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The Social Performance Report 2012

Girija Srinivasan

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Microfinance India

The Social Performance Report 2012

Girija Srinivasan

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Abbreviations

ABHA	Axis Bank Bandhan Holistic Assistance
ADSC	Ati Daridro Sahayak Committee
AKMI	Association of Karnataka Microfinance Institutions
AP	Andhra Pradesh
APR	Annual Percentage Rate
BC	Business Correspondent
BMBCS	Bagnan Mahila Bikash Cooperative Credit Society
BOD	Board of Director
BPL	Below Poverty Line
BRI	Bank Rakyat Indonesia
BSFL	Bhartiya Samruddhi Finance Limited
BT	Bacillus Thuringiensis
CASHPOR	Credit and Saving for the Hard Core Poor
CBS	Core Banking Solutions
CDF	Cooperative Development Foundation
CFI	Centre for Financial Inclusion
CHI	CASHPOR Housing Index
CHL	Community Health Leaders
CoC	Code of Conduct
CPA	Client Protection Assessment
CPP	Client Protection Principle
CSR	Corporate Social Responsibility
DAN	Deepthi Arogya Nidhi
DFI	Development Financial Institution
DWCRA	Development of Women and Children in Rural Areas
EC	Enforcement Committee
EMFIL	ESAF Microfinance India Limited
ESG	Environmental Social and Governance
FBE	Family Business Enterprise
FMS	Fish Marketing Society
FWWB	Friends of Women's World Banking
GMSS	Grameen Mahila Swayamsiddha Sangha
GRAM	Grama Abhyudaya Mandali
GVC	Governance and Value Creation
HFF	Healing Fields Foundation
HiH	Hand-in-hand
ICAI	Institute of Chartered Accountants of India
IDF	Initiatives for Development Foundation
IFC	International Finance Cooperation
IFMR	Institute of Financial Management and Research
IGA	Income Generating Activity
IGL	Income Generating Loan
IIMPS	Invest India Micro Pension Services
IMFP	India Microfinance Platform
IRDA	Insurance Regulatory and Development Authority
IRDP	Integrated Rural Development Program
JCPL	Janadhar Constructions Private Limited
JFS	Janalakshmi Financial Services
JLG	Joint Liability Groups
JPAL	Jameel Poverty Action Lab
JSS	Janalakshmi Social Services

KYC	Know Your Client
LWE	Left Wing Extremism
MACS	Mutually Aided Cooperative Society
MBT	Mutual Benefit Trust
MD	Managing Director
MFI	Microfinance Institution
MFIN	Microfinance Institutions Network
MHLS	Micro Home Loan Solution
MIR	Microfinance Institutional Rating
MIS	Management Information System
MIV	Microfinance Investment Vehicle
MIX	Microfinance Information Exchange
MMFL	Madura Microfinance Limited
MSDF	Michael and Susan Dell Foundation
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non-banking Financial Company
NCAER	National Council for Applied Economic Research
NED	Non-executive Directors
NGO	Non-governmental Organization
NMI	Norwegian Microfinance Initiative
NPS	New Pension Scheme
NRLM	National Rural Livelihood Mission
PA	Professional Assistance
PE	Private Equity
PFDRA	Pension Fund Regulatory and Development Authority
PFSPL	Pudhuaaru Financial Services Private Limited
PIIF	Principles for Investors in Inclusive Finance
POS	Point of Sale
PPI	Progress out of Poverty Index
PRA	Participatory Rural Appraisal
RADER	Responsibility Development Effectiveness Rating
RBI	Reserve Bank of India
RCT	Randomized Control Trilas
ROE	Return on Equity
SBPL	SHG Bank Linkage Programme
SEWA	Self-employed Women's Association
SHG	Self-help Group
SIDBI	Small Industries Development Bank of India
SIFF	South Indian Federation of Fishermen's Society
SKDRDP	Shree Kshetra Dharmasthala Rural Development Project
SPIRIT	Social Performance, Impact Reporting and Intelligence Tool
SPM	Social Performance Management
SPTF	Social Performance Task Force
SROI	Social Return on Investment Analysis
THP	Targeting Hard-core Poor
UCoC	Unified Code of Conduct
USSPM	Universal Standards of Social Performance Management
VimoSEWA	National Insurance VimoSEWA Cooperative Limited
WATSAN	Water and Sanitation Programme
WM	Wealth Manager

Foreword

This June, I participated in the annual Social Performance Task Force (SPTF) meet in Jordan and was quite impressed to witness a gathering of about 500+ people participating in the meeting from across the globe. Three years back in Berne this number was less than 300, and prior to that only a bunch of stakeholders participated in a workshop mode. The big outcome of the Jordan SPTF meet was the announcement of the Universal Standards for Social Performance Management. Meeting the standards signifies that an institution has strong social management practices. The Steering Committee of the SMART Campaign also met at Jordan, which has its own seven principles on client protection. The big emphasis in the meeting was the need for certification of microfinance institutions (MFIs) as a way of ensuring institutional commitment towards adherence to Client Protection Principles. In a similar vein, Microcredit Summit is pursuing its own idea of instituting a Seal of Excellence. Across the globe, the sector has, in the last few years, come under severe scrutiny. Besides questions on whether microfinance actually lifts the clients out of poverty or not, MFIs have been accused of unethical practices, client abuse, lack of transparency, reckless growth and profiteering. As a response to these accusations, a few stakeholders have tried to bring to the fore the idea of a double bottom line approach to serve the clients where financial and social performance need to be brought together as operating principles. At last, there is a sense within the sector that unless these principles are deeply embedded within practice, the repute of the sector, built over the last two decades, would be seriously eroded. Unless the social performance management (SPM) principles are universally accepted by all—donors, investors, debt providers and the MFIs themselves—it will be difficult to restore the lost credibility.

In India, the sector was rudely shaken out of a complacent arrogance with the Andhra Pradesh government's tough ordinance severely clamping MFI operations. Although it has been two years since the Andhra crisis, the sector has seen limited signs of recovery. In this period, efforts have been made by several in the sector to help restore its lost respect. There are new pressures from the regulator on transparency, disclosure, pricing and ethics, and MFIs are aware that new investments, either debt or equity, will not begin to flow unless there is tangible evidence on good practices among institutions. The MFIs were seen dropping interest rates soon after the crisis hit the sector; a harmonized code of conduct was announced by the two industry associations and SIDBI, Sa-Dhan and Microfinance Institutions Network (MFIN) have all commissioned code of conduct assessments. A sectoral effort has propped up the Responsible Finance Forum under the aegis of International Finance Cooperation (IFC). These are all credible efforts; however, the markets have still not responded positively and the picture still looks gloomy.

Last year, ACCESS launched Microfinance India: Social Performance Report on the basis of a hunch that in the prevailing 'post AP Ordinance' context, bringing together social performance data as well the good practices, corrective measures and developmental initiatives of MFIs and other players in the form of a single document will contribute to the sector's knowledge and bolster the public image of the sector. The State of Sector (SOS) Report traditionally carried a chapter on issues related to mission of microfinance and SPM. The idea was to develop this further into a separate comprehensive annual report. Since this was a new initiative, ACCESS engaged sector experts and stakeholders through consultations both before the first report was conceptualized and after it was released and reviewed. While the pre-consultations were more to vet the rationale of bringing together such a document and develop its initial structure and design, the

post-consultations served to seek feedback on the first report and decide on future course of action. The stakeholders were unanimous in the feedback that there was merit in continuing with this report on an annual basis since it did provide in-depth insights both into the evidence-based practices on the ground and SPM efforts at sector level.

Going forward, the real challenges, however, were to develop a distinctive structure, identify themes and practices and generate content for the next report such that it adds value to the knowledge and information in this area while avoiding repetition and rhetoric. Fortunately, Girija Srinivasan, who had led the report editing team last year, agreed to take on the authorship this year. With the keen eye for detail and analysis that Girija has, in addition to the long-standing domain experience of banking and supporting and advising institutions in India and outside, we were reassured of a higher level of quality and comprehensiveness in the 2012 report. The new technical partnership with M-CRIL, given the legacy and pioneering contributions of EDA and M-CRIL in establishing and furthering the SPM agenda in the country as well as globally, further bolstered our confidence immensely.

The Social Performance Report 2011 being the first effort, provided an introduction to evolution of the SPM concepts, a comprehensive trend analysis of SP data collected by the Microfinance Information Exchange (MIX) and presented the perceptions and efforts of funders towards SPM. These sector-level updates were followed by chapters on selected SP themes that described MFI practices on the ground identified and collected through field visits, including targeting and monitoring, product design, HR management and client protection. The themes for the current report were identified considering that while a couple of critical themes such as responsible product offering, client protection and code of conduct are carried forward to provide an update and share more best practices, some other themes that could not be covered adequately last year could be presented and analyzed in greater detail. The intricacies of institutional governance and the impact of this aspect on the MFIs' performance and mission congruence is an incredibly significant aspect that needs serious attention, and an attempt has been made to discuss these in the report. Community-based organizations have an inherent member centricity and a separate chapter has been devoted to bring together examples and learning from well-performing CBOs. Finally, moving beyond systems and practices, a chapter brings together insights from the available research on outcomes and impact, which are supported by findings from a separate sample survey conducted for the purpose of this report. We hope that this provides comprehensive reading and reference for various sectoral players. I am glad that through significant support from all relevant players in the sector, the second India SPM Report has been brought together—more insightful, more analytical and one which brings in deeper evidence of the principles and practices that the institutions embed in their operations.

