of-mouth referrals.

⁵⁷ Arohan. (2020). Microsave Survey.

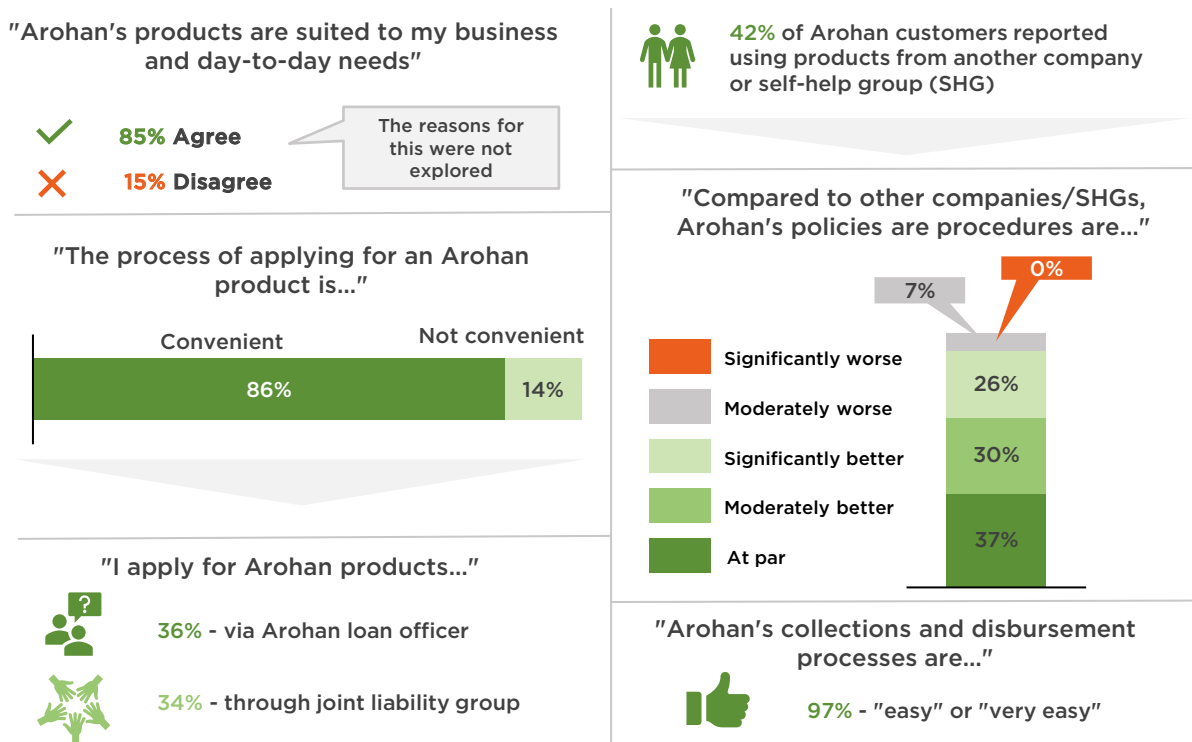
Figure 13: Survey profile responses to - Why did you choose Arohan for your microfinance needs (per cent of total respondents mentioning each reason)



Source: Arohan borrower survey, 2021

Arohan's large scale and the presence of its branches, even compared to large peers as shown earlier, may have played a role in promoting this word-of-mouth effect. Arohan has a sizable presence and is better able to serve additional borrowers referred to it. In addition, its size and accessibility may provide comfort and convenience to the borrowers it serves. Of course, Arohan is not the only MFI to offer a wide reach and large presence, but given the size of the Indian market, there is likely sufficient demand to allow Arohan to benefit from its wide reach even in the presence of other established peers. Furthermore, though low fees and interest rates were quoted as relatively common reasons for choosing Arohan products, they were not the two key drivers. This is aligned with respondents' answers when they were asked how Arohan's interest rates compare to alternative sources of funds. The most common response (49 per cent) was that interest rates across Arohan and other providers are "comparable". Finally, it is worth noting that only 20 per cent of respondents mentioned that Arohan is the only financial institution with the product they need, or the only financial institution accessible to them. Hence, it is possible that borrowers would have been able to access MFI loans elsewhere, and that benefits they describe in the subsequent subsection would still have been realised.

Figure 14: Borrowers' perceptions of Arohan



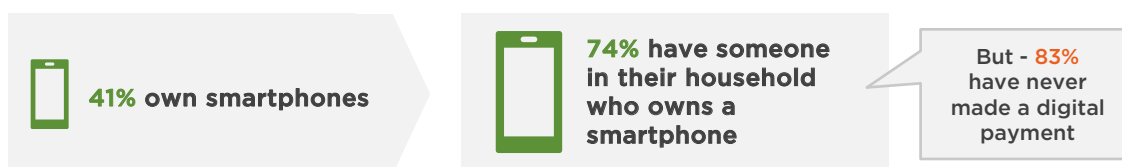
Source: Arohan borrower survey, 2021

Given the tightly controlled nature of the MFI industry in India, it was surprising to find a majority of borrowers rating Arohan's processes so highly compared to other companies that they have interacted with. Though stakeholder discussions revealed that Arohan's disbursement process takes less than a week, several of Arohan's larger peers offer similar turnaround times.⁵⁸ In addition, while Arohan offers borrowers a monthly repayment model, other peers offer a similar option.⁵⁹ On paper, Arohan seems to not stand out from competitors. However, Arohan believes that the transparency of its processes and the professionalism of its loan officers make the difference, though this is difficult to verify in practice.

