



Promoting Financial Inclusion in India

Evidence from
Au FINANCIERS (INDIA) LIMITED

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This study was authored by Dan Goldblum, Mahima Khanna (IFC's Financial Institutions Group's Strategy and M&E Unit) and Melina Mirmulstein Moses (IFC's Development Impact Department).

The authors acknowledge guidance and insights from Anup K. Agarwal, Deepa Chakrapani, Alexis Diamond, William C. Haworth and Nilesch Srivastava.

DISCLAIMER

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Abbreviations

CV	Commercial vehicles
CRR	Cash reserve ratio
CAGR	Compounded annual growth rate
CGEDI	Development impact department
GDP	Gross domestic product
FIs	Financial institutions
FY	Financial year
LIS	Low income states
LAP	Loan against property
MSME	Micro, small and medium enterprises
NBFCs	Non-banking financial companies
NCDs	Non-convertible debentures
PE	Private equity
RBI	Reserve Bank of India
SME	Small and medium enterprises

Executive summary

An additional 600 million new jobs will be needed by 2020 due to global population growth. The private sector, which currently provides nine out of ten jobs in developing countries will be critical to meeting this challenge. IFC, a member of the World Bank Group, promotes private sector-led growth to help people escape poverty and boost shared prosperity. As part of this, IFC provides both investment and advisory services to financial institutions (FIs) in India, to expand access to finance for local micro, small and medium enterprises (MSMEs), support the growth of their businesses, create new jobs, and, with this, contribute to the country's economic growth. In 2012, the MSME sector in India consisted of around 29.8 million participants. Together, they contributed 11.5 percent of gross domestic product (GDP), over 45 percent of India's industrial output, 40 percent of exports and employed 69 million people.

As a part of its investment activities in low income states (LIS) of India, IFC has supported Au FINANCIERS (INDIA) LIMITED (referred to as "Au FINANCIERS" or "Au" in this study) since 2010 to expand its transport finance to small road transport operators (referred to as commercial vehicle (CV) business) and to offer new services such as MSME and housing finance in LIS. Au started its operations in Rajasthan (one of the poorest states in India) and, over the last decade, has expanded to other underserved markets in Madhya Pradesh, Gujarat, Maharashtra, Delhi and Punjab. Au has expanded its loan portfolio to Indian rupees 46.36 billion and increased its number of MSME borrowers to 183,867 while maintaining healthy portfolio quality (at 1.3 percent) and reducing loan processing time. The primary objective of this study is to assess Au's contribution towards financial inclusion, job creation and firm financial performance in India over financial years 2012-14 (FY12-14)^[1]. In particular, this study examines SME and CV borrowers, explores how financing is utilized, how many jobs are created or supported, how real income is changing and how many borrowers were included in the formal financial system.

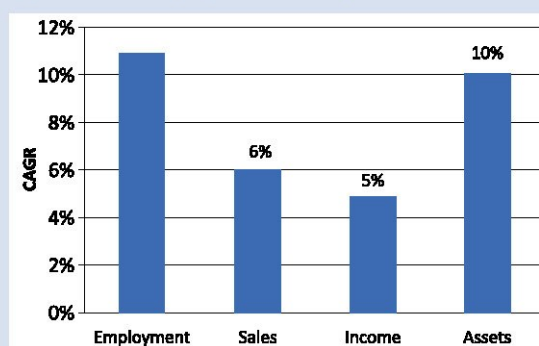
This study was conducted in December, 2014. It triangulates data from secondary sources along with primary data from loan file reviews, field interviews with Au's employees and, MSME beneficiaries and CV beneficiaries using simple statistical techniques,

including regressions.

Despite challenging macro-economic downturns in 2011-12, MSME and CV loans show positive effects on jobs, assets, income, and sales. The MSME^[2] analysis shows the following:

- *Employment in the sample grew at a compound annual growth rate (CAGR) of 11 percent^[3].*
- *Sales for the MSME beneficiaries in the sample grew by a CAGR of 6 percent^[3].*
- *MSME beneficiaries in the sample saw an increase in their incomes during the study period at a CAGR of 5 percent^[3].*
- *Beneficiaries accumulated additional productive assets, such as commercial property, vehicles, and equipment/machinery. The growth in asset value for MSMEs sampled was an impressive 10 percent CAGR^[3]. Retail and Services enterprises in the sample consistently performed the best across different parameters, while loans taken for working capital performed the best across the different parameters observed.*
- *Au FINANCIERS successfully reach unserved and underserved populations, such as first-time and LIS borrowers. First-time borrowers performed well on all measured growth metrics, including employment, sales, income, and assets.*
- *Regression analysis shows jobs and sales are positively associated with increased access to financial services. An Indian*

Figure 1: Average growth in key variables



Source: Au loan files, loan officer review and authors' computation

rupees 690,000 loan in FY12 is associated with one additional job⁴¹.

- The CV analysis shows the following:
 - 20 customers with multiple CV loans grew their annual real income by 39 percent CAGR.^[3]
 - 25 percent of the clients' sampled shifted into home ownership during the period studied.
 - Sampled clients grew their vehicle fleet by 141 percent CAGR^[3] in the time from taking a loan from Au in FY12 to the most recent loan taken by them.
 - Through their financing of the sampled CV portfolio, Au indirectly supported at least 125 jobs, of which 63 new jobs were created over FY12-FY15.

Interviews with Au beneficiaries confirmed the impact that working with Au FINANCIERS had on their lives. Beneficiaries saw substantial increases in income and assets. They increased employment in their growing businesses and invested disposable income into the education of their children. In addition, many borrowers, who were previously financially excluded (and may have paid usurious rates to money lenders), opened bank accounts, and can now obtain

financing from other FIs due to the documentation and credit history they developed by borrowing from Au FINANCIERS.

These results validate the thinking that MSMEs are vital for economic growth and creating new jobs in developing economies like India. This should encourage other FIs to continue supporting MSMEs through financing and other services. The results also validate the important role that Au FINANCIERS has and will continue to play in India's LIS, increasing financial inclusion, and supporting job creation, increased incomes, and better livelihoods.

Introduction

Globally, MSMEs play a key role in creating jobs. This is especially true in developing economies where the World Bank Group's Enterprise Surveys find that small firms account for the highest share of employment. MSMEs also promote economic growth and contribute to the development of the private sector. At the same time, access to finance is critical to develop the MSME sector in any country. Studies show that improving access to finance can help firms expand their operations, which can have positive effects on the number of jobs created, and these effects might be greatest for smaller firms. An analysis using the World Bank Group's Enterprise Surveys data found a positive relationship between financial development and

MSME hotel construction loan

Mr. Sharma, obtained a loan from Au to finance the construction of a small hotel near the train station in Jaipur. Mr. Sharma previously operated a food trolley in the train station. With money he saved, he built the first floor of the hotel. However it was not successful due to its small size. He reached out to various lenders for financing to add more floors to the hotel. After being rejected by all other lenders, he obtained the financing of Indian rupees 1.5 million in 2011 from Au. Since he had not taken any loan previously, he could use the hotel property as collateral.

Mr. Sharma used the loan to build two additional floors with 27 rooms in all. The hotel now employs 10 people, including him and his family. Previously, he had earned a monthly income of Indian rupees 30,000 a month from his food trolley business. While, he has still retained that business, he now makes an additional Indian rupees 100,000 a month on average from the hotel. Mr. Sharma said that he may soon apply for an additional loan from Au to further expand his hotel.



entrepreneurship, suggesting that improved access to finance is associated with a vibrant private sector^[5].

FIs play a fundamental role in supporting private sector development through financial services. Financial systems help mobilize and pool savings, provide payments services that facilitate the exchange of goods and services, produce and process information about investors and investment projects to enable efficient allocation of funds, monitor investments and exert corporate governance after these funds are allocated, and help diversify, transform and manage risk^[6].

Clearly, IFC through investments and advisory services to FIs and by promoting responsible finance in developing countries is supporting job creation. For example, when IFC invests in client FIs, these FIs can expand operations, provide loans to more firms, or widen their range of products or services. FIs may also hire more staff to serve new clients and train them in the new products developed. Firms obtain loans from FIs to start operations, finance working capital needs, or expand operations (by increasing capacity or entering new business lines). These MSMEs, if profitable and operating in a supportive political and economic environment should grow their businesses and create jobs in the economy.

In 2012-13, IFC's Development Impact Department (CGEDI) developed a series of case studies on "Assessing Private Sector Contributions to Job Creation and Poverty Reduction",^[7] which estimated indirect job creation effects across industries and countries. As a part of this global study, CGEDI conducted five case studies focused on job creation by MSMEs supported through partner FIs.