I take this opportunity to thank all the stakeholders who have continued to support this initiative and some others who have joined hands this year. I would like to thank Prashant Thakker, Standard Chartered Bank, who not only was a gracious host in Mumbai for SPM consultations but also continued to commit support to the ACCESS SPM Report effort. Bob Annibale and Maneesha Chadha from Citi, like last year, were quick to agree continued support. I am grateful to Jennifer from IFC to assure long-term support to this effort. I am thankful to SIDBI, which has begun to increasingly take a leadership role in pushing the responsible finance agenda, to support this effort, and particularly Mr Saha who has been very encouraging. I also thank Mr Sundara Rao from Maanaveeya, good friend Laura Foose from SPTF, K.C. Ranjani from Dia Vikas Capital and Vishal and Venky from Lok Capital to rally behind the effort. I appreciate their faith in ACCESS and ASSIST's abilities to deliver on this critical sectoral series and hope that we have been able to meet their expectations through this output. At ACCESS and ASSIST, it is our continuous endeavour to help deepen our knowledge with honest critique and introspection.

I would like to thank all the institutions and individuals that were visited and interviewed by Girija and team for enriching the content of the report through their inputs and data. I deeply appreciate the efforts of Dr Alok Misra, CEO, M-CRIL, and Berenice from his team for contributing the two chapters on products and code of conduct. The MIX and SMART Campaign have continued to provide significant inputs to the content of the report, and Grameen Foundation and MicroSave joined the effort as technical partners, providing important data and insights from their respective rich body of experience of working closely with MFIs. Centre for Microfinance (CMF) were the research partner for the sample study conducted for capturing client voices from the field and I appreciate efforts of Santadarshan and the team for completing this in the short time frame. Both the industry networks, MFIN and Sa-dhan, were forthcoming with their support and inputs. I sincerely thank Michael Krell from MIX, Graham, Manoj and Yamini at MicroSave,

Achla Savyasaachi, Sa-Dhan, and Priya at MFIN for their inputs. I also take this opportunity to thank N. Srinivasan, Viji Das, Samit Ghosh and Suresh Krishna for their guidance, candid feedback and support.

From within ACCESS and ACCESS-ASSIST, I would like to thank Deepak, Sudipto and Albert for the excellent support and coordination to the author and to the process, particularly in helping with data collection from MFIs and Lalitha for providing efficient logistic support. Since from this year onwards, the task of bringing together the SPM Report is largely managed by my small ASSIST team, it fills me with pride that they anchored the process smoothly. Finally, I would like to thank Vipin, CEO, ACCESS, for being the inspiration behind the effort. He was always present whenever we required guidance and support—for ideas and consultations, resource raising, troubleshooting; without him, the small young teams feel ill-equipped to take on complex sectoral initiatives.

SAGE has been a publishing partner for ACCESS for all our flagship knowledge products. While the first SPM Report was brought out by ACCESS internally, this year SAGE has published this along with the SOS Report. We also have a media partnership with MINT, and with these two associates, we hope to reach out with this document to a much wider stakeholder base, which is important for this initiative. The dissemination of the report findings, I am sure, will be much stronger this year. I hope that similar to the SOS Report, the Social Performance Report will also be referred widely and is able to contribute both to knowledge and sharing within the sector and effective communication and image building of the sector among external stakeholders.

Radhika Agashe
Executive Director, ACCESS-ASSIST

Preface

I have been shifted from the editor's job I had last year to that of author of the report this year. In times that are hard to write about the microfinance sector, I found the making of this report surprisingly easy on account of the support received from the sector. The eagerness to own this report within the sector resulted in a deluge of information. I have a lot of people to thank for who willingly gave their time, spared resources and, more importantly, information for the report.

There are several organizations that I visited along with Radhika Agashe and Sudipto Saha of ACCESS-ASSIST. P.N. Vasudevan, Equitas, C.S. Ghosh, Bandhan, Kalpana Sankar and Jeyaseelan, Hand-in-hand, Samit Ghosh, Ujjivan, Suresh Krishna, Grameen Koota, Radhakrishnan, Janalakshmi, Paul Thomas, EMFIL, Mukul Jaiswal, CASHPOR, Vivekanand Salimath, IDF, Praseeda Khunam, Samhita, Govind Singh, Utkarsh, Deepak Kindo, Sambhandh, Kalpana Pant, Chaitanya, N. Samson, GRAM and Uma Maheshwar Rao, IIMF, Lakshman, CDF, Gopal Ghosh, Bagnan Cooperative, spent their valuable time and shared their experiences and initiatives which makes this report informative.

Brij Mohan, Y.C. Nanda, N. Srinivasan, Niraj Verma, World Bank, Vijayalakshmi Das, Ananya Finance, Manoj Sharma, MicroSave, gave insights and perspectives on not only where the sector is at present but also on where it should be. Frances Sinha, EDA Rural Systems, shared her thoughts on global initiatives and the pioneering work of EDA in mainstreaming social performance management in MFIs. Achla Savyasaachi, Sa-Dhan and Alok Prasad, MFIN, explained the path-breaking work of the industry associations in code of conduct compliance. Girish Bhaskaran Nair and his team in IFC shared the sectoral initiatives undertaken by IFC. K.C. Ranjani and her team in Dia Vikas, Sundara Rao and his team in Manaveeya, Venky Natarajan, Lok Advisory Services, Rahil Rangwala, MSDF, Royston Braganza, Grameen Capital, Abhijit Ray, Unitus Capital, brought in the investors' perspectives on the investment climate and how investors drive social performance.

Alok Misra, M-CRIL, Jayesh Jain, Grameen Foundation, Veena Yamini Annadanam, MicroSave updated me on their initiatives in rating, PPI implementation and technical assistance for social performance, respectively.

P.K. Saha and his team in SIDBI, Jayesh Modi and his team in HSBC, Prashant Thakker, Standard Chartered Bank, provided information on lenders' initiatives to improve responsible financing. This report also benefitted from the bankers' perspective shared in the special conference arranged by DFID and IIBF and also in Sa-Dhan conference. Micol Pistelli and Michael Krell, MIX, Alok Misra, Bernice Da Gama Rose, MCRIL, Radhika Agashe and Sudipto Saha, ACCESS-ASSIST, Hema Bansal, SMART Campaign, Santadarshan Sadhu of CMF provided drafts that facilitated writing of some chapters for which I am thankful. Phani Priya as a research assistant did a thorough literature survey of impact studies and helped in analyzing the responses received from MFIs. Special thanks to Santhanam for the quality check on the findings of the literature survey. N. Srinivasan reviewed the report and provided critical inputs for which I am very grateful.

I thank the donors—Standard Chartered Bank, Citi, SIDBI, IFC, Dia Vikas Capital, Maanaveeya Holdings, Lok capital, SPTF—for offering total support and the freedom to decide the content and style of this report.

I am thankful to Vipin Sharma for roping me in to look at the social side of microfinance, which has been an enriching experience. Radhika Agashe anchored this initiative in ACCESS-ASSIST and accompanied

me in the field. She coordinated the information flow from different sources and ensured that I had least problems in writing this report. Deepak and Albert from ASSIST team helped with collection and analysis of the outreach data of MFIs. With support from Lalitha, Juhi and Sairam in ACCESS, I had no logistical problems of any kind. Pravin Shende keyed in the initial draft from voice files. While I have tried to acknowledge all those who helped, I apologize to those that might have been left out inadvertently.

This year's initiative started with two rounds of discussions with different stakeholders in the industry and their suggestions were taken to design the themes of the report. The microfinance India advisory group also offered guidance regarding the expectations from the sector.

Only two chapters on products and services and lenders and investors continue from last year. This year's report consists of new themes such as governance, non-financial services, code of conduct, outcomes and impacts as seen by MFIs, community-owned institutions and client voices from the field. My learning is that the sector is very actively engaged in customer protection and responsible finance. Many have been serving customers beyond finance but critically fall short in documenting their work. I hope that I have managed to capture the essence of developments in the sector and bring much-needed balance to the debate on social relevance of MFIs.

The opinions in the report are mine as also errors of omission and commission. I would be very happy to have reader responses and views, which would be very useful for the next report.

Girija Srinivasan
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Overview—finally customers at the core

1
Chapter

In the last two years the customer has come to the centre stage in microfinance. The need for customer protection, responsible finance and social performance came sharply to the fore in the aftermath of Andhra Pradesh (AP) crisis. It is not necessarily because all the microfinance institutions (MFIs) were irresponsible or were not conscious of their responsibility to customers and society obligations; but like in any other industry, in microfinance industry too there were a few erring institutions that were not mindful of the hardship caused to their clients through their methods. But a large number of MFIs were quite thoughtful of their actions and were sensitive enough to ensure that customers do not get adversely affected.

The year was uneventful compared to the previous fiscal, which saw catastrophic developments. The defining development in the year came in the form of regulations that required banks and MFIs to ensure that a set of customer protection and responsible finance practices are adopted. The tabling of the draft microfinance bill in the Parliament possibly broke the tendency towards despair in the sector. The year also saw several organizations in the public sphere making it their mission to educate, train and push MFIs into compliance with client protection and responsible finance practices. The increased attention to customer and social performance did not seem to persuade banks to extend loans to MFIs, especially the small and medium ones. There seemed to be no means of recovering incremental costs of compliance with regulation mandated actions and other stakeholder demands for responsible finance. Despite the considerable effort, retraining and costs, the MFIs have set about improving field practice, hoping that the other stakeholders would take notice and improve funds flow for the vulnerable customers who are affected by the stagnating business levels.

On account of what happened in AP, the sector became very concerned with the reasons stated by the government for taking such precipitate action. Lenders, investors, MFIs themselves and other stakeholders have come around to the idea that the sector should not only practice responsibility in its business, but should also prove doing so. A significant development has been that the sector today focuses on taking visible efforts to show that it is responsible and socially sensitive—that it really means to do well by its customers. This change in the perception and the consequent approach to dealings with customers by different stakeholders in the sector is significant and visible.

Regulators have to ensure that the sector develops and grows in an orderly manner. Earlier they probably were culpable of not taking their role seriously. Once the state government of AP entered the regulator's space by seeking to control institutions in the financial sector, the Reserve Bank of India (RBI) responded with strong content of customer protection in regulation which augers well for the sector. Though it is widely perceived that RBI guidelines relate to non-banking financial company (NBFC) MFIs, these apply to all the MFIs because RBI has used the priority sector eligibility norms for the banks as a base for implementing the guidelines; the banks need to ensure that all borrowing entities regardless of their legal form confirm that customer protection related issues are adhered to. This provides comfort to all stakeholders who deal with MFIs that RBI's regulations and monitoring will ensure compliance. Importantly, RBI regulations establish the minima required on the part of MFIs in customer protection and responsible finance, the

absence of which led to widely varying expectations becoming shifting benchmarks.