Discussions with Arohan's management revealed that the company is undergoing a shift in the processing of disbursement and collections. Disbursement has become fully digital, while collections are roughly 80 per cent digital with an aim to progress to full digitalisation, which is helpful in providing more payment options to borrowers and also in reducing the costs and risks associated with cash handling from Arohan's perspective.⁶⁰ The shift to digital disbursement and collection could possibly exclude borrowers without access to digital means of payment or collection, such as smartphones. However, as noted later, the majority of Arohan's borrowers either own a smartphone or share a house with someone who does. Furthermore, digitalisation is a broader trend in the Indian MFI industry, which has traditionally been highly manual and based on physical interaction. Progress is being made in areas such as the implementation of core banking systems, and the use of artificial intelligence to streamline credit assessment, including in areas such as know-your-customer and credit underwriting, as well as cashless disbursements.⁶¹ While the above examples highlight a digital shift in the MFIs' processes, they do not point, as yet, to digitalisation of the borrower interface, which still involves a sizable amount of physical interaction.

As previously stated, Arohan's borrowers have a clear preference for cash. However, as shown in the figure below, access to smartphones is reasonably high, while the use of digital payments remains low.

Figure 15: Survey respondents' smartphone usage⁶²



Source: Arohan borrower survey, 2021

It was mentioned earlier that 97 per cent of respondents reported that Arohan's disbursement and collections were "easy" or "very easy". There appears to be some inconsistency between the reported preference for cash and low use of digital payments on the one hand and a shift towards digital disbursement and collection on the other hand. There are a few reasons behind this. Digital disbursements appear to have become something of a norm across the industry. As of March 2020, 75 per cent of the value of NBFC-MFI disbursements were digital, while by March 2021, the figure may have been as high as 90 per cent.^{63,64}

From the collections perspective, stakeholder interviews revealed that while Arohan's collections are now 80 per cent digital, in reality, borrowers are still able to make use of a variety of cash-based drop-off services to make their repayments. From their perspective, the repayment may therefore still be cash based.

⁵⁸ MFI. (2021). Annual reports.

⁵⁹ Ibid

⁶⁰ This 80 per cent figure includes digital collections, cash-drops by borrowers at different banking/Bharat Bill Pay (BBPS) points as well as cash-drops by field officers at their nearest payment bank outlets.

⁶¹ KPMG. (2021). *Rejuvenating microfinance in India - embracing digital*.

⁶² A survey by Arohan across 1,743 respondents found that 69 per cent of borrowers have a smartphone within their household, while 41 per cent reported using their smartphones for online transactions.

⁶³

⁶⁴ KPMG. (2021). *Rejuvenating microfinance in India - embracing digital*.

Table 7: Lesson: backing microfinance's transition

QUESTION 3: Has Aavishkaar's investment enabled an increase in access to finance for MSMEs and households?

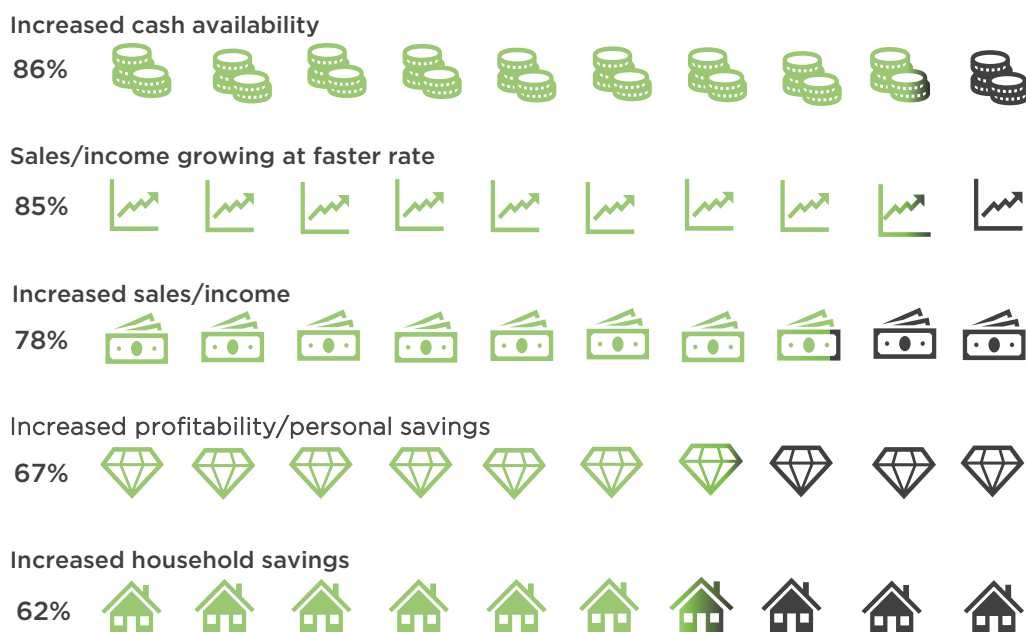
Lesson 3.1: There may be room for DFIs to back the Indian microfinance sector's transition towards digitalisation

The Indian microfinance industry has traditionally been focused on a high-touch model, with a large amount of physical interaction between borrowers and lenders. Given the tightly regulated structure of the industry that prevailed until recently, it was unlikely that smaller players could feasibly overtake big players, who have expanded their networks and grown their borrower networks aggressively over the past decade or so. In the case of Arohan, the company is heavily reliant on a single product and in a single sector, offering a highly standardised product to a particular market. Based on the portfolio data and survey responses shared above, Arohan clearly serves its particular set of borrowers well, and it is adding to their number. However, the gradual loosening of regulations in the industry and the continued process of digitalisation may open up new investment opportunities. In looking beyond the current incumbents, greater reliance on digital services may open up additional diversification opportunities in the market, as borrowers could be assessed on their individual risk levels, rather than relying on the "social" collateral that is currently common across the industry. This could enhance financial inclusion by expanding access to borrowers that are not being served by the current market structure, and as importantly facilitate 'graduation' of current users of MFIs to accessing the broader array of services provided by other financial intermediaries. On the other hand, there could be some marginalisation of borrowers with little/no access to digital means of making/receiving payments. Nevertheless, the primary research conducted suggested that most borrowers already have access to a smartphone in their households. Hence, while the process of digitalisation may require some behaviour change from borrowers, it is likely to facilitate inclusion of a significantly greater number of users.