This study replicates and improves upon the methodology used for the IFC Jobs Study, it adds to the initial body of evidence on job creation effects of expanding access to finance to MSMEs. It focuses on Au FINANCIERS, one of IFC's partner NBFIs, to study the development effects of the FI's MSME finance activities in LIS of India. The findings of this study support the belief that Au FINANCERS work has resulted and is expected to further improve access to finance for the underserved segments through enabling access to credit and other financial products.

Country context

The MSME sector is been widely acknowledged to be of substantial importance to the Indian economy. The sector feeds crucial industrial value chains and provides broad-based employment to the country's working age population including its semi-skilled and unskilled workers. As per an IFC – Government of Japan study on MSME financing in India, the MSME sector in 2012 consisted of approximately 29.8 million participants, which contributed 11.5 percent of gross domestic product (GDP), over 45 percent of India's industrial output and 40 percent of exports. It employs 69 million people^[8]. 33 percent of these MSMEs are in LIS^[9], which have low access to financial and infrastructure services. Other studies have suggested MSMEs are the largest source of employment in the country after agriculture. Despite its importance to the socio-economic development of the country, the sector's growth is constrained by poor infrastructure and inadequate market linkages.

On the demand side, lack of adequate and timely access to finance is a major challenge to the sector. FIs have limited exposure to the sector due to a higher risk perception and limited access that MSMEs have to immovable collateral. According to the IFC study cited above, the total debt financing gap for the MSME sector is estimated at Indian rupees 19 trillion, of which around Indian rupees 2.9 trillion is projected as viable and addressable under the current policy framework. The micro, small, and medium enterprise segments respectively account for Indian rupees 2.93 trillion of the viable debt gap that can be addressed by FIs in the near term. 66 percent of this debt gap is in LIS (for example, Rajasthan). This debt gap is partly addressed by informal sources such as money lenders.

Lack of access to financial services, coupled with complex and time-consuming registration procedures has resulted in approximately 94 percent of MSMEs remaining informal^[10]. As these enterprises are not registered and many do not pay income tax, it is difficult for them to raise money directly for their business. The lack of documents

forces them to take personal loans, to support their businesses.

On the supply side, FIs are reluctant to lend to many MSMEs due to information asymmetry - informal unregistered firms have poor documentations and lack appropriate accounting practices with multiple balance sheets. As National FIs may not always have local knowledge on financial viability of these MSMEs, they are reluctant to lend to them. However, local non-banking financial companies (NBFCs) have local knowledge and are better able to manage loan performances, keeping non-performing loans (NPLs) low.

These demand and supply-side constraints are even more challenging in LIS (for example, Rajasthan). In 2012, LIS housed 45 percent of India's population but 60 percent of its poor^[10]. These states are characterized by lower per capita GDP; and access to services is below country average. As a result, a higher proportion of LIS firms are informal and unregistered with little or no documents. FIs are reluctant to lend to firms with little or no credit history because of low upside and high risk.

Over the last decade NBFCs in India have undergone a consolidation process, with many merging or closing down. According to the Ministry of Finance, the number of NBFCs decreased from 13,014 in 2006 to 12,409 in 2011, while the NBFC industry itself grew 2.6 times over the same period at a CAGR of 21 percent^[11]. The MSME loan market for NBFCs in India is growing at a CAGR of 23.3 percent^[12]. It is estimated that MSMEs in India have a total finance demand of Indian rupees 32.5 trillion, of which the addressable market for FIs is Indian rupees 11.8 trillion^[13]. Given that Indian rupees 7.0 trillion is provided by FIs, the supply-demand gap of close to Indian rupees 4.8 trillion has broadened the potential markets for NBFCs in India, on which they need to capitalize^[14].

NBFCs are aggressively focusing on providing loans to the MSME sector. Though the cost of funding through NBFCs is generally 1 to 1.5 percent higher than bank lending rates, the terms of funding—such as security and collateral requirements and structured repayment terms—are more benign than those of banks. Further, NBFCs focused on a new

segment of clients, who are not yet served by banks, that is, they finance MSMEs through innovative products and services such as loans against property and finance for secondhand and reconditioned vehicles, construction equipment, and secured and unsecured working capital. One such business model is to offer multiple products to clients—MSME loans, CV loans, personal loans, and insurance. Insights from CV financing are used to facilitate additional credit decisions, including providing larger loans.

The CV Financing Industry in India has seen impressive growth. In the five years till 2012-13, CV loan disbursements grew by around 11 percent^[15]. NBFCs play an important role in CV financing because their regulatory requirements are less stringent when compared to banks. They can customize their products and are not bound by priority-sector lending or cash reserve ratio (CRR) norms. Over the last decade, the vehicle finance industry in India has fragmented; banks focus on car loans while NBFCs focus on CV loans.

This industry is expected to continue to grow at a CAGR of 15 percent over the period 2011-12 to 2016-17^[16]. Improvements in road infrastructure in rural and semi-urban areas will be one of the main driver of this growth. In addition, the growth of the CV industry is linked to the country's industrial activities and the overall GDP.

Au and its relationship with IFC

Au FINANCIERS (INDIA) LIMITED (referred to as “Au FINANCIERS” or “Au” in this study) is a registered, non-deposit taking, systematically important NBFC headquartered in the low income state of Rajasthan. Au targets rural and semi-urban markets in India (for example Maharashtra, Gujarat, Madhya Pradesh, Punjab, Goa, and Chhattisgarh). Au is engaged primarily in CV loans (new and used) with a developing business of loans against property (“LAP”) for MSME financing, housing finance, and insurance broking under its new

subsidiaries. Au provides loans to low-income, self-employed, first-time, and small transport entrepreneurs, while its LAP loans support income-generating activities of micro and small manufacturers and service enterprises and agriculture-based MSMEs. Over 95 percent of loans provided by Au are classified as priority sector lending under Reserve Bank of India (RBI) guidelines. It is rated “A Stable” by CRISIL. As of October 2014, Au has a presence in 10 states through 223 branches, the majority of which are in Rajasthan (104 branches), Maharashtra (40 branches), and Gujarat (40 branches). It has reached approximately 254,000 CV customers since 2003.

Au was incorporated in 1996 by a first-generation entrepreneur. In its initial phase, it raised funding from high net-worth individuals to provide vehicle loans within Rajasthan. In 1999, it adopted a fee-based model, working as an originator for private banks. In 2006 it expanded operations to Maharashtra and, in 2008, expanded further into Gujarat. It also received a first round of private equity (PE) funding and began to directly fund its assets. In 2010 Au attained NBFC status and began its MSME business. In 2011, Au established Au Housing Finance and expanded into Punjab, Madhya Pradesh, and Goa. In 2012, the company started Au Insurance, a licensed insurance broking company, and diversified its liability mix to multiple sources and instruments. It also expanded to Chhattisgarh. In 2013-14 Au expanded into Delhi, Haryana, and Himachal Pradesh and received its fourth round of equity.

Au's competitive advantages include its quick turnaround time, its broad coverage in largely untapped semi-urban and rural markets, strong asset quality portfolio, local manpower with high employee retention, a diversified resource mix, and high quality priority sector assets.

As of September 2014, Au's loan portfolio was Indian rupees 46.46 billion outstanding for 183,867 clients. Transport finance loans comprise 67 percent of its portfolio, including heavy CVs, light CVs, small and multi-utility CVs, three-wheelers, and cars. The average outstanding loan size for this portfolio ranges

from approximately Indian rupees 119,000 for three-wheelers to Indian rupees 721,000 for heavy CVs, with an average outstanding loan size of Indian rupees 301,000. MSMEs comprise 22 percent of the portfolio; this includes loans against property for business purposes provided to manufacturers, retailers, schools, service providers, and others. The average outstanding loan size in the MSME category is around Indian rupees 619,000, while the maximum loan size is Indian rupees 2.5 million. As of September 2014, 56 percent of Au's assets under management were in Rajasthan, 17 percent in Maharashtra, and 14 percent in Gujarat.

Au's housing finance subsidiary company provides home loans for renovation, home improvement, and new homes. It also provides affordable housing finance (low-cost housing to low-income groups in semi-urban /rural areas) and rural housing finance. The average ticket size across this product suite is Indian rupees 690,000 and total outstanding is Indian rupees 5.3 billion.

In March 2010, IFC supported Au (then with an asset base of Indian rupees 4.9 billion), through an equity investment of \$7.8 million. In Feb 2012, IFC made an additional investment of \$6.6 million (equity) along with Warburg Pincus, bringing IFC's total investment in Au to \$14.4 million, for an 18.3 percent stake. Since IFC's first investment in Au in FY10-11, Au has grown its branch network by three times, assets under management by eight times, its customer base by six times, and net worth by almost seven times. In April 2014, IFC also made an additional investment of Indian rupees 285 million in the new round of rights/preference issued by the company, raising its stake from 18.05 percent to 18.71 percent due to partial dilution by the promoter. In June 2014, IFC subscribed to Au's listed, secured, non-convertible debentures (NCDs) worth Indian rupees 1.45 billion. This was IFC's first local currency debt to FIs in India.