The Government of India has been seen to be proactive in its response to the requirements of the sector. In order to ensure that different state governments do not indulge in competitive occupation of the regulatory space that belongs to the Centre, the government has tabled the revised Micro Finance Institutions (Development and Regulation) Bill, 2012, in the Parliament that has been referred to the Standing Committee on Finance of Parliament. The chairman of the Standing Committee on Finance has been positive about the form and content of the bill.[1] Passing of the bill will hopefully address many of the problems relating to responsible finance in the sector and will boost the confidence of investors and lenders further.

Another significant development has been the unification of code of conduct of both the industry associations, Sa-dhan and Microfinance Institutions Networks (MFIN). This code combines the most important elements from the earlier versions of codes developed by Sa-Dhan and MFIN as well as inputs from the Client Protection Principles (CPPs) of the SMART Campaign, RBI's Fair Practices Code for NBFCs and clauses from the RBI guidelines for MFIs, 2011. In the unified code staff recruitment practices and good governance are emphasized. The MFIs have signed up the code of conduct that had been designed by the two industry associations and based on this code of conduct, the staff have been trained. The borrowers have been made aware of contents of the code of conduct relating to the interface between the field officers and the borrowers. The MFIs that are not members of the associations are also proactively adopting the code and ensuring compliance since banks are stipulating code of conduct adherence as a condition for bank loan.

EXCESSES ARE BEING SET RIGHT

Some practices of MFIs were cited as causing harm to clients leading to the crisis—usurious and non-transparent pricing of loans and other products, several MFIs lending to same set of clients leading to over-indebtedness of clients and coercive recovery practices. The RBI regulations address these concerns and have set margin caps and other fees that can be charged on loans. The MFIs have adjusted their interest rates to conform to regulation. The associations have set up internal whistle blowing mechanism to ensure that no MFI charges more than the prescribed rates of interest to the customers. Code of conduct compliance assessments also looks into these aspects. There is little scope for MFIs to charge high rates of interest in violation of regulatory limits.

The MFIs in recent past have been able to ensure that the debt burden of the customer is within limits. The RBI has defined the excessive debt level and MFIs have responded by making more thorough enquiries from the customers and also by referring the credit proposals to RBI approved credit bureaus, which are able to provide information on the number of loans and institutions from which the customers have taken credit facilities. It is worth noting that the initiative of setting up a credit bureau for the microfinance sector was taken by MFIN before the AP crisis. The interesting development has been improvement in self-declaration of clients on their indebtedness since they are made aware of their data in the 'know all computer' with credit bureaus.[2]

However, the database of the credit bureaus is limited only to the MFIs. If a customer has taken loan from a bank, self-help group (SHG) or an informal source, the credit bureau would not have these records. Thus to a limited extent, borrowing from within the MFIs are being monitored to avoid excessive lending. There is a serious danger of credit bureau references becoming the only tool to assess whether a customer has high level of debts. In practice, MFIs know that there are several sources from which a customer could have borrowed, and as a measure of customer protection and responsible financing in the real sense, they should go beyond referring to credit bureaus and make an earnest attempt through their field-level staff to assess the actual levels of debt and take appropriate credit decisions. The regulator should mandate that the SHG loans as also direct loans by banks to customers should become part of credit bureau records so that the concerns of avoiding excessive debt are fully addressed.

The RBI has also laid down the fair practices code that includes staff behaviour towards clients and appropriate recovery practices. The code of conduct reinforces this regulatory guidance and further elaborates on the staff behaviour. In order to improve staff behaviour, the flawed incentive mechanism that rewarded high recovery rates has been revised by many MFIs. The staff are being trained in fair treatment of clients and the extent of pressure they can exert on clients for repayment. Regulatory restrictions on MFI staff visiting the client homes and workplaces have also helped.

Most MFIs have established grievance redressal mechanism through which the customers can lodge complaints and also give feedback to the customers

about the action taken thereon. Toll free phone numbers have been announced by many MFIs to which the customer can make a call to register complaints or offer feedback. The phone numbers of higher level officials in each MFI have been given to customers, which is reportedly being well used. Moreover, the MFIs have also tried to appoint ombudsman and similar such arrangements to give an opportunity to the customers for approaching an arbitrator/appellate authority in case they are not happy with the remedies given by the concerned MFI.

Thus the regulator, in a clear departure from the recent past experiences in financial sector, has seen it fit to introduce norms for customer protection. The MFIs are fast recovering from their negligent past in pursuing customer protection agenda and rapidly scaling up responsible finance practices. Going beyond remedying past problems, many of the MFIs with the support of other stakeholders had been carrying out several affirmative actions that are likely to lead to positive outcomes for the customers.

ARE THE INVESTORS AND FUNDERS ON BOARD?

Globally, fund managers are increasing their focus on social performance and end-client protection to ensure more responsible use of their capital. Many of the investment funds are funded by sovereign governments for development financing. The negative media reports and charges against iconic leaders[3] have forced many investors (who are ultimately answerable to their governments) to strengthen their due diligence process and focus on client protection and social performance management (SPM).

Several industry efforts are underway to promote transparency and accountability. Worldwide, 54 investment organizations, including several leading Microfinance Investment Vehicles (MIVs), endorsed the Principles for Investors in Inclusive Finance in 2011.[4] The Principles for Investors in Inclusive Finance (PIIF) principles incorporate the CPPs and Universal Standards of Social Performance Management (USSPM) and commit the signatories to fund responsible institutions and create the right incentives for their investees to treat clients ethically and responsibly.

There are signs that investors have resumed taking fresh equity position in deserving Indian MFIs. Some of these deals have been of significant size. Equity investors have been keen to support the well-run, professionally managed MFIs outside AP. The valuation at which they make equity investment has undergone a change as the market sentiments have turned negative; the price to book value ratio that was above three as recently as two years back has come to below two in the recent investments,[5] and this will continue to be so for some time to come. As a consequence, the pressure on producing returns will be low and customer comfort with pricing will change for the better.

Investors have appetite only for those MFIs with a track record and where they see a future calibrated growth potential in diverse geographies. Several other MFIs which are not well known have been finding it difficult to attract investor interest in small ticket equity financing except from socially oriented investors. Many social investors unfortunately do not have deep pockets.

There is a need for augmenting Indian social equity funding. The Small Industries Development Bank of India (SIDBI) has launched the India Micro Finance Equity Fund of ₹100 crores, which is perpetual in nature and meant for Tiers 2 and 3 MFIs. This fund can be enlarged with contributions from banks and investors so that small and medium MFIs are able to access equity.

The experience from equity funding, especially from commercial sources, has shown that such funding does bring in its wake of undesirable influences in terms of growth requirements and pricing. The MFIs, in order to attract equity on an ongoing basis, have to demonstrate consistent profitability to their investors. High growth aimed at high profitability to improve enterprise value and offer good returns to equity investors has been a driver of several profit-maximizing practices in the sector. While universal standards are emerging on several aspects of social performance, for investors, a single global standard for acceptable growth, profitability, return guidance is not likely to emerge. However, MFIs expect investors also to exhibit their social responsibility by staying invested with the institution for a longer tenure and with realistic return expectations.

One also finds that there is a disconnect within the investors, different arms of the social investors, especially where they are large investing entities. The social performance units of the investors set a course for MFIs to improve social performance whereas the investing arms underline the need for high profitability and high future valuations at which they could exit. These practices within the large investing institutions should be bridged and they should come to a cogent theory of how they invest in sectors where a large number of vulnerable people participate.

Responsible investors and fund managers need to further integrate social considerations into their

decision-making process in order to send a clear message about their commitment towards social performance issues and to differentiate from the exclusively profit-seeking players. As members of the governing board, the investors should seek controlled and balanced growth, providing guidance on avoidance of the risk of mission drift and delivery of client-oriented products and services.

The banks and financial institutions in the past by and large were satisfied if the institutions that borrow from them were functioning efficiently, had competent staff in place, had a reasonable portfolio quality and were able to service their loans. However, post crisis, the lenders have drastically reduced lending and denied loans to many MFIs for fear that the reputation risk as also the financial risk might affect them. In order to improve responsible financing by MFIs, through the lenders' forum as well as on their own, the banks and financial institutions have been insisting that the MFIs should observe codes of conduct in the field, ensure selection of the right kind of customers, listen to and satisfactorily resolve customers grievances and also ensure that the recovery practices in the field are appropriate. Scrutiny of field-level practices of MFIs through third-party assessments and through bank's own staff has increased. Many banks and financial institutions are ensuring through loan agreements that MFIs undergo an independent assessment of adherence to the code of conduct as well as other measures to ensure transparency and ethical behaviour.

Given that more than 80 per cent of financial flows of MFIs come from banks and financial institutions, their attitude towards the sector will probably hold the key as to the future of MFIs. If the liquidity issues faced by MFIs are not addressed soon by the banks, the MFIs will have to scale down their operations further and some institutions will even have to close down operations, which will affect the clients' access to financial services. Studies show that many microfinance clients in AP had to source high-cost loans from informal sources after the MFIs stopped lending[6] and clients in other states will face the same situation if MFIs shut shop. If for want of banks funding people face disruptions to the only financial service that they had access to, then the actions of the banks cannot be deemed socially responsible.

CORPORATE GOVERNANCE

The MFI boards have often been blamed for not steering the growth of the institutions with due care and for not balancing the twin goals of the MFIs. The realization that role of MFI governance is a lot different than that of mainstream financial institutions since MFI clients are vulnerable and often uneducated about finance is sinking into the boards of MFIs. Constitution of quality boards and establishing good governance practices has become very important to deal with the external scrutiny of for-profit organizations. Some of the MFIs that wanted to establish a sound governance base have ensured induction of qualified professionals with required skill sets into their boards who have the capacity to focus on social and financial goals.