2.2.3 Arohan's impact on borrowers

The survey allowed for a more granular view of Arohan's impact on borrowers to be established. This includes questions around changes in income and savings, business profitability, borrowers' ability to access further credit and the impact of the Covid-19 pandemic. The headline results for the sample are shown in the figure below and are subsequently discussed in more detail. As shown, sample respondents conclusively reported increased cash availability, faster sales/income growth and increases in sales/income. Increased profitability/personal savings and household savings were also reported, but not to the same extent as the previous three metrics.

Figure 16: Share of survey respondents answering affirmatively to selected questions (per cent of total respondents)



Source: Arohan borrower survey, 2021

The above metrics were also controlled to identify any statistically significant differences by gender or geography. As shown in the table below, the reported benefits are largely equally distributed. This suggests that while the impact reported is substantial, it was not more likely to be experienced by more vulnerable groups, such as women or rural borrowers. Men, in particular, were more likely to report faster growth in sales/income than women.

Table 8: Impact metrics - differences by gender and geography

Metric	Gender differences?	Geography differences?
Cash availability	No	No
Sales/income at faster rate	Yes - men more likely to report faster growth	No
Increased sales/income ⁶⁵	No	No
Profitability/personal savings	No	Only weak evidence
Household savings	No	No

Source: Arohan borrower survey, 2021

⁶⁵ Arohan's internal survey similarly suggested that about 80 per cent of respondents reported an increase in income.

Table 9: Lesson: microfinance’s impact on borrowers

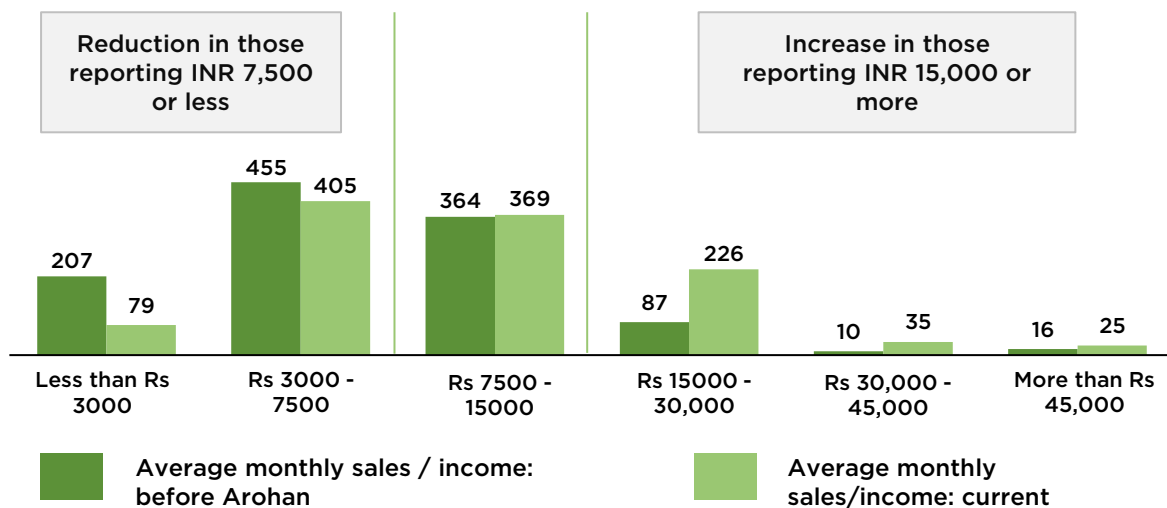
QUESTION 4: What is the impact of the finance provided by Arohan on MSMEs and households?

Lesson 4.1: The impacts of microfinance may include higher productivity and are therefore more diverse than the impacts reported in some literature

The reporting of faster growth in sales and income than borrowers had previously experienced by survey respondents is a striking finding. This highlights that Arohan’s borrowers have been able to use their loans for productive purposes (which aligns with the reported finding that the majority of loans are used for the borrowers’ businesses). This finding is notable, given that the literature around microfinance is not unanimous around this finding, and some studies have found that microfinance loans help borrowers to smooth their consumption rather than to allow for entrepreneurial activity.⁶⁶ In practice, it might be somewhat difficult to disentangle these uses. Many of Arohan’s borrowers own businesses in which they are the only employees, which may lead to challenges in practically separating business and personal usage of the loan. Regardless, survey respondents highlighting increased sales and income are encouraging in terms of microfinance’s ultimate impact at borrower level, whether that be in the domain of consumption smoothing or productivity.

The **Figure 17** shows the responses of survey respondents when asked to indicate their average sales or income before making use of Arohan’s products versus their current average sales or income. As shown, the number of respondents reporting current sales or income of 7,500 rupees or less was lower after using Arohan products than the number reporting sales or income of 7,500 rupees before using Arohan products. At the same time, the number of respondents currently reporting sales or income of 15,000 rupees or more increased compared to before using Arohan products.⁶⁷ In other words, though those reporting income or sales of less than 15,000 rupees remain the majority, there appears to have been a general shift towards increased sales/income.⁶⁸

Figure 17: Survey respondents’ income/sales, before using Arohan products versus current



⁶⁶ J-PAL. (2023). Microcredit: Impacts and promising innovations.