IFC has provided advisory and investment assistance to Au to improve its corporate governance standards, asset liability and risk management systems, and to scope MSME and affordable housing finance market potential for product diversification. Further, IFC assisted Au in

diversifying funding sources, now comprising over 50 major banks in India, including the Small Industries Development Bank of India, hiring and retaining senior resources, attracting new investors of high pedigree (Warburg Pincus and Chrys Capital), and improving its credit rating.

Methodology

This study was based on data reviewed for 128 active clients from Au's MSME and CV portfolios. A sample of 108 active MSME clients that received a loan of Indian rupees 500,000 (or above)^[17] but below Indian rupees 2.5 million^[18] in FY12 was randomly selected. An Indian rupees 500,000 threshold was used to identify and focus on the SME portion of the MSME portfolio (referred to as MSME loans in this document). The number of clients selected (108) represents a small sample, given the practical constraints, but large enough to enable meaningful inferences about the population from which this sample was drawn. In addition, it is representative of the sectoral distribution and covered 13 percent of the total population^[19]. This is the first study of its kind, conducted by IFC, that includes non-performing loans. In addition, a small random sample of 20 active clients with multiple CV loans and at least one CV loan approved in FY 2012 were included in the study. The CV analysis is not representative but provides interesting qualitative findings. The MSME results and CV results are presented in two different sections of this report.

In December 2014, a joint IFC team comprising the Financial Institutions Group Strategy and Development Impact Departments visited Au FINANCIERS in Jaipur to conduct a Development Impact study. The team was supported by South Asia's Financial Institutions Group's portfolio team and Au's

team.

The team reviewed 108 MSME client loan files and 20 CV client loan files during the visit to understand characteristics of clients at the time of loan origination. The team also conducted a qualitative analysis of clients by visiting the premises of some clients sampled and discussing with them the evolution of their businesses and impact of the financing. In addition, Au's team provided complementary data from its MIS system and contacted the sampled MSMEs to collect updated information two years after obtaining the MSME loan from Au. It achieved a response rate of more than 80 percent.

The reviews and data collection conducted by the Au and IFC team aimed to obtain firm-level information on financial inclusion, job creation^[20] and financial performance between 2012 and 2014. This two year period was chosen to measure employment effects for firms having the capital to start and expand operations, while limiting other external factors on job growth that could occur over a longer period. Of the 108 MSME clients reviewed, Au's team collected 2012 and 2014 information for the key variables (employment, assets, sales, and income) for about 90 clients (slightly varies by variable). Nominal changes in these figures were converted to real figures with 2012 as base year.^[21]

Caveats

Given the data limitations in the loan files and nature of field-based interviews, these must be kept in mind while interpreting the results. These include:

(i) Attribution: The study measures changes in key variables for the sampled MSMEs and extrapolates to Au's MSME portfolio (loans

from Indian rupees 500,000 to Indian rupees 2.5 million) in FY12. However, given that the firms may obtain loans from other FIs, and that it is difficult to isolate macroeconomic and business conditions in the country, the total effects on key variables cannot be attributed solely to the loans obtained from Au or to IFC's engagement with Au.

(ii) Omitted variable bias: Changes in key variables may be influenced by other indicators that were not analyzed in this study. For example, macroeconomic conditions and age and experience of business owners are likely determinants of key variables (for example, loan size, job, and asset growth). The omission of such variables results in omitted variable bias and limits statistical inference, particularly for regressions that try to measure causal effects.

(iii) Generalization and prediction: The results of this study are specific to the sample reviewed and can only be used to extrapolate to a population with similar characteristics (MSME clients with loans originated in FY12 and between Indian rupees 500,000 and Indian rupees 2.5 million). The multipliers should not be used to extrapolate for non-representative populations, or predict effects in the future as these would not be statistically significant.

(iv) Measurement error: Given the nature of the survey, measurement error is a likely issue in the data. For instance, the results for key variables used in this analysis were provided by clients over the phone to their loan officers and there may have been some sensitivity when some questions, such as those on their incomes. The extrapolation was done using a conservative 95 percent confidence interval for the population of MSMEs with loan sizes at origination in between Indian rupees 500,000 and Indian rupees 2.5 million in 2012. The growth of jobs and financial performance of the extrapolations are therefore underestimates, as they were done for 900 MSMEs, while Au's portfolio comprises of approximately 20,000 MSMEs. Further, the study did not take into consideration growth in

the value chains of the surveyed firm (suppliers or distributors), which could also lead us to understand total job growth.

(iv) Small sample bias: Analysis of the effects of CV is based on a small sample of 20 clients, while their portfolio is much larger. As a result, these conclusions may not be representative of the entire portfolio and should not be used in extrapolation.

Au MSME sample description

As described earlier, IFC's team reviewed a sample of 108 loan files from Au's MSME portfolio. As seen in Figure 2a, of the 108 files, the biggest sector represented was retail, with

Figure 2a: Sectorial distribution of sample files

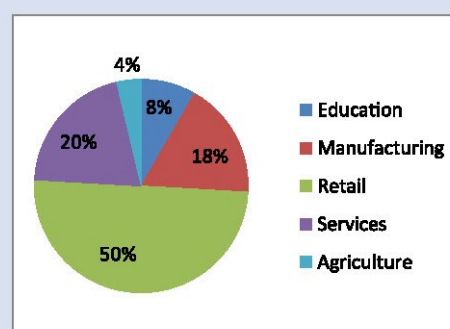
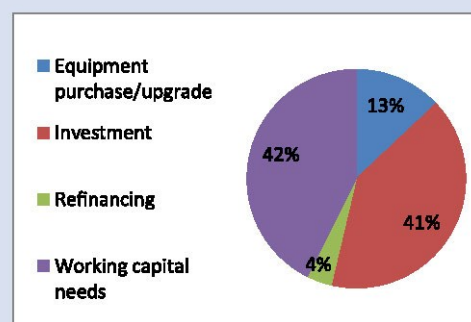


Figure 2b: Purpose of loans sampled



Source: Au FINANCIERS loan file review

exactly 50 percent of the files, followed by services with 20 percent, manufacturing with 18 percent, education with 8 percent and agriculture with 4 percent. The loans were primarily for working capital (42 percent of loans) and investment (41 percent), with a smaller portion for equipment purchase (13 percent) and refinancing (4 percent), as shown in Figure 2b.

The most typical size of firms in the sample is between 2-10 employees (55 percent of sample firms), 26 percent of firms are single-employee firms, and 19 percent have more than 10 employees. The firm sizes served by Au, as represented in the sample, are typically defined as micro or small enterprises, those that have difficulty obtaining access to financing. The World Bank Enterprise Survey for India showed

significant differences in the use of bank loans between small enterprises (between 5-20 employees), with 36.1 percent of such firms using banks to finance investments, as compared with 54.4 percent for medium-sized firms (20-99 employees) and 63.2 percent for large firms (100 employees and above). The differences in the small firms' access to finance increases when considering working capital: only 21.3 percent of small firms use banks to finance working capital, as compared with 67.1 percent of medium-sized firms and 81.7 percent of large firms.

In terms of age of firms, the majority of firms in

the MSME sample are mature firms, which have existed for over 10 years (56 percent of the sample). The rest were divided equally between firms with 5-10 years in existence, and new firms of 5 years and under (both 22 percent of the sample).

Approximately 60 percent of respondents had not previously received a loan. This statistic strongly illustrates the outreach that Au is able to achieve to underserved populations. Despite this impressive outreach, NPL (over 90 days past due) statistics for the sample were quite low, at 1.46 percent (this is, in fact, slightly higher than the NPL figure for the overall MSME portfolio, currently at 1.28 percent). Au relies on property as collateral for MSME loans. In the sample, 63 percent of borrowers had pledged their home as collateral, while 32 percent used commercial property. In several cases, the properties used as collateral were dual residential and commercial buildings.