The practice of appointing independent directors is gaining ground in MFIs, especially to protect the interest of those stakeholders who do not have a voice on the board since other directors represent specific interests. Independent directors who have a commitment for the community and customers interest can enable balancing the twin goals. Some MFIs are having a re-look at CEO compensation, since high-pay packets are largely paid out of the interest paid by poor clients and there has been a concern that board should fix reasonable compensation. Investors reported paying more attention to quality of governance in due diligence, agreements and reporting frameworks. Investor board representatives have largely been supportive of the balanced returns and fund allocation for non-financial welfare activities. While, in general, directors nominated to fill board seats for investors bring useful expertise and perspectives, their duty of loyalty and their willingness and ability to balance social and financial goals and targets has been an area of concern.

A database of independent directors should be maintained from which the MFIs can draw upon in case of need. The directors on boards of MFIs might be able to sharpen their focus and increase their attention to social performance aspects with some specially designed learning events.

A recent development in a few boards is appointment of subcommittee for SPM or appointing an SPM director to monitor the social performance and responsible financing practices. While boards are largely monitoring the compliance of regulatory norms and code of conduct requirements, a few boards are setting social goals in terms of outreach with segmentation, product usage and even setting targets for movement of clients out of poverty.

ARE THE POOR BEING TARGETED?

Most Indian MFIs cite low-income, poor and very poor clients as their target. Several of them are targeting financially excluded households. However,

RBI has set the norms for income levels of clients to be acquired and serviced by MFIs. The RBI wants the MFIs to focus only on certain segment of clients. Their apprehension appears to be that if MFIs do not have clear norms for customer acquisition, MFIs may shift business to any segment that is attractive and profitable. However, the current definition is too narrow and has excluded significant numbers of low-income households that are financially excluded. The definition will also keep away customers that already benefit from the MFI services. Moreover, the present practice of getting a self-declaration from the client as proof of their income does not serve the purpose. The RBI has shifted the onus of appropriate selection to the client rather than to MFIs. It would be a better option to retain the rigour of selection through appropriate tools but enlarge the income limits so that the MFIs are able to address the requirement of most of the financially excluded households. Many MFIs are functioning in the poorest districts and blocks which do not have much banking facilities. Some of the larger MFIs had the intent and where withal to expand to remoter areas. With the recent margin cap of 10 per cent imposed on these MFIs, they will find it difficult to generate surplus to expand to more rural, hard-to-reach areas.

Many of the MFIs have been collecting client information on certain metrics that define the poverty level of clients. Only a few of them were processing these data and measuring the poverty and vulnerability level of clients. However, when it comes to reporting poverty figures, Indian MFIs have much to achieve. According to Microfinance Information Exchange (MIX), only 23 per cent out of 71 MFIs have submitted 2010 and/or 2011 client poverty measurements. The available poverty data shows that the majority of Indian MFI clients fall below the US$2/day poverty line.[7]

The key issue for MFIs has been collating and reporting in a form that would make the data comparable to poverty lines either national or international. The MFIs had been using tools that did not correlate their poverty indicators with the national/international poverty lines which is necessary to validate the assessment, facilitate comparison among MFIs and report to external stakeholders. The availability of tools such as Progress out of Poverty Index (PPI) is making measurement and reporting possible. The PPI score card for India has been revised in consultation with industry stakeholders. The revision has been based on results of Household Consumer Expenditure Survey[8] conducted by National Sample Survey Organisation.

Regional and state-wide differences,[9] urban and rural features, are not reflected in the tool which is constructed for the nation as a whole. The staff do not relate to those indicators which do not reflect local conditions and hence doubt the tool's effectiveness.[10] Institutional buy-in is still far away with many institutions using the tool on a small sample basis whereas the PPI gives reliable results in a large database. Most of the MFIs want to measure other poverty/access-related features of the client as well for which technical service providers have been assisting the MFIs.[11] Integrating the data effectively into MFI internal databases has been a concern expressed by Indian PPI implementers. However, this problem is not specific to the PPI and relates more to the management information system (MIS) in the MFI. With only 10 indicators, the PPI is probably easier to integrate than most other tools. Grameen foundation is also working on solutions for effective integration.

ARE THE AVAILABLE PRODUCTS APPROPRIATE?

Clients' experience and satisfaction with the MFIs is largely through its products and services. During high-growth periods, many of the MFIs focused on client addition and for the ease of expanding business had a standard loan product, which had many takers in a credit-starved market. With increased competition, MFIs are paying increasing attention to product design in the recent past. In accordance with the regulation, larger loans are being given with a longer repayment period of two years or so, which makes it possible for the smaller borrowers with limited income to service a loan in easier instalments.

There is more realization that good product and process features make for satisfied customers and improve customer loyalty. Most MFIs find their loan portfolios shrinking due to liquidity challenges, which limit their ability to offer diversified credit products.

The average loan outstanding per borrower as of March 2012 is only ₹6,466, which is one-third lower than that of 2010 reflecting the decrease in size of loan portfolio of MFIs. However, over a period of time, the loan size has to increase in order to serve the double bottom line objectives. With larger loans, the customers will not be pushed to seek loans from different and costly sources and the affordability of the loan instalments for the borrowers will improve. The reduced cost arising from larger loan sizes would improve profitability of the MFIs.

While many MFIs still continue to offer single loan product, there are a number of institutions that have offered a variety of credit products suited to the purpose of loans, client segments and stage of the client's business. The MFIs offer social purpose products—water and sanitation, solar energy, education, etc.—which were usually priced lower. On account of the current interest rate and margin cap environment brought in by the regulator coupled with prescriptions on the purpose of the loans, MFIs are compelled to withdraw some of these socially oriented low-priced loan products. The restrictions imposed by the regulatory framework did not permit other services like savings and remittances. Savings products are being offered by a few MFIs through business correspondent (BC) arrangements with banks. Micro-insurance products other than credit life are also being distributed. Micro-pension is being offered by some MFIs even though the commission earned may not cover their costs in the initial years.[12] The MFIs are investing their time in partner development for those products and services that they cannot offer on their own account.

Since MFIs were not perceived to lend responsibly, the regulator had to step in and set limits on interest, purpose, size and term of loans and customer segmentation, which are normally within the scope of internal business decisions of MFIs. These norms limit the scope for need-based and innovative product design. When more evidence of responsible lending and field conduct becomes available, the regulator should relax these norms and enable MFIs to offer more varied and appropriate products.

BEYOND FINANCIAL SERVICES

Well beyond financial products and services, many MFIs are offering non-financial services to improve the livelihoods and quality of life of clients. They support customer households in health, education, skills training, housing, marketing and a variety of other aspects either directly or through dedicated groups' entities. Some of the for-profit MFIs and cooperatives allocate a part of the profits for client welfare measures.[13] Though the types of services differ from MFI to MFI, education and health seem to be of common focus, often responding to the customer needs. Given the intent and reach of MFIs, governments could partner with MFIs, which can ensure effective implementation of welfare programmes of government in health and education.

Rehabilitation of ultra-poor programme is also being scaled up by a few MFIs, though this requires very intensive work. The MFIs have been training their clients—financial literacy aimed at increasing awareness of over-indebtedness, product features including interest rates and training on relevant features of code of conduct have been the two focus areas for training. It is commendable that institutions operating on thin margins have also taken up these efforts.[14] Some of the MFIs are also sharing these training resources[15] for wider dissemination and cost efficiencies. The MFIs make a strong case that they are not soulless, profit-maximizing entities as they are often made out to be.

LISTENING TO CLIENTS

There is much more intent and action on the part of MFIs to listen to the clients. Clients have been sharing their needs about the size of loans, the frequency of repayment, the non-alignment of repayment instalment with their own cash flows, the hardships that were caused when the groups had to pay up for defaults of the individuals and also may be the behaviour of staff. There was no clear avenue or mechanism through which these voices were heard, analyzed and acted upon. Regulatory norms as well as unified code lay emphasis on client grievance redressal mechanism. The MFIs are developing grievance redressal policies that will ensure that customers' complaints are investigated and resolved. Many MFIs have provided a toll free number for customers to lodge their complaints or seek clarifications and also disseminate information to clients on the usage of this.

Going beyond the regulatory requirement and codes, in order to listen to the client voices and opinions, some of the MFIs have carried out client satisfaction studies and are making adjustments to their programmes. With the support of technical service providers such as EDA Rural Systems and Micro Save, some MFIs are re-looking at their systems to enhance social performance towards clients.

IS THERE A FUTURE FOR COMMUNITY OWNERSHIP IN MICROFINANCE?

Community ownership in MFIs offers a route by which the customers can participate in governance and set the goals and determine business of the institutions. Community ownership is seen in all forms of organizations but more so in NBFCs and cooperatives. A few institutions have used the route of bringing together customers into trust or societies and through them have invested in the microfinance companies where the external investors are co-investors. This is proving to be a difficult model

since participation in subsequent rounds of equity issue has been tough for the customer groups. Given the current environment and distrust in the Mutual Benefit Trust (MBT) structure, it is very difficult for the customers to be the owners of the MFIs, especially when they are set up as companies.

There are other forms, especially cooperatives, where customers are the exclusive owners of the institution. However, these institutions do not find favour with the rating institutions, the financial institutions and banks. They are starved for funds and their needs are not realistically appraised. Their performance is not reckoned in a manner that is consistent with their mission and objectives. All these led to the community-owned institutions being squeezed out of the market. There are very few institutions that are self-reliant in their financial resources and are not dependant on external funding. Though self-reliant model is good, the fact that there are only a handful of them operational in the country shows their limited scalability. The meagre financial resources of the community should be augmented by banks through bulk loans so that this customer-centric form is able to continue to provide sustained socially relevant services. The inevitable conclusion is that other stakeholders find it hard to believe that customers can actually become owners of the institutions which finance them. Exaggerated perceptions of risk, governance quality and customer influence on business decisions dominate investor and funder thinking, finding an echo in the rating agencies resulting in highly selective support to such institutions. Mainstreaming a customer participating institutional model is proving to be very difficult.