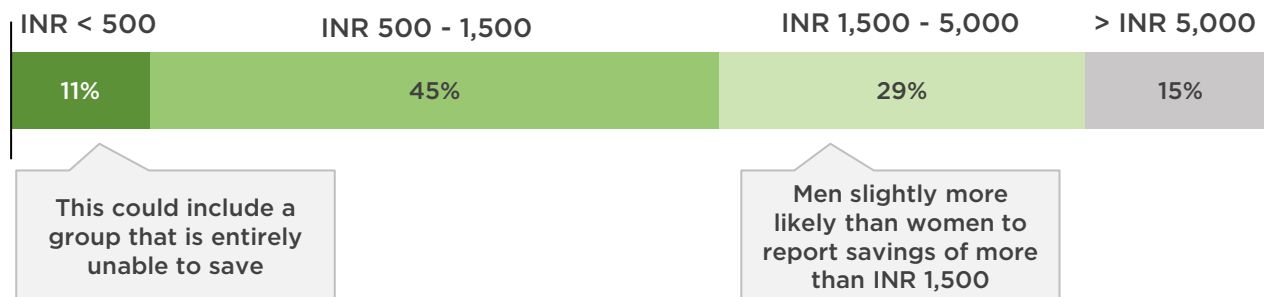
⁶⁷ This was also found to be the case in an internal Arohan survey, where respondents earning less than 10,000 rupees three years before the survey generally reported a movement towards the 10,000 - 15,000 rupees bracket.

⁶⁸ The figure of 15,000 rupees per month translates to about \$202, or about \$6.73 per day in USD market rates. BII use a poverty line of daily individual consumption of \$6.85/day, as defined by the World Bank, based on 2017 purchasing power parities (this was previously \$5.50/day based on 2011 PPP).

Source: Arohan borrower survey, 2021

In addition to the increased incomes reported by survey respondents, the survey also brought other financial benefits to light. Borrowers were asked how much money they were able to save from their business or daily activities each month.

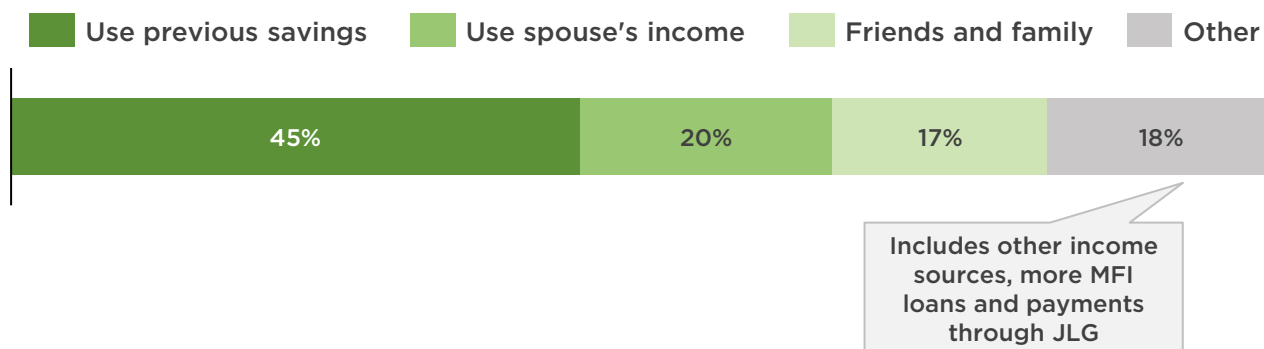
Figure 18: Survey respondents' ability to save from their business or daily activities



Source: Arohan borrower survey, 2021

The ability to save should be compared with borrowers' ability to repay loans in cases where their income or sales falls unexpectedly, which is summarised in the figure below.

Figure 19: How survey respondents repay loans in case their income unexpectedly falls



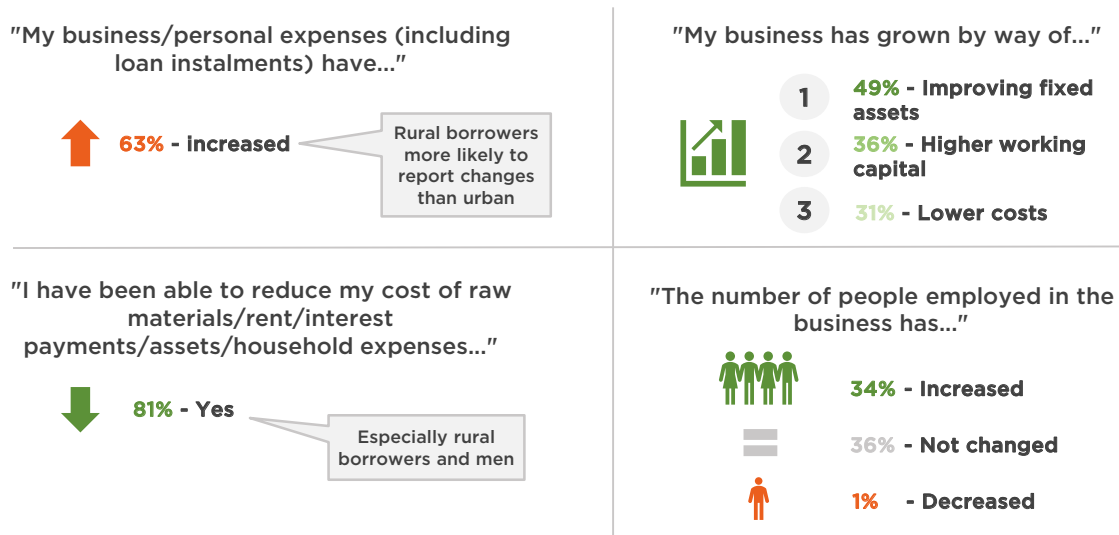
Source: Arohan borrower survey, 2021

The **Figure 19** suggest that Arohan's borrowers are generally able to repay their loans without undue hardship or further debt in the case of an unexpected fall in income. This points to a sense of sustainability in the relationship between Arohan and its borrowers. Borrowers are not only able to repay their loans if everything "goes as planned" but have a safety margin. This finding also ties in with wider findings around borrower savings and cash availability since taking loans from Arohan.

Overall, the survey suggests positive impacts across borrowers in areas such as income, savings/profitability and cash availability.

The survey also explored the effects of Arohan's loans on borrower costs. The results are shown in the figure below.