The average loan size at origination in the sample

Clients with multiple loans: CV, MSME and housing loans

The client, Mr. Nayak, runs a tour and travel business named Akshay Tours. He obtained his first CV loan from Au in 2010, and now owns five CVs. Before Mr. Nayak began his business, he worked in a hospital, earning Indian rupees 15,000-20,000 a month. Now, income from his fleet is around Indian rupees 100,000-150,000 a month, representing a multiple of five to ten times his previous income. He was also able to buy a house with a housing finance loan from Au. He

previously rented a house at a rate of Indian rupees 7000 a month. In addition to these improvements to his income and standard of living, the business also employs Mr. Nayak's son, and four other drivers. Further, Mr. Nayak now files taxes for himself and for his business, thus expanding the tax base in the country. The client explained that he worked with Au FINANCERS because they did not require paperwork from him that would have been difficult or impossible to obtain. He only needed to present a guarantor to receive financing. He thus obtained in total five CV loans from Au, of which three are currently paid off in full and two are still outstanding. He subsequently obtained an MSME loan to further expand his business and a housing finance loan to purchase a house. The home served as the collateral for both these loans. He can now obtain financing from other banks because of the documentation and credit history he developed with Au.



was Indian rupees 725,047 while the average value of collateral used was Indian rupees 2,657,605. On average, MSME clients in the sample have 37 percent of collateral coverage. Further, Au's credit policy does not allow extending a loan in excess of 50 percent of the value of the collateral offered. On average, education loans in the sample were the largest, with an average size at origination of Indian rupees 833,333, while agriculture loans were the smallest, with an average size at origination of Indian rupees 500,000.

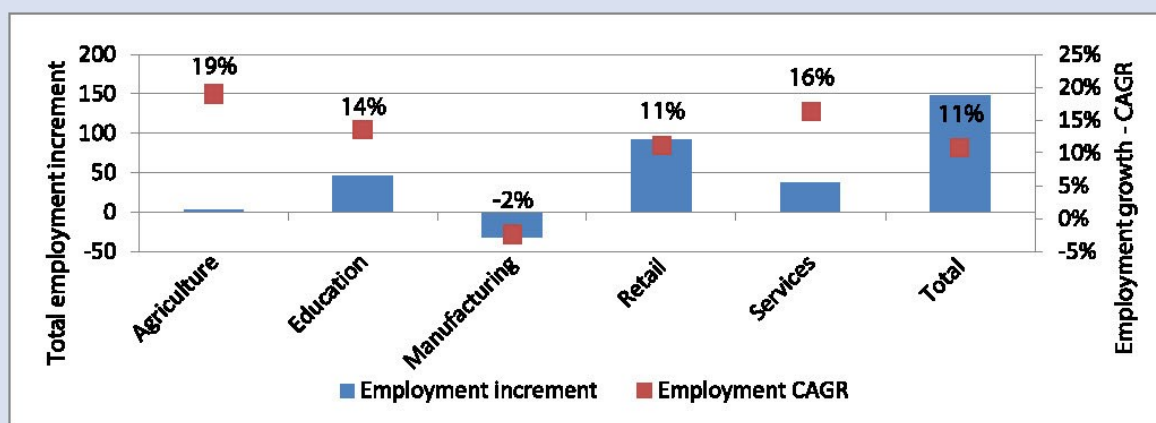
Changes in key variables from FY12 to FY14

Jobs

Overall, the Au beneficiaries sampled showed strong employment growth during the time covered by the study. On average, firms in the sample increased employment by an increment

3. Most sectors showed impressive growth, ranging from 11 percent CAGR for retail to 19 percent for agriculture (albeit with a small sample size). However, manufacturing firms financed showed a small decrease of 2 percent in employment. This is consistent with the other variables studied, indicating that manufacturing firms were harder hit than others due to the macroeconomic conditions during this period. Most growth in jobs in the sampled firms during the study period came from the retail sector, which also accounted for over half of the observations in the sample. Thus, employment in the retail sector observations grew by 92 jobs, out of the total growth of 148 in the sample. The services and education sectors also showed strong total employment increments, with 38 and 47 incremental jobs, respectively.

Figure 3: Employment increment and growth by sector



Source: Au loan files, loan officer review and authors' computation

of two workers during the study period. Employment in the overall sample grew from 655 to 803 employees, representing an 11 percent CAGR in jobs. This compares favorably with the overall growth rate of the Indian economy of 10 percent^[22] during the same time period, and is particularly notable in the LIS in which Au primarily operates.

Within the sample, different results were observed for different economic sectors, as shown in Figure

Examining the sample by looking carefully at how loans were used reveals that most loans resulted in strong and positive employment growth, ranging from 11 percent for investment purposes to 13 percent for working capital and equipment purchase/upgrade loans. Only four loans in the sample were taken for refinancing, and they were associated with job losses of 17 percent.

MSME school loan

The client, Mr. Mishra, runs a school in Jaipur. The school, which was started in 1994, teaches from kindergarten to 12th grade, and has around 1,200 students. The school employs 60 people in total including teachers and other staff. The client obtained an MSME loan for Indian rupees 1.5 million from Au for construction of two additional floors to the school, with an area of 4,500 square feet. These new floors would enable the school to add approximately 300 to 400 additional students, as well as labs and a library. The plan was to add approximately another 10 teachers as well, thus not only expanding educational opportunities but also employment opportunities.

Mr. Mishra currently earns between Indian rupees 3 to 5 million annually. He expects the income to grow by 20-25 percent once the construction and school expansion is completed. At the time of our visit the school had applied for an additional loan from Au in order to complete the construction. Mr. Mishra said that he had previously received a loan from another source, but that he chose to work with Au due to the ease of loan processing.

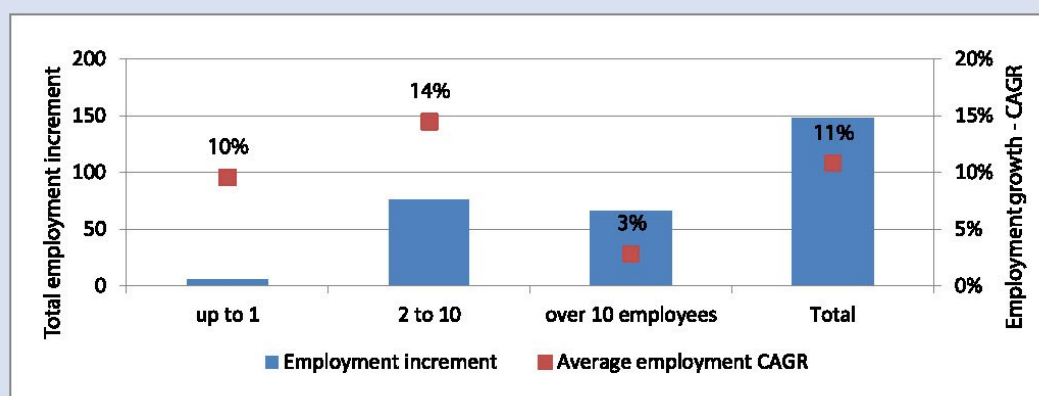


Firms of different ages exhibited different patterns of employment growth. While new firms (0-5 years) grew strongly at a CAGR of 20 percent, and older firms (over 10 years) also grew at a rate of 12 percent, mid-age firms (5-10 years) lost jobs at a rate of 7 percent annually. Overall, the contribution of older firms to incremental growth of jobs in the sample was the highest, with 69 jobs gained.

The size of the firms studied also showed

important differences in employment growth, as can be observed in Figure 4. While firms with 2-10 employees showed an average CAGR of 14 percent, those with more than 10 employees only grew at 3 percent. This may indicate that these firms have an unmet need for further financing, or that other constraints could be hampering these firms from growing further. However, in absolute terms, the contribution of the larger firms (above 10 employees) to growth in the sample was significant, with 66 incremental jobs added, slightly less than the 76 jobs added by firms with 2-10 employees.

Figure 4: Employment increment and growth by firm size



Source: Au loan files, loan officer review and authors' computation

Single-employee firms showed a close to average employment CAGR of 10 percent.

Comparing loan sizes at origination with the number of incremental jobs obtained in the sample allows us to estimate the size of loans required to create a job. For the Au sample, one job was created for every Indian rupees 460,000. Applying this rate to the overall outstanding MSME portfolio as of March 2012, which is Indian rupees 1.92 billion, suggests that over 4,190 jobs may be supported through this

part of Au's portfolio alone. However, since this portfolio contains loans to medium-sized and micro enterprises, this calculation could be subject to both under and overestimation effects, which we cannot analyze with existing data.

Also, a deeper analysis was conducted for a slice of Au's MSME portfolio consisting of 857 loans that were generated in 2012 and were above Indian rupees 500,000 at origination. With the sample drawn from these 857 observations, we used a 95 percent confidence interval to extrapolate

MSME loan- equipment finance

The borrower, Mr. Sharma, works for a promoter who manufactures bearings for cars in Jaipur. The facility visited is owned by the promoter, who also supplies machine operators with raw materials for production, and pays employees based on their production. The facility has four machines, one of which was purchased by the borrower using the loan proceeds from Au (cost of machine: Indian rupees 1,500,000 loan amount Indian rupees 1,250,000). Besides working in the facility himself, Mr. Sharma also employs a machine operator. Further, the facility as a whole employs (at least) two women employees to conduct quality control and pack the bearings. The borrower owns a house, which he used as collateral for the equipment loan from Au.