The SHGs being member-owned institutions are seen to be member-centric that serve the needs of their members. Since the members act within their own groups, it is expected that design and terms of the financial services, the recovery procedures and practices would be consistent with what the members desire. Mainstreaming this model, Government of India has launched National Rural Livelihood Mission (NRLM), which promotes financial services through the SHGs and their federations. The National Bank for Agriculture and Rural Development (NABARD) has also launched the SHG 2, emphasizing voluntary savings, self-monitoring by SHGs and graduation of members for enterprise financing.

However, in a savings accumulating model such as that of SHG, the management capacities of the groups are stretched and with low supervision over a period of time, wrong practices can set in. Leader capture of the groups, cornering of loans by powerful members and poor repayment of internal loans leading to savings of poorer members being put to risk are issues which are being increasingly reported. The metrics of responsible financing should be applied on SHGs and it should be ensured that members of SHGs get the protection that is available for other users of the financial sector. The SHG model requires tweaking to make it responsible; periodic distribution of savings and accumulated income, leadership rotation and capacity development for new leaders, revival of the good practices in lending and clear exit route for members who want to quit will enable better functioning by SHGs and promote responsible finance practices in this dominant segment of microfinance.

Whether the federations are responsible financiers is largely determined by the genetic code of these institutions in terms of who has designed their goals and business models. There are a number of federations of SHGs which have been in existence and have proved to be doing well by their members with a suite of products which are clearly aligned to members' needs. However, the federations that have come up at the behest of the governments cannot be upheld to be prime models of responsible lending where both the groups and federations have been led by bureaucracy to act in a manner that subserves the overall interest of the programme. So it is somewhat difficult to conclude that federations of SHGs would automatically be models of responsible finance and would be socially performing just because SHGs are presumed to be participating therein. Excessive debt is a clear concern for a number of members in AP both in the SHGs and in the federations. Leader capture, elitist members influencing the decision to the detriment of poorer members and services that are designed by the programme officials and not by the community are critical concerns. If the same model is sought to be mainstreamed across the country through the NRLM, the model may not promote responsible financing practices.

What is needed is to ensure that the federations enjoy autonomy, they are trained in good governance and they are trained in how to do qualitative financial intermediation for the benefit of their own members. The external support whether financial or technical from the government and NGOs should remain at a technical level and it should not take over governance of these institutions. Without providing the autonomy and enabling need based services, creating federations of SHGs in the name of participatory institutions and heralding them as responsible financiers would sound hollow.

ARE BANKS RESPONSIBLE IN DEALING WITH THEIR SHG CUSTOMERS?

The SHG bank financing is considered as superior to MFI lending especially on the counts of opportunity to savings mobilization, lower interest rates, savings linked and group assessment-based credit and opportunity for graduation of SHG members to graduate as individual clients of banks. However, banks fall short in several parameters. Product innovations have largely not happened. Though interest rate of loans is lower at 13–15 per cent as compared to the maximum of 26 per cent in MFIs, the transaction time and cost of the borrowers is higher;[16] if these are computed and included in the costs, the bank loans will be far more expensive. Repeat loans are often available after a lag of three months to six months and after several visits to branch. In southern states, larger loans are given without ascertaining the purpose or their current loan exposure, which is leading to over-indebtedness. In mature groups, on an average three to four members require larger enterprise loans but are forced to take smaller loans only from groups. Even after 20 years of SHG bank linkage programme, banks do not consider SHG lending as a business proposition and hence banks do not treat SHGs as clients to be served and retained. Banks should internalize social performance principles that they are keen to instil in the MFIs. The customers being the same, they deserve better in the hands of banks. Banks would do well to understand that responsible finance is not just for other retail lenders but for the banks too in relation to their direct customers.

HOW DO MFIs KNOW WHAT HAPPENS TO THE CLIENTS?

Microfinance has to achieve the social bottom line of improving the clients' lives. However, there have been high expectations (fuelled with the hype generated by MFIs) that poverty will be reduced if not eradicated through microfinance. The high claims and expectations regarding microfinance being a poverty reduction tool have exposed the microfinance sector to constant public scrutiny. The industry is belatedly seen agreeing that microcredit is not a 'silver bullet' to end poverty. Microcredit gives people a new option to manage their complex and unpredictable financial lives and helps some build tiny enterprises. Microfinance has reduced the misery that accompanies poor people's lives and helped poor manage their poverty. People have been able to manage situations such as hunger, disease, lifecycle expenses or schooling of children with small loans from MFIs. Credit has helped millions of borrowers to start small income generation activities and for a smaller number to graduate to microenterprises.

'Financial services are like clean water and electricity—they are essential to leading a better life.'[17] To significantly improve the lives of the ones living in poverty, other essential services are needed: education, health care, basic nutrition, the rule of law, infrastructure—and access to a variety of financial services, especially designed for the poor, including credit at reasonable rates. Micro-loans, which is what most of the microfinance industry is presently disbursing, cannot achieve substantial impact across all their clients. The cost of credit is still high and size of loans too low to combat the paucity of incomes that are endemic in the lives of the poor.

The MFIs have always believed that they were making improvements in their clients' lives and many of them had set to achieve realistic and minimal outcomes and impacts in their clients' lives. While the external stakeholders propagate lofty expectations of poverty eradication, the MFIs have much lower, practical expectations in terms of impact. The desk-based study carried out specifically for this report on outcomes and impacts that MFIs pursue shows[18] that MFIs aim for more of economic impacts. Improvement in family income, reduction in poverty level and avoidance of borrowing from high-cost informal sources emerged as three most often cited outcomes that MFIs intended to achieve.

Though several MFIs have their intent on achieving an outcome/impact, many of them do not have the mechanisms/systems to measure the change. The MFIs do not systematically analyze collected data to convert it into useful information. The PPI is emerging as a tool for collecting and analyzing the clients' progress over time through different loan cycles. From the limited data available, it is heartening to see more clients progressing and becoming less poor over successive loan cycles, though purists question the attribution of this effect to only microcredit.

Given the reputation risk suffered by the sector, measures to prove the effectiveness and impact of the efforts of MFIs have to be undertaken. Since MFIs have set a mission of changing the lives of their clients for the better, it has become necessary to prove that there are positive changes in the client households. In well-governed and managed institutions, such measurement of changes, reviewing and making adjustments to products and services for

better outcomes should be an ongoing mechanism. However, there are costs attached to such measurement which donors, investors should provide for.

THE CONCERNS ARE GLOBAL

The growth-related problems and loss of client focus were experienced not only in India but also in several other countries.[19] Globally there are moves to ensure that consumer protection and social performance principles get firmly ingrained in microfinance sector. These initiatives come in the form of designing implementation and measurement tools for assessing whether consumer protection initiatives are duly taken up by the MFIs, whether social performance principles have been incorporated in governance and operational systems, whether staff behaviour is attuned to field sensitivities, whether basket of products are aligned to customers requirements and overall whether the MFIs are achieving what they set out to achieve. The Social Performance Task Force (SPTF), SMART Campaign and Microcredit Summit are actively engaged in several parts of the world on these themes.

'SMART Campaign' that propagates a set of CPPs to guide the microfinance industry is a large global effort. The CPPs are considered as minimum objectives to be achieved in responsible financing. In India the campaign is identifying the state of practices on client protection by assessing a range of Indian MFIs, to create India-specific benchmarks on CPPs. The campaign has partnered with MFIN, Sa-Dhan and ACCESS-ASSIST to help with its efforts in this direction. The campaign is also disseminating knowledge and building capabilities amongst microfinance stakeholders by training them in client protection assessments. SMART has also initiated certification of MFIs for adopting CPPs, which will indicate that the MFI meets the minimum standards for client protection.

The SPTF has launched USSPM, involving a global team of key stakeholders.[20] The standards are based on the premise that 'we can only manage what we measure', and hence focuses on active measurement and monitoring of social performance goals. The standards require MFIs to have clear goals for client outcomes, to respond to clients' needs and to measure and track progress towards client-outcome goals. They include CPPs. Some of the members of SPTF will be working with a number of institutions to 'beta test' the standards[21] and identify the areas for improvement. Over time, it is expected that the industry will develop benchmarks and standards for client outcomes.

Microcredit Summit has launched the concept of the Seal of Excellence for Poverty Outreach and Transformation, which seeks to identify those organizations that can demonstrate that they are meeting their objective of reaching poor people and helping them move out of poverty. The Seal has aligned with the SMART Campaign and the SPTF to build upon the principles and standards already established. Each institution applying for the Seal would first have to be certified by these initiatives, showing that they meet the CPPs and the universal standards as defined. In addition, each institution must meet financial and organizational indicators as prerequisites to receive the Seal. Thus, the Seal would certify those institutions that not only protect their clients and meet double bottom line commitments but also achieve results by demonstrating significant outreach to the poor.[22] The indicators that will be used to evaluate institutions are under beta testing.

The MFIs and other key stakeholders are concerned that there are too many initiatives looking at aspects that are similar. SMART Campaign, SPTF and Microcredit Summit have jointly clarified that they are coordinating these initiatives but working independently and are also working with social raters to integrate their indicators.

Apart from these initiatives, institutions both in the public and in private domain have taken it upon themselves to prove that they have got the better tool, the better method and the better set of ideas to assess whether MFIs are socially relevant, whether they are responsible, whether their field practices are appropriate, etc. There are excessive demands for social ratings and due diligence, assessment of portfolio and also assessment of field behaviour, training of staff in several aspects of responsible finance. The competing industry-level concepts, which are sought to be applied to practice, may be for the first time through Indian MFIs, do seem to be external compulsions and not the internal requirements of the sector. That MFIs are put to avoidable repetitive learning of marginally different methods and tools is an understatement.