Figure 20: Survey respondents to changes in costs, business growth and employment growth⁶⁹



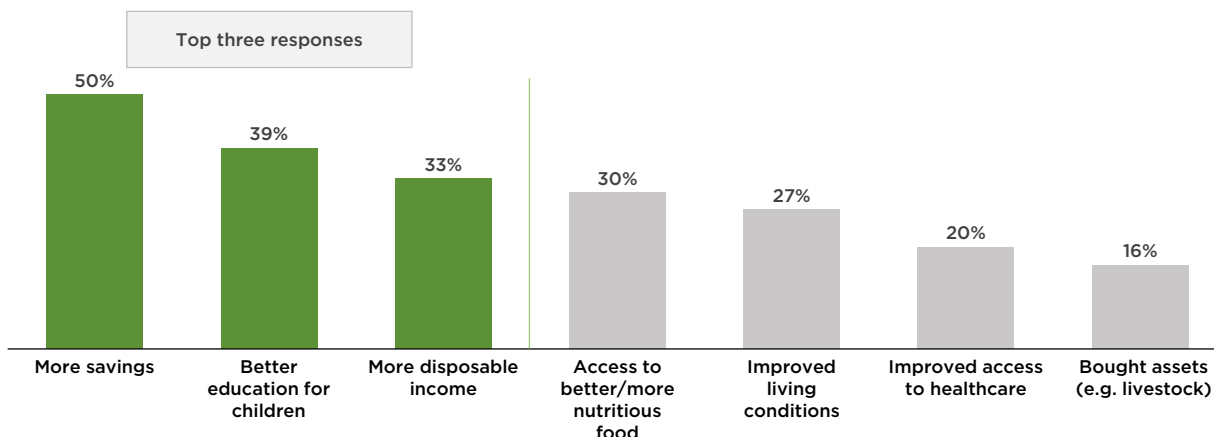
Source: Arohan borrower survey, 2021

As shown above, most respondents reported increased business/personal expenses, including loan instalments. They also reported that they have been able to reduce certain costs, such as raw materials, which can be interpreted as inputs or inventory, or rent, as well as being able to improve their fixed assets and enjoy higher working capital because of the loan. Though the reasons for these responses were not explored in greater detail, these findings may be tied to the finding around cash availability earlier, which suggests better liquidity, and hence the ability to earn better terms on input/inventory payments. Similarly, the increase in costs reported could be tied to the growth in sales mentioned earlier. This is to say that the borrowers could be purchasing more inputs to cater for the higher sales, meaning that the increased costs are part of broader business growth. Finally, there was relatively little change in the reported number of individuals employed by respondents' businesses, suggesting that while MFI loans increased income and savings at the individual and household level, there was not necessarily a step-change in the size of the underlying businesses.

Respondents were asked about changes in their household well-being, with the option to select multiple choices. The figure below shows the share of respondents selecting the various options as having improved due to their use of Arohan's products. None of the options received an overwhelming majority of selections, though greater savings and better education for children proved the most substantial, along with more disposable income.

⁶⁹ Fixed assets' refers to assets used to improve mobility or enhance services

Figure 21: Share of respondents selecting various options related to improvement of household well-being (per cent of total respondents)

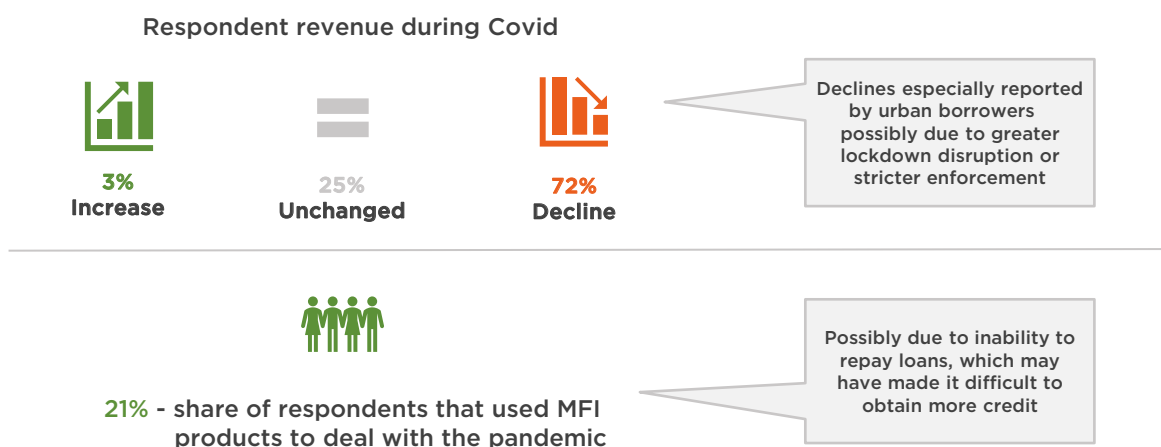


Source: Arohan borrower survey, 2021

In investigating the three most frequently selected options further, it was found that urban respondents were more likely to select increased savings than rural respondents, while also being more likely to select better education for children. There was some evidence that women are more likely to select better education for children, while men were more likely to mention more disposable income.

Given the global impact of Covid-19, respondents were asked how their revenues had changed during the pandemic, with the responses shown in the figure below.

Figure 22: Arohan's borrowers - revenue changes during Covid-19



Source: Arohan borrower survey, 2021

Following an exploration of their usage of Arohan's products and the impact that they have experienced, borrowers were asked about their future plans, specifically as they pertain to accessing and using future credit options. One finding here is that borrowers from Arohan are much more likely to take another loan from Arohan than to seek financing from any other source, suggesting that becoming an MFI borrower does not necessarily suggest graduation to other financial inclusion strands, such as opening a bank account.