Before purchasing the machine, Mr. Sharma used manual processes to produce the bearings. According to the borrower, his production increased tenfold after he started purchased the new machine. The quality of the product also increased significantly, and he is now able to obtain a price of Indian rupees 3 per piece from the promoter, compared with a price of Indian rupees 0.10 previously. Due to the increase in productivity and quality (and despite an increase in electricity consumption), the borrower's net income has increased ten times. Since receiving the loan from Au, Mr. Sharma was also able to purchase two additional machines with loans from state banks. These subsidized loans were available to him now because of the documentation built up through his borrowing from Au, thus representing another tangible benefit to his income and livelihood.



incremental employment effects for the whole relevant section. The results are at a range of 268 to 2,460 incremental jobs added for the 857 observations, at the 95 percent confidence interval. This again highlights the relationship with employment in the regions where Au operates.

Sales

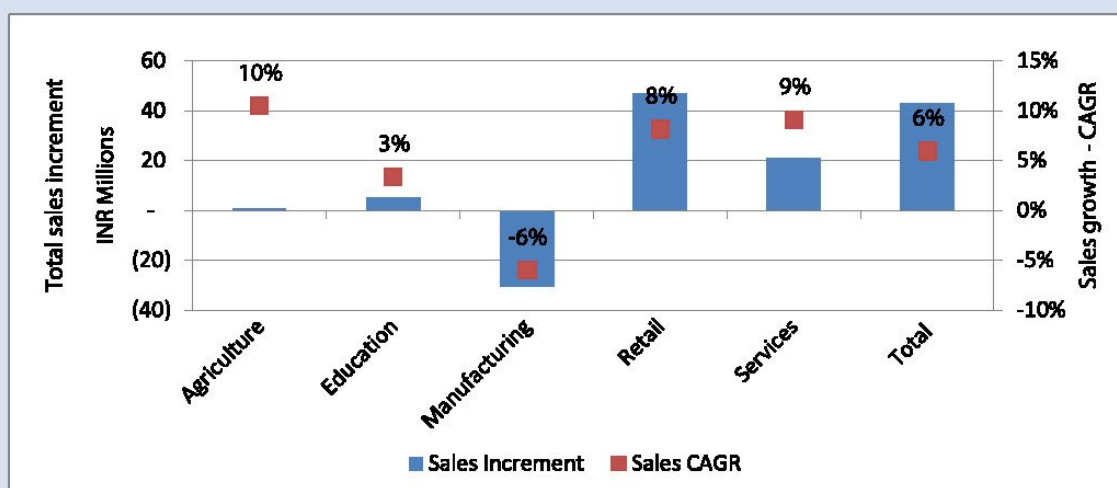
Overall, sales for the beneficiaries in the sample grew by an average CAGR of 6 percent^[24]. The average sales increment was approximately Indian rupees 468,000 for beneficiaries for whom observations were available in 2012 and 2014.

The sampled firms showed an overall growth in sales of approximately Indian rupees 43 million. Again, enterprises in different sectors showed different levels of growth in sales, as

services firms, with roughly Indian rupees 47 million and Indian rupees 21 million, respectively. However, these gains were partially offset by the decline in sales of manufacturing firms in the sample, a reduction of nearly Indian rupees 31 million.

Loans taken for different purposes yielded varied results in terms of sales growth. Working capital loans had very strong impact on sales growth, at 12 percent CAGR on average for firms in the sample. However, loans for investment saw 1 percent average sales CAGR^[24], and equipment purchase/upgrade loans had a CAGR of 3 percent^[24] on average. Refinancing loans had a negative CAGR of 7 percent. However, only four loans in the sample were used for this purpose, thus not making generalization possible. In absolute terms, working capital loans had an increment in sales of nearly Indian rupees 62 million, which was offset by negative increments in sales for investment and

Figure 5: Sales increment and growth by sector



Source: Au loan files, loan officer review and authors' computation

shown in Figure 5. While retail and services enterprises grew sales at a rate of 8 percent and 9 percent, respectively, education enterprises grew by a rate of 3 percent, and manufacturing firms experienced a decline of 6 percent in sales, again indicating difficulties they encountered over the past couple of years. A small sample of agricultural enterprises saw sales increase by a CAGR of 10 percent.^[24] In absolute terms, the majority of the increase in sales came from retail and

refinancing loans, with declines of approximately Indian rupees 9 and 12 million, respectively. Thus working capital loans were associated with average sales increases of about Indian rupees 1.5 million.

New firms showed the strongest sales growth of the firms sampled, with a CAGR of 11 percent.^[24] These firms also had the largest share of the growth in sales, with Indian rupees 32.5 million of the total growth. This compares with 7 percent

CAGR^[24] for firms over 10 years in existence, which had an increment of Indian rupees 23 million in sales overall. On the other hand, firms of 5-10 years in age exhibited sales declines at an average CAGR of -5 percent.^[24]

Firms with one employee and firms with 2-10 employees showed an average CAGR of 9 percent^[24] in sales. Firms with 2-10 employees and firms with 1 employee had an absolute sales growth of about Indian rupees 58.5 million and Indian rupees 10.5 million respectively. However, firms with more than 10 employees saw a reduction in sales at a CAGR of 5 percent.^[24] As already mentioned, this again reflects the unique challenges to growth faced by enterprises of this size when it comes to jobs.

Income

MSME beneficiaries in the sample saw an increase in incomes during the study period at a CAGR of 5 percent,^[24] slightly below the rate at which sales increased. As observed for sales, there were significant differences between the performances of different sectors in terms of income growth. Retail, services and agriculture performed strongly, with CAGRs of 7 percent, 7 percent and 8 percent,^[24] respectively, while education beneficiaries saw a CAGR of 1 percent,^[24] and manufacturing firms saw a negative CAGR of -7 percent^[24] during this period. In absolute terms, retail firms in the sample saw an overall increase in their incomes amounting to Indian rupees 3.7 million, while service firms saw an increase of Indian rupees 1.9 million. At the same time, manufacturing firms saw a decline in income of Indian rupees 7.2 million, thus offsetting the gains for the sample as a whole.

Similar to sales, loans taken for different purposes resulted in varied growth rates in income. Working capital loans had the best results, with an income CAGR of 7 percent,^[24] while equipment purchase/upgrade loans had a CAGR of 5 percent,^[24] and investment saw a 3 percent CAGR^[24] in income. Again, refinancing loans had a negative CAGR of 6 percent,^[24] but with a very small sample size.

New firms (0-5 years in age) had the largest increases in income in the sample, with a CAGR of

9 percent.^[24] Firms over 10 years in age also saw strong increases in income, with an average CAGR of 6 percent.^[24] However, firms in between these two categories, with 5-10 years history, did not perform as well and saw real decreases in income of 8 percent year on year.

The effects of firm size on income were clear in the sample - the biggest increase was enjoyed by single-employee firms, at an average CAGR of 9 percent.^[24] This was followed by enterprises with 2-10 employees, which saw incomes rise by a CAGR of 5 percent.^[24] Firms in the larger category of above 10 employees saw incomes decrease at a CAGR of -3 percent.^[24]

Assets

With the loans taken from Au, and the additional income generated, beneficiaries were able to accumulated additional productive assets, such as commercial properties, vehicles and equipment/machinery. The growth in asset value for MSMEs sampled was an impressive 10% average CAGR^[24], or Indian rupees 113.5 million for the 87 beneficiaries for which data were available for both years. On average, beneficiaries expanded their assets by over Indian rupees 1.3 million.