There are concerns that external players looking into MFIs may not serve the interest of customers as much as supporting MFIs to carry out internal actions with regard to social performance and customer protection aspects. Public funds, which are being allocated for these external efforts, would serve a much better cause if substantial part of the funding is directed to the MFIs themselves and enable them to embark on specific deliverables. If assessments are accompanied by funding for actual measures that the MFIs should undertake in order

to improve their field practices, these exercises will be result oriented.

Technical service institutions are helping the MFIs in different ways by building up their capacities, training their staff, rating them, carrying out audit of their portfolio so that the MFIs could access finance from different sources. Some of these institutions in the past have been talking about the need for changes in the way that the MFIs function. But, by and large, most of them did go along with what MFIs did. They are on an overdrive now and there is a tendency to alarm the MFIs beyond what's required and make them take actions relating to responsible finance and social performance, which may or may not serve any purpose.

The MFIs are carrying on a business in which they have to keep the expectations of customers, investors and external stakeholders balanced. This balance is not achieved by external assessors certifying it. Typically, the goals of securing qualitative performance and excellence in responsible finance should be secured through the boards and governance of these MFIs. However, MFIs find that rating/assessment/certification exercise has become a self-propelling industry with which neither the MFI nor its board is able to connect. If the industry effort is aimed at capacity development of board and senior management on designing responsible finance practices and client-centric services and equip them to monitor the achievement through their own board, possibly the interest of customers will be served much better. Otherwise the competing and sometimes conflicting theories of how an MFI should perform in order to be able to prove to a particular institution or a particular network that it is socially relevant and responsible is overwhelming MFIs.

There are a few MFIs who set themselves to be measured against the standards for mainstream institutions. Ujjivan and Equitas have been assessed as part of the exercise to see whether HR climate is a positive one which makes the employees feel good. In the Great Place to Work Survey, both Ujjian and Equitas figure in the top 25 list. Equitas has gone in for a rating of its governance and has been awarded a high rating (CRISIL GVC Level 2), only a notch below the highest possible rating by CRISIL.[23]

SOCIAL METRICS STILL TO BE DEFINED

Indian MFIs are performing well as compared to global standards being very efficient, focusing on financial and non-financial services that benefit clients and have taken several measures to improve responsible lending practices. What does the industry expect MFIs to do on which aspects and how much is still not defined. Several MFIs mention that they are ethical lenders and are responsible in their dealing with clients and also take measures to improve client welfare. What more should they do to be socially performing is unclear to several of them.

For the sector, financial indicators and benchmarks are available against which they can measure their performance. As far as social performance is concerned, what is to be measured, what will be the unit of measurement and what is the benchmark against which the performance is to be measured is still not clear. For example, most of the MFI clients are poor if measured against the several poverty lines that are existing. Even today the industry is not agreeing to a common poverty line of measurement. Similarly on aspects such as transparency and governance, there is not enough clarity on how to measure and benchmark performance. The ratings and assessments should search for common ground and unify their approaches to arrive at methodologies and scoring, which make for easy comparison against benchmarks and across MFIs.

CONCLUSION

The biggest risk to the microfinance industry currently is a reputational one. Contrary to common perception, the risk is not just confined to MFIs but others involved such as regulator, investors and funders. While the erring actors among MFIs have been revealed, collateral damage has been high. Other MFIs that had responsible practices and lenders with high exposure to AP MFIs have been negatively impacted. Equity investors face the prospect of either a very long wait or erosion of their investment. Added to all this is the burden of proof cast on the microfinance industry to continuously prove its social intent, which carries high costs.

The developments have brought out several responses to improve the SPM content and quality in the sector. A deluge of new tools, reporting formats and management approaches have left many institutions overwhelmed. The remedial response from others is probably erring on the side of excess. It should have been more mature and calibrated in proportion to what is required of MFIs. Indian MFIs do several things right compared to average MFIs elsewhere. On outreach to poor, pricing, social and welfare initiatives, Indian MFIs fare better than MFIs in most other countries. Due recognition

of the positive and responsible role played by some of the MFIs would be a good starting point to search for good practices in social performance.

The RBI has responded with alacrity to bring certainty on responsible finance aspects as well as customer protection. While ongoing changes would be effected to the regulations, it is worthwhile to keep in mind that hardwired regulation will reduce the customer coverage, prevent expansion to excluded areas and discourage small institutions that fit remote geographies well. Since regulatory intent is to provide certainty to MFIs, frequent recalibration of guidelines is best avoided. The customers of microfinance are from the same vulnerable sections of the society regardless of programmes and form of organizations that serve them. The protection of members of SHGs and their federations is a critical area requiring regulatory attention.

Finally the realization that MFIs alone did not fail the social performance test should sink in. All others involved in promoting, nurturing and supporting those erring MFIs cannot wish away their collective responsibility. While credit for successes is easier to claim, responsibility for failures should be shared. This would pave the way for collaborative action to improve the sentiment and field practice in MFIs. While there might be no limits to the desirable maxima to be achieved in delighting the customers, the reality of low margins should be factored. The cost of each desired improvement should be weighed against the benefits before asking MFIs to take decisive action. If governance in MFI is made subservient to external pressures, quality of implementation of responsible finance agenda would not rise above the level of compliance. The aggressive tenor of dialogue with MFIs should be replaced with a mature and reasoned approach that will be received well by the boards of governance. Over time, it is governance of MFIs that would take care of its customers and it is those in boards who should be brought on board as a priority.

'Have the clients' interest in your mind, take your hands off their pockets, keep your name out of the press and you will be seen to be responsible', an industry observer.

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Governance and social performance

Chapter 2

> *Corporate governance is … holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society. The incentive to corporations is to achieve their corporate aims and to attract investment. The incentive for states is to strengthen their economics and discourage fraud and mismanagement.*
>
> —Sir Adrian Cadbury[1]

Good governance is a primary requirement of any organization, regardless of the nature of its business or its form. In MFIs, good governance is a greater necessity given the close external scrutiny of aspects relating to customer protection, responsibility and sensitivity to customer welfare. Good governance enables MFIs to implement appropriate business plans, strategies, decision-making and resource allocation and to adapt to changes in the business environment. Governance serves to mediate interests of diverse stakeholders including shareholders, management and employees. In MFIs, the diverse interests also include protecting vulnerable clients and pursuing social as well as financial goals. On account of the nature of clientele, MFI directors are required to observe a higher 'duty of care' than those in conventional financial institutions. Thus, governance of MFIs has to ensure that business decisions are client sensitive and interests of clients are protected.

The crisis in the sector has brought sharply into focus the role and efficacy of governance in MFIs. The failure of boards to ensure that the MFIs pursue a sustainable growth model where the interests of the clients are also protected has been often highlighted in conferences and media. There have been strident questions on quality of governance and the need for setting standards of good governance. In the Banana Skin Survey 2012, the corporate governance is considered as the second most important risk. Investors, regulators and technical service providers rated corporate governance as the top most risk. Governance was widely perceived to be inadequate, failing to provide sufficiently strong leadership to keep MFIs on a healthy growth path[2] with adequate focus on achieving its mission. Although much work has been done to improve governance standards of MFIs in recent years, the perception persists that several institutions need to improve their leadership in order to inspire confidence among investors and lenders.

OWNERSHIP AND GOVERNANCE

Governance is closely related to its ownership. Owners provide the institution's initial set of ideas and capital. They set the vision and mission of the organization and are interested in the achievement of results. The ownership structure has a significant effect on board structure and its effectiveness.

Indian microfinance has three dominant institutional ownership types—*(a)* for profit shareholder-owned NBFCs, which covers 85 per cent of MFI clients and thus a predominant model; *(b)* non-profit company, society/trust; and *(c)* user-member-owned institutions such as federations.

The user-member-owned institutions have normally a set of owners who are more or less aligned in their expectations on the performance of the MFI. Profits and financial returns as a goal are not very seriously pursued. The owners who are also clients largely expect adequate and timely financial services at a reasonable cost. What the boards

of such institutions lack in terms of professional qualifications, they compensate by being member centric.

Many Indian MFIs still adopt the non-governmental organization (NGO) form where ownership is unclear. Several of them had (and some continue to have) cousin boards, which raised concerns among lenders about their efficacy and independence. The NGOs with large microfinance operations have been advised to transform to company form; others who had credible but small operations have been advised to improve their systems including governance. 'The days of what are essentially family businesses being trusted by investors and banks are over.'[3]

Though many Indian MFIs commenced their operations in the not-for-profit NGO form, the growth in assets and clients necessitated a change in form to a shareholder-owned institution in the for-profit mode. As an institution transforms from non-profit ownership to for-profit, its governance structure and the composition of board members undergo a change. This has meant transitioning from an institution dominated by a founder or social entrepreneur into a more professionally managed institution with broader ownership and a formal governance structure. Such a transition requires significant delegation of authority to management and sharing of governance control with incoming shareholders.

This transition is a difficult process for parent boards, as it requires the board members to give up significant control to investors entering the company. Current owners and MFI managers would do well to assess prospective shareholders carefully for compatibility of the different parties' overall goals, targets and time horizons. Those new entrants may not share the same social goals at all or in the least ask for adequate emphasis to be placed on commercially oriented goals. These shareholders also usually insist on changes in by-laws, changes in governance, board seats or targets and specific agreements that safeguard the rights of the new owners. The founder teams often lament that the boards of for-profit institutions that they had floated did not pursue the social goals as vigorously as the NGO board. The promoters find that the social orientation presumed to be part of the organization when they were an NGO 'has to be proved to exist' in the for-profit form. This change has made the task of promoters difficult, especially in the backdrop of demands for financial performance by the other shareholders. Constitution of quality boards and establishing good governance practices become very important to deal with the external scrutiny of for-profit organizations.