Figure 23: Respondents' future plans around credit



Source: Arohan borrower survey, 2021

The assessment of impact included a gender lens as a consideration throughout. The survey brought to light that in some cases, though the borrower may be female, the end user of the loan is likely to be a man. Specifically, in 194 cases out of 1,139 (17 per cent) respondents were expected to be female but were male. It is possible that these borrowers do not own their own phones, and hence share them with a spouse or male relative. However, survey respondents were also asked whether they run their businesses themselves, or whether a man and a woman run the business together. For men, 79 per cent reported running the business themselves, compared with 49 per cent for women. Taken together, these observations mean that it is possible that in certain cases, loans taken out by women are being passed on to men, possibly for use in the family business.

This finding is not unique to Arohan. There is a substantial amount of literature finding a similar pattern, not just in India, but in microfinance in general. For example, in Bangladesh, it was found that husbands and other male family members are typically the end users of MFI loans, with doubts expressed around whether microfinance ultimately represented a positive effect on women's empowerment.⁷⁰ From an Indian perspective, there is evidence that women often do not manage the business that they take loans for - a finding consistent with survey responses - which may raise questions around the level of female empowerment taking place.^{71,72} The phenomenon of men being the actual end users of microfinance loans was also raised elsewhere.^{73,74}

In Arohan's case, borrowers list a relative as a co-borrower, usually the borrower's spouse. Furthermore, Arohan conducts loan utilisation checks one month after loan disbursement to determine the loan's usage. Based on the most recently available data, in 99 per cent of cases, loans are utilised for the purpose reported on the loan application.⁷⁵ In addition, an internal survey of Arohan's borrowers in November 2020 showed that in 51 per cent

70 ↓ Banerjee, S. B., and Jackson, L. (2017). *Microfinance and the business of poverty reduction: Critical perspectives from rural Bangladesh*. Human Relations, 70(1), 63-91.

71 ↓ Patole, M. and Sinha, F. (2005). *Microfinance and women's empowerment: research approach and findings from an impact assessment of MFIs in India*.

72 ↓ International Labour Office. (2006). *Small change, Big changes: Women and Microfinance*.

73 ↓ Kumar, L. (2013). *Illusion of Women Empowerment in Microfinance: A Case Study*. Economic and Political Weekly. vol. 48, no. 15, pp. 70-76.

74 ↓ Sharma, K. (2011). *Small Loans, Big Dreams: Women and Microcredit in a Globalising Economy*. Economic and Political Weekly. 46(43), 58-63.

75 Arohan, 2021, Loan Utilisation Check Report: February 2021.

of cases, any future loans taken out by the respondent would be used either by the respondent and her spouse (31 per cent) or only by the spouse (20 per cent), highlighting again that this is an understood and common occurrence.

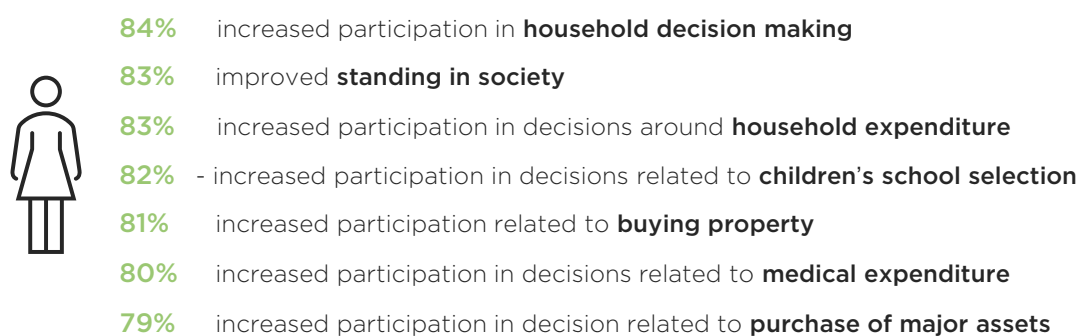
This finding, and its potential effects on the impact that microfinance has on the lives of women, suggests that, despite impact studies, it may be difficult to conclusively evaluate the effects of microfinance loans on the lives of female borrowers.

A focus on female entrepreneurs

The survey contained a section aimed specifically at female entrepreneurs, women who own a business and run it either by themselves or in conjunction with a man.⁷⁶ The aim of the questions asked was to establish whether female entrepreneurs have experienced changes in terms of empowerment as a result of borrowing from Arohan, while also providing a number of insights around this cohort.

Only 24 per cent of female entrepreneurs, as defined above, have independent savings that they control themselves, while 59 per cent have land in their own name.⁷⁷ Nonetheless, as shown in the **Figure 24**, the majority of female entrepreneurs reported improvements in their decision-making ability across a variety of metrics as a result of access to and use of MFI products. Overall, 83 per cent of these respondents agreed that the use of MFI products have improved their standing in society, which could potentially have future benefits, such as an increased willingness for the community to do business with the respondent. With the finding around the true users of the loans in question in mind, this suggests that there is nevertheless a group of women who run their own business and report improvements in their well-being across a variety of measures because of using Arohan MFI products.

Figure 24: Female entrepreneurs, responses to questions targeted specifically at them



Source: Arohan borrower survey, 2021

There were no statistically significant differences around changes in income, profitability or personal savings for female entrepreneurs compared to the rest of the sample. This suggests that while outcomes for female entrepreneurs compared to the rest of the sample are not better for these metrics, they are at least no worse.

⁷⁶ There were 388 such respondents - women who did not report owning a business are excluded from this definition.

⁷⁷ The point around savings was contradicted by Arohan's internal survey, which suggested that 72 per cent of overall female respondents (not just female entrepreneurs) have savings accounts in their own names that they control.

There was some weak evidence that female entrepreneurs are more likely to report increases in cash availability at home compared to the rest of the sample. Likewise, they were slightly more likely to report increases in household savings compared to the rest of the sample, despite no difference in personal savings. Arohan's internal survey suggested that the majority of female respondents have come to feel more secure and respected as members of their families.⁷⁸

The results above suggest that there is little difference between the group of female entrepreneurs and the rest of the sample in reporting changes on the five key impact metrics mentioned earlier: sales, faster sales growth, household and personal savings and cash availability.