Retail enterprises account for the largest absolute share of the growth in assets in the sample, with an increase of over Indian rupees 50 million. This is followed by education enterprises with an increase in assets of over Indian rupees 28 million, and service firms with nearly Indian rupees 27 million. Manufacturing and agriculture enterprises saw smaller increases. In percentage terms, education firms had the highest CAGR in assets, with 23 percent,^[24] however with a relatively small sample size. Retail followed with a CAGR of 12 percent^[24] and services with 9 percent CAGR^[24] in the real value of assets. Although manufacturing firms saw an absolute increase in as-sets, their average CAGR was slightly negative, at -3 percent.^[24]

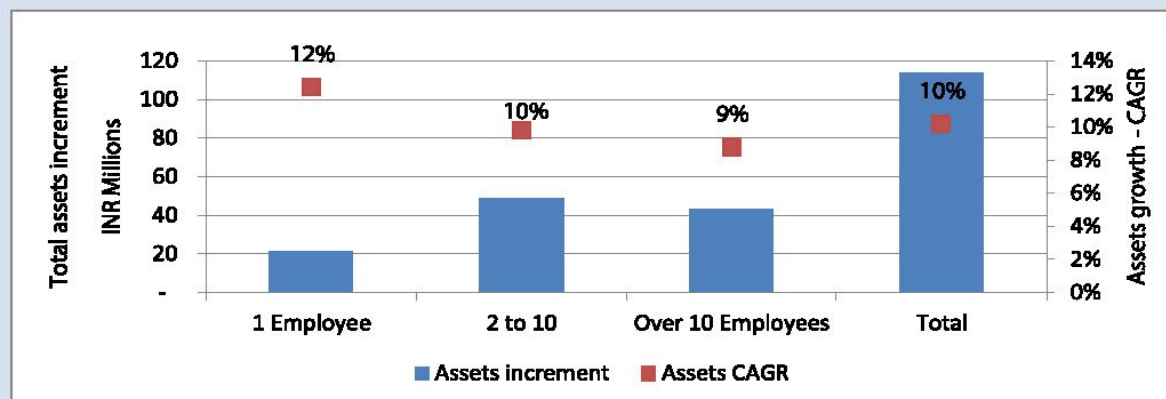
Enterprises that used loans for investment and for working capital experienced an average CAGR in their assets of 12 percent.^[24] In absolute terms, those that borrowed for investment had an overall increment of nearly Indian rupees 60 million during the study period, while enterprises using

the loan for working capital saw assets grow by over Indian rupees 40 million. Loans taken to upgrade/purchase equipment were surprisingly less beneficial to asset growth, with a 2 percent average CAGR^[24] and an Indian rupees 15.5 million overall increment. Finally, a slightly negative CAGR of -3 percent^[24] in the real value of assets was observed in the small sample of firms that used loans for refinancing.

year, while single-employee firms had the best average CAGR in the sample, at 12 percent.^[24]

We have also estimated the aggregate effect on assets for the 857 observations from which our sample was drawn. As mentioned earlier, this universe includes loans from Au's MSME portfolio generated in 2012 excluding all loans below \$8000 at origination. We have used a 95

Figure 6: Assets increment and growth by firm size



Source: Au loan files, loan officer review and authors' computation

MSMEs of all ages saw increases in assets during the study period, with older firms seeing slightly higher increases. Assets of firms over 10 years old increased by an average CAGR of 11 percent,^[24] while those between 5-10 years old increased by 10 percent, and single-employee enterprises' assets grew by 8 percent. The largest share of increase in assets came from mature enterprises, with real growth of nearly Indian rupees 49 million in assets. This was followed by single-employee firms, with an absolute increase of Indian rupees 45.5 million.

As shown in Figure 6, enterprises of all size categories within the sample benefited from increases in their assets during the period studied. Enterprises with 2-10 employees contributed the largest share of the increment in assets, with nearly Indian rupees 49 million. The average CAGR^[24] in assets for these enterprises was 10 percent during this period. Firms with over 10 employees showed increases of 9 percent in their assets year on

percent confidence interval to extrapolate the incremental asset growth effects for the whole relevant section of 857 observations. The results show growth in assets for these firms within a range of Indian rupees 469 million to Indian rupees 1769 million.

MSME sample- overall observations

Overall, retail and services enterprises in the sample performed the best consistently across different measures, as can be seen in the table (Table 1). While education and agriculture enterprises also performed well across most measures, both sectors had small sample sizes (less than 10) and therefore the analysis of these sectors in isolation is not as significant. Manufacturing enterprises showed the worst performance in the sample across measures. However, this performance was influenced by negative outliers, and an analysis of trimmed means for the sample showed improved results across all measures.

Table 1: Sectorial growth in all 4 dimensions

Sector	Employment CAGR	Sales CAGR	Assets CAGR	Income CAGR
Agriculture	19%	10%	2%	8%
Education	14%	3%	23%	1%
Manufacturing	-2%	-6%	-3%	-7%
Retail	11%	8%	12%	7%
Services	16%	9%	9%	7%
Total	11%	6%	10%	5%

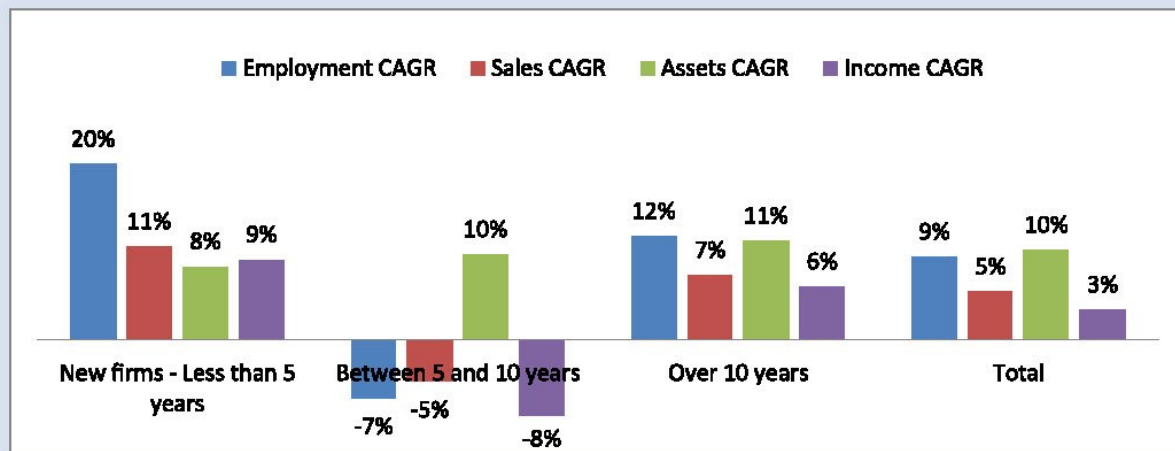
Source: Au loan files, loan officer review and authors' computation

Loans taken for working capital performed the best across the different measures observed, with growth in employment, sales, and assets at 13 percent, 12 percent and 12 percent respectively. Growth in income was also above the sample average, at 7 percent. This could suggest that MSME beneficiaries of Au are credit constrained and even small amounts of working capital (which is usually smaller in size than investment capital) can result in significant development results.

Firms with one employee showed the most consistent growth in the sample studied, with positive CAGRs between 9-12 percent^[24] for all measures. Other firms performed positively on most indicators, except for income for middle category firms, and sales for larger firms with ten or more employees.

As noted earlier, Au FINANCIERS is able to successfully reach unserved and underserved populations, such as first time borrowers and

Figure 7: Firm age growth in all 4 dimensions



Source: Au loan files, loan officer review and authors' computation

As illustrated in Figure 7, new firms performed best in the sample, outpacing others on three out of four measures (except asset growth). Firms between 5-10 years in age had negative performance on most variables, however these were influenced by outliers, and median values for all variables were higher and positive (except for employment, with 0 percent median growth). Older firms showed positive performance for all growth measures.

borrowers in LIS. First time borrowers performed well on all measured growth metrics, including employment, sales, income and assets. However their performance was on average lower than that of non-first time borrowers (except in the asset growth variable). For example, while employment growth was 9 percent for first time borrowers, existing borrowers saw a 13 percent CAGR in employment^[24].

Borrowers in LIS (representing about 69 percent of the sample) performed significantly better than those in non-LIS, suggesting that despite recent expansion, Au has had the most impact so far in LIS. For example, growth in employment was slightly negative in non-LIS, while it stood at a 16 percent CAGR^[25] in LIS. Assets saw real growth of 13 percent^[25] in LIS, while growing at a rate of 4 percent^[25] in other states.

Jobs and sales are positively impacted by access to financial services

Employing simple linear regressions for the MSME sample, we estimated the direction and magnitude of the association between access to financial services and changes in jobs and changes in sales. The dependent variable change in jobs or sales was modeled as follows:

$$\Delta Y_{FY12-14} = \alpha + \beta_i \Delta X_{iFY12-14} + e$$

Where :

Y is Jobs or Sales

X_i are the independent variables like Indian rupee Loan amount at origination

α is fixed effect or constant

A positive β implies that change in X_i will result in positive change in Y

Equation 1 shows the effects of change in assets, income over FY12-14 and loan taken in FY12 on change in jobs. Positive coefficients suggest that increase in loan, assets and income is likely to result in increase in jobs. Numerically, additional Indian rupees 690,000 loan taken in FY12 is expected to result in approximately one new jobs over FY12-14^[25]. Similarly, Indian rupees 1,000,000 of asset growth or income growth over FY12-14 is expected to result in approximately one and two new jobs respectively. Analysis of the p value shows that these results are statistically significant at 90 percent level of significance^[26]

for loan and 99 percent level of significance^[27] for asset and income.