The for-profit corporate boards have different types of owners—promoter group, private/social equity investors, employees, clients—who have specific economic objectives, all of which tend to be closely linked to what the owners are hoping to gain from the investment. Social investors such as Dia Vikas – Opportunity International, Manaveeya – Oiko Credit, Lok Capital and Incofin have financial and non-financial priorities, and they balance financial goals with a social mission. Manaveeya pursues a 'triple bottom line' and adds environmental concerns to the agenda of investee MFIs. They take board positions and provide strategic inputs for achieving both financial and social goals. However, some of these social investors lack deep pockets to participate beyond the initial round of equity infusion, and thus over a period of time the structure of ownership changes in the MFIs.

Box 2.1 Active board members

The founder of an MFI in transition observes:

> *Board members of the NGO deeply question the outcomes and impacts on the clients. They visit the field often to interact with clients. The financials of the MF operations were not given as much importance since it was difficult to segregate costs for MF activity. However, in the NBFC which has been recently floated, the board is more focused on financial sustainability and building efficient operations. Client related discussions are more about adoption of client protection principles.*

Box 2.2 Investors in governance

Both Dia Vikas and Manaveeya are equity investors in Evangelic Social Action Forum (ESAF) Microfinance India Limited (EMFIL). The company officials have found that both the investors through representation in the board drive the social agenda, especially adequate returns to the clients. Both the investors are invested for long term. They have provided need-based technical support. The company is keen to raise further equity but finds that like-minded social investors are very few.

Source: Personal Communication with Mr Paul, MD.

Community ownership in for-profits

Some of the promoters, especially those who have adopted SHG lending methodology such as Initiatives for Development Foundation (IDF), EMFIL, Bullock Workers Development Agency (BWDA), Hand-in-hand, have ensured that the clients are shareholders in the for-profit entity. They have ensured that the community has ownership so that the members are able to express their choices as to what company should do for them and be able to participate in the governance of the company and guide the management in the provision financial services. Since mobilization of small capital from millions of members will be expensive and unmanageable, MBTs of SHGs have been formed through which share capital for the company have been mobilized. As community has limitations to provide sufficient growth capital, external investors are brought in. The community representatives from the MBTs participate in the board of some of these institutions like IDF and EMFIL and bring in the client perspective, which is appreciated by the other board members.

However, with the concern of abuse of the MBT structure (based on past experience in a few MFIs[4]), the external investors are wary of investing in such companies. The equity mobilization efforts of the community-based promoters are hitting the headwinds. Some of the social investors argue that there is a very limited role that MBTs can play in governance and hence there is little value in bringing in share capital of the community. The assessment that community organizations such as MBTs can bring very little substance to governance is a patronizing one. The community representatives will certainly be able to represent members' issues. In fact, boards comprising exclusively of community representatives have shown good standards of governance;[5] to the extent they are not fully aware of board practices and governance-related issues, it is the responsibility of other investors to build the capacities. Instead, some investors are choosing to reduce the participation of community organizations in ownership and governance. This goes against social performance principles espoused by such investors.

Private equity investment funds/investors fall under two categories—profit seekers and patient capital providers. They are active on the boards of the investee MFIs and largely influence the financial goals of the MFIs. However, the challenge private investors often face is in ensuring their objectives of investment are adequately addressed and evenly balanced with the interests of other investors and stakeholders.

But a number of MFIs such as Equitas, Janalakshmi, Utkarsh, etc., seem to have clarity on the right balance between financial and social goals, and the agreements with the investors reflect this explicitly. Where promoters are clear on their mission and on nature of balance they want to achieve, it has been usually possible to set governance standards that meets expectations of the investors without compromising responsible finance principles.

Equitas has spelt out that the return on equity would be capped and benefits arising from efficiency of operations would be passed on to the clients. This explicit policy on profits had made it possible to attract the right kind of independent directors to the board. Investors with high return expectations were not entertained by the company, though they offered better valuation, thus avoiding potential dissensions at board level.

Since investors would take part in governance through their board participation, the search for investors should be guided by the requirements of the mission of the MFI to avoid loss of focus. Janalakshmi had set its mission as financial inclusion of urban low-income households offering multi-products and has been identifying equity investors that subscribe to the mission. Thus, it designed a two-part structure to offer multiple products to urban-poor and low-income households—NBFC to raise capital, expand business and offer returns to investors and Section 25 company[6] to offer social services and facilitate products which NBFC cannot. The company has invested heavily in technology that enables the company to be client-focused and facilitates client research.

Private investors in microfinance may be divided between two types of owners: profit seekers and patient capitalists. Profit seekers are primarily interested in making a high return on their investment, attracted by the impressive financial results that some MFIs have achieved. Institutional mission is not an overriding concern for this group of investors, and there is a temptation to forgo longer-term objectives and sustainability for short-term profits. They require an exit strategy to ensure that they can take out profits in the near to medium term. Patient investors are motivated by long-term return on their investment and a sense of their own social responsibility. They generally support the institutional mission and are motivated to protect the financial health of the organization as the basis for future returns.[7]

Thus, some investors are more sensitive to protection of financial or physical assets; others, to reputation, developmental goals or institutional social mission.[8]

While existing guidance and how-to tools describe the ideal of effective MFI governance, practices on the ground are still nascent.[9] The standard roles of corporate governance—setting mission and strategy, overseeing operations and management and ensuring the company's long-term survival—are relevant for MFI governance. The vulnerability of clients and trade-offs that may arise between the financial and social bottom lines are the additional aspects of governance that should be specifically addressed by the MFI boards.

BOARD COMPOSITION—BALANCING SOCIAL WITH FINANCIAL GOALS

Regulators, investors, lenders and others have been taking initiatives and paying more attention to improve the governance practices in MFIs and have been insisting on improving the board composition. Some of the MFIs like Equitas, Janalakshmi, Credit and Saving for the Hard Core Poor (CASHPOR) and Utkarsh that wanted to establish a sound governance base for their institutions have very actively ensured appropriate board composition by inducting qualified professionals with required skill sets into their boards who have the capacity to unflinchingly focus on social and financial goals.

As MFIs transform, just as they expand their operations and suite of products and services, they also need to upgrade boards. They will need to balance director skills, independence and their accessibility. Boards are more likely to achieve robust and balanced strategies if directors bring diverse but complementary skills and perspectives.

Equity investors participate in active governance by nominating individuals to serve on boards of MFIs or funds. Investors' policies and practices vary widely. While most investors nominate staff, it is also becoming more common to nominate others, usually professionals (either local or international). Similarly, some of the lenders also take board positions. While, in general, directors nominated to fill board seats for investors bring useful expertise and perspectives, their time commitment and continuity have been issues. Nominee directors' duty of loyalty and their willingness and ability to balance social and financial goals and targets has been another area of concern. Gaps are also evident in social orientation and business perspectives.

As an MFI head observes,

> *... some of the nominee directors often seen to lack the client perspective; they recommend actions without having a clear understanding and appreciation of what is happening at the ground level. Some have not visited the poor and seen their actual conditions. We are now making it a practice that when ever a board member is inducted we will first provide orientation of our business model including arranging for field visits.*

Independent directors

In large public limited companies, appointment of independent directors is favoured for more balanced governance, promoting independence, challenging behaviour and push for a longer term perspective by boards. Since other directors represent specific interests, a board consisting of only such directors might overlook the larger interest of the company and also the interest of those stakeholders who do not have a voice on the board.

In MFIs, the need for independent directors is more acute because the customers are numerous and vulnerable, they mostly do not have the means of making their issues heard at the highest levels of management in the company. The lack of capacity of significant stakeholder groups, i.e., the customers to effectively raise their issues, has to be overcome by the boards proactively seeking information on clients. This would be possible for committed set of independent directors rather than for others in the board. The independent directors are expected to exercise extra care to influence the board to take long-term strategic decisions rather than narrow, short-term, tactical decisions. The most important role that independent directors play in relation to the board is the balancing of interests of the different stakeholders with their objective views.

The practice of appointing independent directors by MFI, where shareholders agree to appoint individuals without ties to any single investor, is gaining ground in MFIs. In Equitas, out of 13 directors, seven are independent constituting 60 per cent of the board members. Though Equitas is not a listed company, it complies with the requirements of a listed public limited company by having independent directors chair the key committees such as audit committee, governance committee and nomination and remuneration committee. One-third of the board in Grameen Koota are independent directors. The ESAF Microfinance India Limited (EMFIL) has three independent directors out of a 10-member board.

The value and practicality of appointing independent directors—i.e., persons who do not represent any single shareholder—is being debated. The appropriateness of the independent directors selected

Box 2.3 Need for independent directors

Conditions on constitution of boards for companies listing in stock exchange (Clause 49)

There are two sources of the board-related norms on corporate governance—the listing agreement with the stock exchanges for listed companies and the guidelines of Ministry of Corporate Affairs.

Clause 49 of the listing agreement with Stock Exchanges requires that

(i) The Board of directors of the company shall have an optimum combination of executive and non-executive directors with not less than 50 per cent of the board of directors comprising of non-executive directors.
(ii) Where the chairman of the board is a non-executive director, at least one-third of the board should comprise of independent directors.
(iii) For the purpose of the subclause (ii), the expression 'independent director' shall mean a non-executive director of the company who
   1. apart from receiving the director's remuneration, does not have any material pecuniary relationships or transactions with the company, its promoters, its directors, its senior management or its holding company, its subsidiaries and associates which may affect the independence of the director;
   2. is not related to promoters or persons occupying management positions at the board.

Guidelines issues by DCA on appointment of independent directors

The companies may have a nomination committee comprising of majority of independent directors, including its chairman. This committee should consider

1. proposals for searching, evaluating and recommending appropriate Independent Directors and Non-executive Directors (NED) based on an objective and transparent set of guidelines that should be disclosed and should inter alia include the criteria for determining qualifications, positive attributes, independence of a director and availability of time with him or her to devote to the job;
2. determining processes for evaluating the skill, knowledge, experience and effectiveness of individual directors as well as the board as a whole.

largely determines the success of the mechanism. The individuals need to be of high standing, have a reputation to protect and known to be diligent. They face the risk of losing their reputation if poor governance standards and practices are prevalent in the MFI. If they are unable to influence the MFI of what is fair and appropriate, then along with company they also suffer reputation risk. Their conscience and identity as a person of some standing puts pressure on them to perform. However, MFI boards need to choose independent directors based on their qualities and competence; otherwise they lose out on the advantages such mechanisms can offer.