Table 10: Lesson: the qualitative impact of microfinance

QUESTION 4: What is the impact of the finance provided by Arohan on MSMEs and households?

Lesson 4.2: In addition to positively affecting productivity, microfinance investments should also be viewed in terms of their ability to drive overall well-being

There was little difference in impact reported across the headline metrics between women and rural borrowers and male or urban borrowers. However, there are a few additional impacts on female entrepreneurs, as shown in **Figure 24**. These impacts are somewhat harder to quantify than the impacts around income and savings. However, they still point to evidence of empowerment amongst women, a traditionally less financially included segment of the population. To that end, while the quantifiable aspects of microfinance impact are important and valid, there is value in understanding the qualitative impacts amongst borrowers, which may improve DFIs' understanding of the overall value of their interventions.

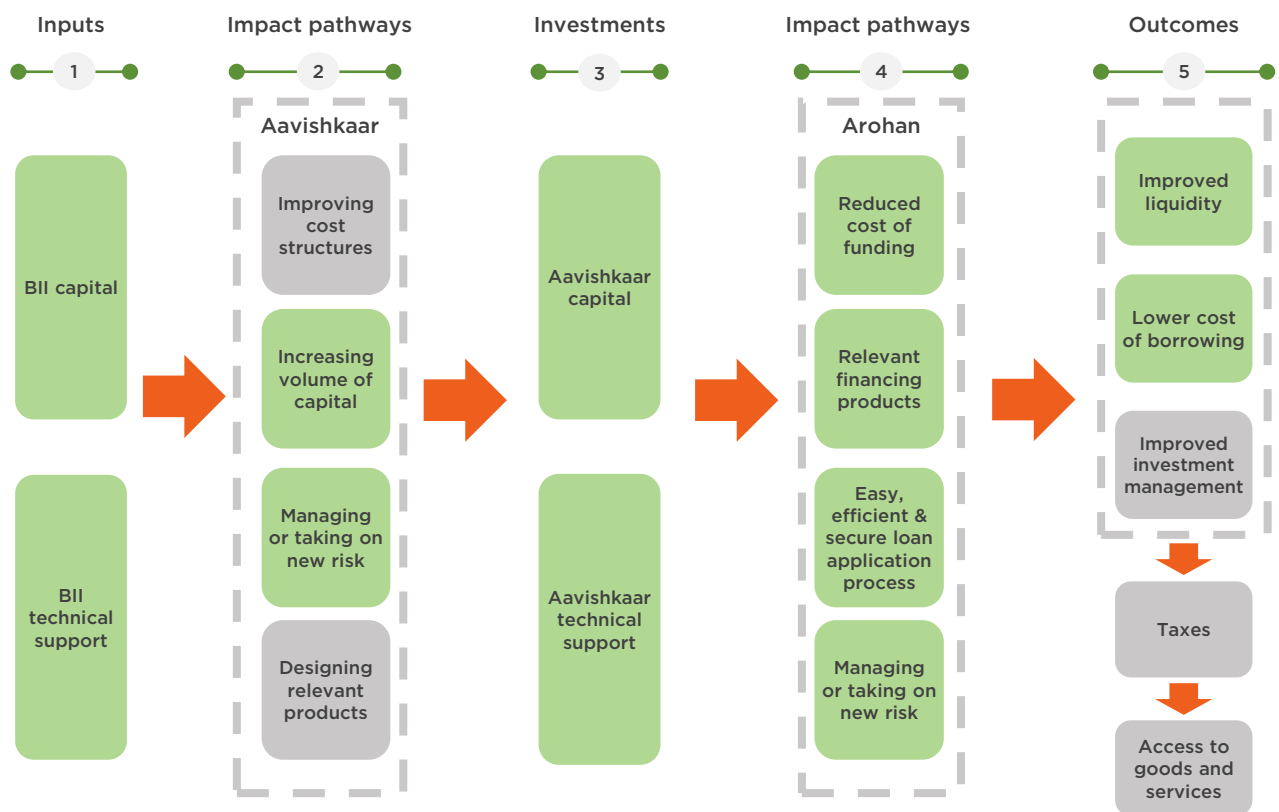
⁷⁸ Arohan, 2020, Microsave survey.

2.3 Impact mapped to FI-DI framework

Under its 2017-2021 strategy, BII produced development impact frameworks for each of its key investment sectors, including financial services. BII developed these frameworks as a consistent way to articulate impact, and to provide a lens to assess expected impact, and monitor it over time.⁷⁹

We used BII's FI-DI impact framework, and retrospectively mapped findings from the study onto this framework. This is shown in the figure below. Areas where we identified strong evidence of impact are highlighted in green, while areas highlighted in grey are areas where we found no or inconclusive evidence.

Figure 25: Findings of evaluation mapped to FI-DI framework⁸⁰



Source: BII, 2021

⁷⁹ [British International Investment. \(2023\). What impact means to us.](#)

⁸⁰ Refer to the Annex for further details.

The **Table 11** follows summarises the findings of the evaluation against the FI-DI framework, with findings provided per impact level.