Equation 1:

$$\Delta \text{Jobs}_{FY12-14} = (1.5 \text{ Loan}_{FY12} + 0.6 \Delta \text{Asset}_{FY12-14} + 2.1 \Delta \text{Income}_{FY12-14}) * 10^{(-6)} + e$$

P value [0.0845] [0.0008] [0.003]

Similarly, equation 2 below shows that change in sales is positively associated with loan in FY12, change in asset and change in income over FY12-14. However, based on the analysis of p values, we conclude that the magnitude of effect is statistically significant only for change in asset and income, i.e. Indian rupees 1 million change in asset or income over FY12-14 is expected to result in increase in sales by Indian rupees 0.29 million and Indian rupees 2.13 million respectively.

Equation 2:

$$\Delta \text{Sales}_{FY12-14} = 0.25 \text{Loan}_{iFY12} + 0.29 \Delta \text{Asset}_{FY12-14} + 2.13 \Delta \text{Income}_{FY12-14} + e$$

P value [0.6648] [0.0227] [0.0000]

The next section analyzes the development effect of Au's CV business based on a review of a small sample of CV loans.

Au Transport Finance Sample Description

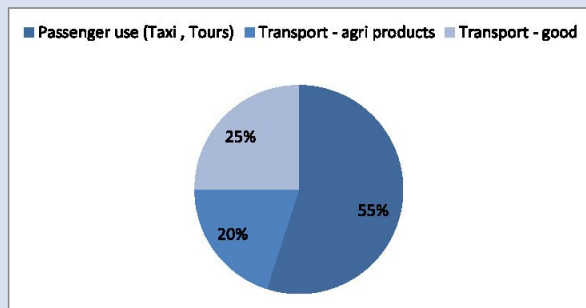
The IFC team reviewed a sample of loan files from Au's transport finance portfolio, which comprises loans to MSMEs to purchase CVs. The files reviewed were of 20 clients with multiple CV loans and at least one CV loan in FY12. This analysis was intended to provide an understanding of the profiles of CV borrowers with multiple loans, and to assess the effects multiple loans have had on their income, assets, etc.

Of the 20 clients reviewed, five clients had no previous loans from any formal FI (credit history review of these clients (CIBIL) showed that this was their first ever loan). Of these five clients, two

had no income from this line of business.

As shown in Figure 8, 55 percent (11 of 20) of the CV loans sampled were for passenger use—taxis used for intra-city travel or cabs used for inter-city tours. 25 percent were used for transport of goods, and 20 percent for transport of agriculture products.

Figure 8: Purpose of CV loans taken in 2012



Source: Au FINANCIERS loan file review

Additionally, the sample comprised four types of CVs—eight heavy commercial vehicles (HCV), two light commercial vehicles (LCV), six multi-utility commercial vehicles (MUV) and four small commercial vehicles (SCV). As shown in Table 2, new LCVs and HCVs were able to secure higher loans to value (LTV) ratio while MUVs and used HCVs secured the lowest LTV.

Over FY12-15, the 20 clients sampled took CV loans worth Indian rupees 59 million, with Indian rupees 30 million outstanding at the time of the review (December FY15).

Table 2: Average LTV for new and used vehicles finance by type of vehicle finance in 2012

	New	Used	Total
HCV	84.45[6]	75.51[2]	82.22[8]
LCV	84.73[2]		84.73[2]
MUV	72.65[4]	77.04[2]	74.11[6]
SCV	80.81[2]	80.29[2]	80.55[4]
Grand Total	80.6[14]	77.61[6]	79.7[20]

Source: Au FINANCIERS MIS data and loan file review.

Note: figure in parenthesis is no. of observations.

Changes in key variables from FY12 until latest loan taken

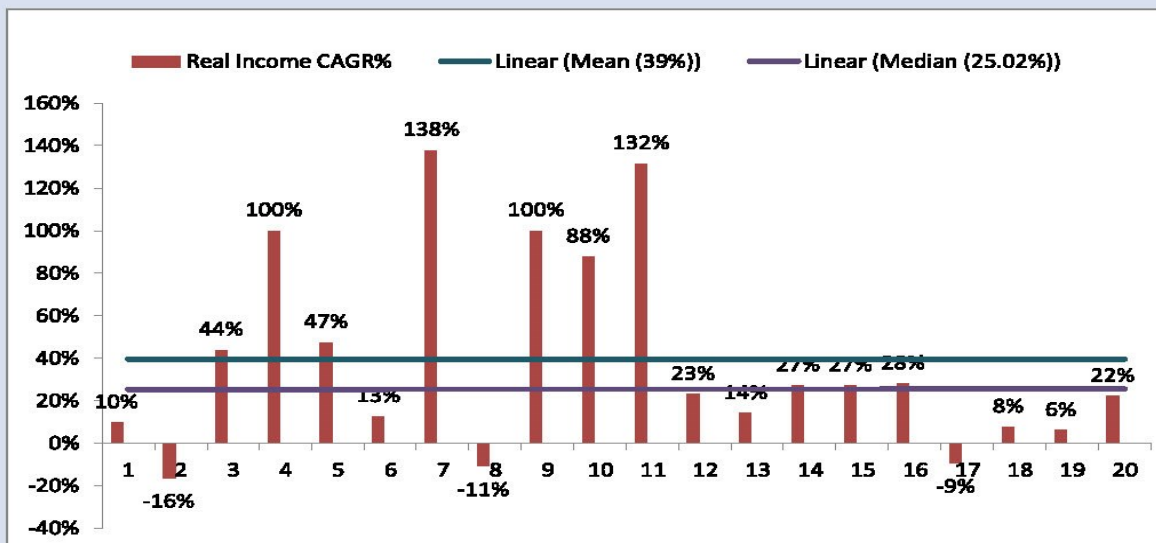
House ownership

25 percent of the clients sampled shifted into home ownership during the period studied. In FY12, five CV clients lived in rented houses, four in parental houses while 11 owned their houses. However, over time many borrowers purchased homes and moved into them. As of FY15, two borrowers live in parental houses, two live in rented houses while 16 live in their own houses. This shift towards home ownership could be a result of increased incomes for borrowers, which resulted in purchase of homes, that is asset building.

Income

On average, 20 customers with multiple CV loans grew their annual real income by 39 percent^[28] CAGR between the loan taken from

Figure 9: Real income CAGR (%)



Source: Au FINANCIERS loan file review

Au in FY12 and the most recent loan taken by them (figure 9 previous page). This corresponds to a total increase in annual income from Indian rupees 11 million to Indian rupees 16.5 million. This growth in annual income was used to build assets (that is purchase houses or new vehicles) or expanding businesses.

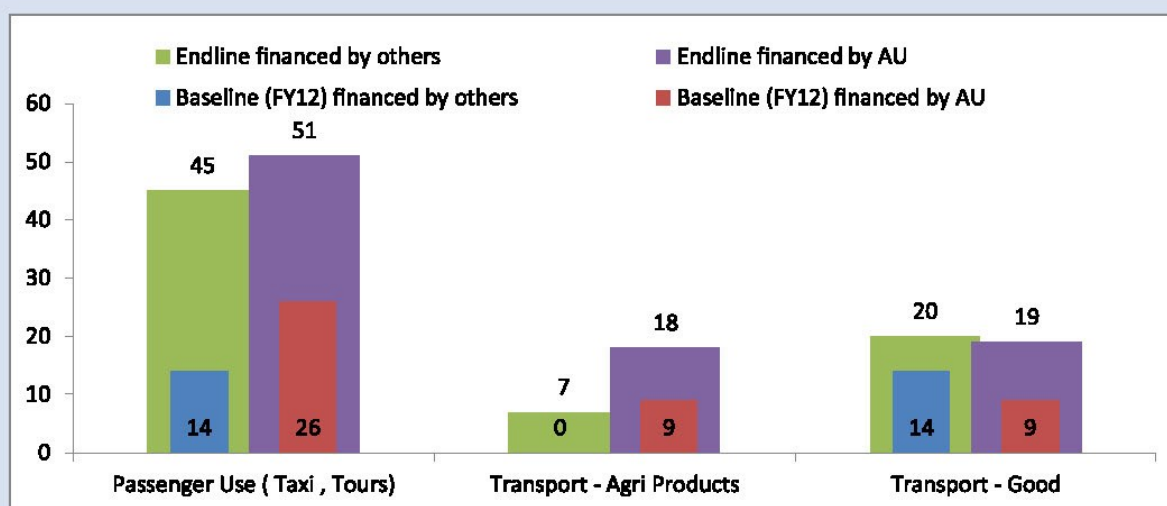
Growth in car fleet

The sampled clients grew their vehicle fleet by 141 percent CAGR between the loan taken from Au in FY12 and the most recent loan taken by them. In FY12, the 20 clients had 73 outstanding CV loans of which 44 (60 percent) were taken from Au in FY12. Over FY12-15, these 20 customers purchased 88 vehicles, of which 44

(50 percent) were financed by Au FINANCIERS.