Table 11: Summary of evaluation findings

Impact level	Summary of evaluation findings
1	<ul style="list-style-type: none"> • BII provided both capital and technical support (especially around corporate governance, ESG and AML/CFT) to Aavishkaar
2	<ul style="list-style-type: none"> • BII's investment increased the size of Aavishkaar's fund and allowed the fund to reach the size required to make its planned investments, including in Arohan. This represents both an increase in the volume of capital and allowed Aavishkaar to take on new risk.
3	<ul style="list-style-type: none"> • Aavishkaar provided both capital and technical support (in the form of strengthening corporate governance) to Arohan.
4	<ul style="list-style-type: none"> • Aavishkaar's focus on strengthening Arohan's corporate governance contributed to it being recognised as a leading performer in this regard. • The investment from Aavishkaar provided Arohan with access to more sources of credit (during a challenging time in the broader MFI industry). • Though products in the Indian MFI industry are heavily regulated, Arohan's products were found to be appropriate for the needs of its borrowers. • Survey respondents flagged that Arohan's loan disbursement and collections processes were easy, and that its policies and processes are generally as good, if not better, than those of competitors (for those who have used products from other MFIs or SHGs). • The investment from Aavishkaar allowed Arohan to expand its operations dramatically, expanding its states of operation and number of branches and serving more than two million borrowers across India.
5	<ul style="list-style-type: none"> • Survey respondents mentioned positive impacts on sales, liquidity, profitability and savings. • Some survey respondents also flagged increases in working capital.

Annex 1: Survey response rates

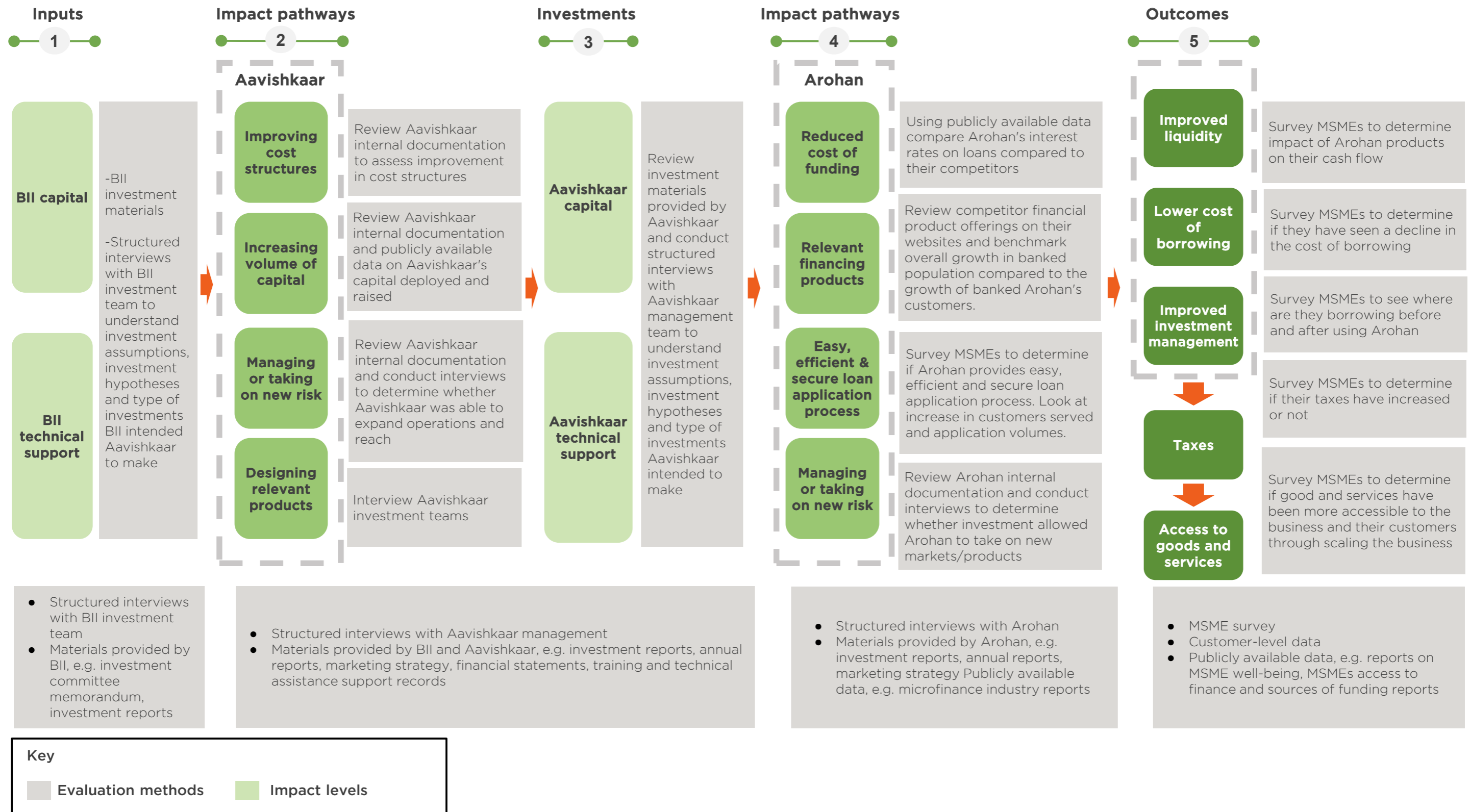
The evaluation team partnered with Kantar, a local survey partner, to administer the survey via a mixture of face-to-face and telephonic interviews, with the aim of achieving a representative sample at 95 per cent confidence interval at state level. Arohan assisted in contacting the required number of borrowers for their consent to take part in the survey, after which the borrowers' contact information was shared with the survey partner. To ensure a sufficient number of responses, contact information for 1,692 borrowers was shared. The initial aim was to conduct 80 per cent of interviews via telephone, with the remainder carried out face-to-face. In practice, 935 responses (81 per cent) were collected telephonically, with the remaining 204 (19 per cent) carried out face to face. The number of responses per state, as well as response rates per state, is shown in the table below.

Table 12: Number of and response rate by state⁸¹

State	Number of telephonic responses	Number of face-to-face responses	Total responses	Number of borrower contact details shared	Response rate
Bihar	333	45	378	494	77%
Uttar Pradesh	317	82	399	623	64%
West Bengal	285	77	362	575	63%
Total	935	204	1,139	1,692	67%

⁸¹ The level of face-to-face interviews in Bihar was relatively lower due to a festival period coinciding with the survey period, which reduced respondent availability.

Annex 2: BII's FI-DI impact framework





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