As Figure 10 shows, passenger vehicles (taxi or tour cars) were the most popular among the sampled clients. Eleven customers had 40 CVs in FY12, with 26 being financed from Au. By FY15, these 11 customers had 96 CVs, with 51 being financed from Au Financiers.

Figure 10: No of commercial vehicles (FY12-15)



Source: Authors computation based on loan file review and Au FINANCIERS MIS date

Note: Baseline refers to FY12, while end line refers to year of most recent loan from Au (it could be FY13-15). The analysis uses no. of outstanding CV loans from all lenders (from CIBIL report) as proxy of Total number of CV vehicles.

Jobs

By financing the sampled CV portfolio, Au FINANCIERS indirectly supported at least 125 jobs while 63 new jobs were created over the period FY12-15. Based on our field interviews and discussions with clients, every passenger vehicle employs at least one person (that is, the driver) while every transport vehicle employs at least two persons (that is, the driver and helper). Also, HCV trucks may employ multiple helpers for loading and unloading goods, that is, may have more than two employees. From Table 3, we conclude that these 20 clients secured finances in FY12 for 160 CVs, with 88

being financed from Au. Thus the 20 clients in the sample supported an estimated 224 jobs, of which Au financing indirectly supported 125 jobs. Over FY12-15, the clients took 88 new CV loans, of which 44 were from Au. This corresponds to at least 120 new jobs being created, with 63 being created as a result of the loans from Au. This represents a CAGR of 138 percent in new job creation for CV drivers or helpers. This is significantly higher than the national CAGR of employment in the transport sector (79 percent). In addition, they grew their real income by 39 percent over FY12-14.

Table 3: Jobs supported and created by the finance of commercial vehicles

	Total CVs financed	Additional CVs	No. of jobs supported	No. of jobs created
Passenger use (taxi, tours)	96 [51]	56 [25]	96 [51]	56 [25]
Transport - agri .products	25 [18]	16 [9]	50 [36]	32 [18]
Transport - good	39 [19]	16 [10]	78 [38]	32 [20]
Grand total	160 [88]	88 [44]	224 [125]	120 [63]

Source: Authors computation based on loan file review and field interview, figures in parenthesis are Au's contribution

Multiple commercial vehicle loans

Mr. Lal is a long-time Au client. He got his first vehicle loan from Au in 1997. Previously, Mr. Lal made a living by washing cars, earning around Indian rupees 1000 a month. Now, he has a fleet of 14 cars used to transport children to schools, by which he earns Indian rupees 50,000 a month. All the borrower's cars were purchased with loans from Au, which is his only source of financing. He originally approached Au for funding since he knew the relationship officer. He has since maintained a perfect track record of repayment with Au, which has enabled him to expand his assets successfully.



The business developed by Mr. Lal has had many positive implications for his life and others lives. He now employs 14 drivers as well as his brother in his business. Beyond the tremendous increase in his income, he has been able to renovate his house (which he received as inheritance), purchase two plots of land, and spends most of his income on educating his three teenage kids (a girl and two boys), as well as his brother's two children.

Conclusion

The private sector, which provides about 90 percent of jobs in developing countries, is a key player in meeting the global development challenge of job creation. It is crucial, therefore, to understand the constraints that prevent the private sector from growing and generating jobs. Jobs in MSMEs account for more than half of all formal employment worldwide. In India, these enterprises are also a significant contributor to GDP. Governments and development finance institutions must help build an environment where these obstacles to the success of MSMEs are minimized or removed.

This study assesses the contribution that an IFC partner FI, Au FINANCIERS made towards financial inclusion, job creation and financial performance of its MSME beneficiaries in India from FY12 – FY14. In particular, the study tries to understand which MSMEs obtain financing, what this financing is being used for, how many jobs are being created or supported, and how have their assets, income, and sales changed over time.

The study concludes that despite challenging macro-economic downturns in 2011-12, clients with MSME and CV loans show positive effects on jobs being supported, sales, assets and income. Data collected for about 100 MSMEs revealed that the overall number of new jobs created in the sample grew at a CAGR of 11 percent between FY12 and FY14, higher than the national average CAGR of 10 percent. Employment growth was complemented by high sales and assets growth. Overall sales grew at a CAGR of 6 percent^[28], and overall assets grew at a CAGR of 10 percent^[28]. In addition, the review of loan files for 20 random clients with multiple CV loans, revealed that they have used these to purchase at least 88 new vehicles, of which 50 percent were financed by Au FINANCIERS. This resulted in 138 percent CAGR in new jobs being created for drivers or helpers for CVs. This is significantly higher than the national average compound growth rate of employment in the transport sector (79 percent). In addition, the CV clients

grew their real income by 39 percent^[28] over FY12-14.

Interviews with Au beneficiaries confirmed the impact that working with Au FINANCIERS has had on their lives. Beneficiaries have seen substantial increases in income and assets. They increased employment in their growing businesses, as well as invested disposable income into the education of their children. In addition, many borrowers who were previously financially excluded opened bank accounts, and now obtain financing from other FIs due to the documentation and credit history they developed by borrowing from Au FINANCIERS but there are some caveats to this. The results validate the thinking that MSMEs are vital to support economic growth and create new jobs in developing economies like India. This should encourage other FIs to continue supporting MSMEs through financing and other services.

The findings of this study reinforce the following:

- *Financial intermediaries like Au FINANCIERS, which provide access to finance for MSMEs in underserved markets, are expected to have significant financial inclusion and job creation effects and positively affect financial performances of MSMEs.*
- *To promote financial inclusion, growth and job creation, IFC and financial intermediaries like Au FINANCIERS should continue their support of MSMEs, in particular in the retail and service sectors, which were observed to have consistently the highest developmental effects.*
- *IFC and financial intermediaries should continue to support small firms and help them become bigger, as small firms have the potential to realize the greatest impact on employment and, as a result, on economic growth;*
- *IFC and financial intermediaries should continue to support unserved MSME and individuals who do not have access to formal financial services, as these firms greatly benefit from lower cost formal access to financial services and contribute to financial inclusion, job creation. This financial inclusion of the unbanked is likely to have linkage effects to their suppliers and associates who may also be unbanked.*
- *More research is needed to better understand the effects of access to financial services on financial institutions, job creation, and firm financial performance via different types of financial intermediaries (banks, small banks, NBFCs),*

different financial products (CV, MSME loans, insurance etc.) and the use of different evaluative techniques such as randomized control trials (RCT).

Endnotes

1. The fiscal year in India runs from April to March.
2. The MSME analysis is based on review of MSME loans between Indian rupees 500,000 to Indian rupees 2.5 million.
3. After adjusting for inflation.
4. This result differs marginally from the extrapolation result (Indian rupees 460,000 loan is expected to result in one additional job) as the regression coefficient is a more conservative estimate and is significant at 90 percent level of significance.
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12. S. Kothari. 2013. Analysis of MSME Small Loan Credit Market for NBFCs in India.
13. The addressable demand comprises of demand from (a) sick enterprises, (b) new enterprises (those with less than a year in operation), (c) enterprises rejected by financial institutions and (d) micro enterprises that prefer finance from information sources.
14. ADB (2013) SME Monitor in Asia.
15. CRISIL Research (2013), Retail Finance- Auto.
16. http://www.ey.com/IN/en/Newsroom/News-releases/Press-Release_Indian-Commercial-Vehicle-sales-to-hit
17. SME in India are defined by asset size of total investment in machinery and equipment. The usual perception is that enterprises who take loans of Indian rupees 5,00,000 (US\$ 8,000) would have total investment of at least Indian rupees 1 million which is the local SME definition. As the sample includes enterprises that took loans greater than Indian rupees 500,000, we can conclude that the sample does not include any micro-enterprises. Hence the sample and associated extrapolation would be applicable to SMEs.
18. Au refers to loans greater than Indian rupees 2.5 million as SME loans. However these are usually considered as corporate loans in the local context.
19. 857 MSME clients that received a loan of Indian rupees 500,000 but below Indian rupees 2.5 million as SME loans in FY12.
20. For the purposes of this case study, the term “job creation” means only the direct jobs created by the specific MSMEs in the sample.
21. Conversion factor for 2014 figures were FY14 Real value = Nominal Value/122*100. CPI for 2014 with 2012 as base year is 122.
22. NSSO 66th round report Avg. Employment CAGR for 2004-5 to 2009-10 is 10%.
23. Adjusted for inflation
24. Adjusted for inflation
25. This result differs marginally from the extrapolation result (Indian rupees 460k loan is expected to result in 1 additional job) as the regression coefficient is a more conservative estimate and is significant at 90 percent level of significance.
26. P value < 0.1
27. P value < 0.01.
28. Adjusted for inflation