BALANCING SOCIAL WITH FINANCIAL GOALS

Product pricing and client protection measures

Boards are set responsible for lending policies and monitoring the way business is conducted by MFIs. The microcredit crisis raised funder, regulator, media and political concerns about pricing policies and practices of MFIs adding to borrower debt stress. Following the regulator setting pricing norms and caps on margins, concerns of high prices have lessened. The pricing debates in the board rooms have reportedly taken a different aspect. Some of the board members have been asking the management to raise the pricing upwards where they have found a gap between the current pricing and the caps fixed by the regulator. Some boards have turned down price reductions proposed by management due to the trend of increase in cost of funds. Overall, the pricing of products is receiving more attention within the boards since it is a struggle for many of them to comply with the regulations and still post reasonable profits.

Some MFIs also described tension between more 'finance-first' and 'social-first' investors as MFIs considered products with high social value and low profitability. The regulatory norms on qualifying assets has led to withdrawal of some social value products like education loan, water and sanitation, house repair loans, etc. Despite the boards having a clear social orientation, the regulatory norms by their narrow definition of microfinance loans have made it difficult for governance alone to deliver in terms of appropriate products.

CEO compensation

Chief executive payments and high incentives had attracted undue attention even before the crisis hit the sector. Since high-pay packets are paid out

of the interest paid by poor clients, there is a concern that CEO compensation should be reasonable. Some of the lenders and investors were advocating restraint even as early as 2008. The ratio of remuneration between the lowest paid employee and the CEO is used as an indicator to examine the reasonability. Manaveeya was not supporting institutions where this ratio was more than 20.

However, not all boards and investor representatives had such foresight. In some of the MFIs, CEO payments were tied to profits based on modest business plans when the companies were still small. The boards could not foresee the vigorous growth of business and profits that were achieved, which were 10 times that of projections. The CEO compensation was very high in a few such cases raising concerns all around. Why the board could not alter the structure of incentives, at least for future, will always be a question in the minds of the sector.

There are good practices which are emerging like that of CASHPOR. CASHPOR incentivises the CEO on the basis of clear social metrics. The CEO gets the incentive only if 50 per cent of mature clients (five and more loan cycles) move out of poverty as measured by PPI and the overall business growth is not more than 20 per cent of what has been set as the target for the year. Please see Annex 2.1 for details.

Balanced profits

The MFI boards are adopting one or more of the following strategies for balancing the profits and ensuring customer welfare: *(a)* scaling down the interest rate on loans once profitability expectations are realized; *(b)* apportioning profits for credit plus non-financial activities; *(c)* charge a reasonable cost-covering interest on loans, which ensures equitable benefit for all clients.

Some MFIs in the aftermath of the crisis are drafting internal guidance on acceptable profit ranges and levels. However, some of the MFIs have always had a balanced profits approach. Equitas, from its inception in 2008, has had itself benchmarked against government banks on the parameters of return on assets and return on equity and capped the latter at 25 per cent. This pricing philosophy voluntarily undertaken by Equitas is fair to clients and investors—the clients get the benefit of reduced pricing with improvement in profitability and investors are assured that their interest is also not compromised. CASHPOR on achieving operational self-sufficiency has reduced the rate of interest on loans. CASHPOR has been historically passing benefits from economies of scale to clients by reduction in interest rates from time to time. In 2003, when CASHPOR broke even, cash discounts were handed over to clients. Pricing was revised downwards in 2008 (when it cleared its accumulated losses and broke even again) and in 2010 (before crisis, as it had made a high operating surplus because of getting income tax exemption status). Grameen Koota's board has adopted a pricing strategy of charging a reasonable interest rate, which ensures equitable benefit for all clients—the interest rates were brought down to 12 per cent flat in 2006 when the institution broke even and in 2009 it was made 24 per cent declining.

Some other boards have set specific rural outreach targets and allocated funding for them instead of capping return on equity (ROE). Bandhan board had been conscious of keeping the interest rates low and affordable to the borrower (currently the rates are well below the regulatory cap) despite the impact on profits.

The MFI boards are allocating a portion of their profits for carrying out credit plus services for client welfare. Utkarsh Samutkarsh Welfare Society, a Section 25 company, has been set up by Utkarsh Microfinance, with a mandate to implement the credit plus activities for Utkarsh's clients. Utkarsh is contributing a fixed portion of its profit before tax for the activities of Samutkarsh. Though the outreach is still small in numbers, vocational training for self-employment, financial literacy trainings and client meets focusing on social issues have been initiated. Samutkarsh plans to intervene in the area of health also. Health camps are planned for the next financial year, and in the long run, it plans to set up mini-health clinics along with the branches. Bandhan allocates 5 per cent of its profits for developmental activities carried out through the parent NGO and the trusts set up for this purpose. Grameen Koota's board also allocates 5 per cent of the profits for developmental activities of the parent NGO.

Equitas board has made financial commitments for developmental activities—health camps are organized in each branch each month; a corporate social responsibility (CSR) representative for 10 branches has been appointed for organizing these health camps. The board has allocated 5 per cent of profits to Equitas Development Initiatives Trust for providing skills training, running schools (Gurukul) for underprivileged children and health camps. Moreover, for purchase of land and construction of school buildings for the Gurukul, 15 per cent of net worth of the company has been earmarked.

Staff of EMFIL are involved in carrying out health camps, financial literacy training. Though the expenditure for these activities are borne by the

federations of SHGs, ESAF incurs indirect costs in staff salaries.

Investor board representatives have largely been supportive of the balanced returns, allocation for non-financial welfare activities and other designated welfare uses. Of late, some investors who have been keen on financial returns have also shown interest in pushing the social agenda of MFIs, though they are yet to explicitly scale down their return expectations.

MONITORING SOCIAL PERFORMANCE

Board committees

A half-day board meeting does not allow time for delving deeply into specifics of responsible finance or social performance. Purpose-specific committees of the board can be a very useful mechanism to carry out in-depth assessment of social performance-related matters. Audit committee, which specifies what management must report to the board, oversees the external audit and develops and oversees internal controls is an important committee, which is usually headed by an independent director. Though audit committee may not specifically look into SPM, an emerging good practice is to place code of conduct compliance reports, compliance reports on customer protection regulation before this committee.

A recent development in boards is the creation of a subcommittee for SPM or appointing an SPM director. Utkarsh has appointed an independent director as the SPM director. An employee designated as the SPM champion prepares a comprehensive monthly report to CEO, which is then used in preparing a quarterly report to the board. This report is reviewed by the SPM director and presented to the board, and the board gives as much importance to this report as to the audit committee report.[10] Grameen Koota has client grievance redressal subcommittee of the board, which is headed by an independent director. Ujjivan created a Social Performance Committee with its managing director and two investors for the specific purpose of directing the non-financial services to be carried out by Parinam Foundation (an NGO) with the funds allocated out of Ujjivan's profits; at present, Ujjivan prefers to carry out the non-financial services largely on its own.

However, some boards find setting up too many committees dysfunctional and prefer to review SPM-related reporting directly in the full board. More and more MFIs are beginning to adopt the SPM good practices within their management and reporting systems, often without a specific committee, but designating a manager for the purpose. As social goals are defined and key indicators are agreed upon, it is making it easier to report and monitor social performance issues at the board level.

Social performance management reporting and monitoring

Adequate information flow from management to board is a critical prerequisite of good decision-making and supervision. A common observation often heard is that information given to boards does not have adequate detail on even the financial performance to provide a total picture on the performance and inform strategic decisions. Good practices on reporting to the boards on SPM are still evolving.

A good practice is to design a 'dashboard' of key performance analytics/indicators to be generated for the board from the management information system. At the core of responsible finance and social performance monitoring is the availability of customer-level information. It is necessary to monitor a critical number of indicators, prioritized according to the MFI specific social goals, context and readiness of MIS.

This is supplemented by reports from internal auditors. Boards can also direct the management to commission periodical studies through external evaluators, especially on client satisfaction, outcomes/impacts, etc. Thus, inputs from multiple sources help create a consistent flow of information from clients to board. More MFIs are getting social audits and ratings, which help the boards to ensure adherence to client protection and social performance policies. Code of conduct assessments carried out by lenders have been found to be useful by the boards in improving practices.

CASHPOR is working towards three objectives—providing financial services to poor, ensuring health of clients and their families and ensuring children of clients go to school. The board reviews quarterly the client grievance redressal—category-wise grievances and action taken reports. CASHPOR carries out an annual impact survey through their internal audit department which covers aspects on *(a)* social impact of progress of clients out of poverty, *(b)* client satisfaction with products and services and *(c)* adoption of CPPs. This report is placed before the board along with reports on progress in health and education programmes.

Board of EMFIL (ESAF's microfinance arm) measures the performance against specific targets set for new client acquisition in poorest districts,

marginalized households, disabled, etc., and usage of ESAF services by different client groups in each board meeting. Poverty targeting data based on PPI scores is also reported to the board. The EMFIL has a social performance department, which carries out client satisfaction studies, develops reports on the basis of PPI and these reports are placed before the boards. Board has also directed that external ratings on social performance should be carried out periodically. Specific impact studies are carried out through external resource persons who make presentations to the board.

Box 2.4 Specific target set by board of EMFIL

For new client acquisition

Income level of $2 per day and less as measured by PPI—70 per cent
SC/ST/OBC at least 40 per cent
Disabled at least 2 per cent
Minority—20 per cent
Clients of poorest districts at least 30 per cent

Range of services

Eighty per cent of the clients avail of two or more of services—loan, insurance, pension, health

Source: Personal Communication with Mr Paul, MD.

Board interaction with clients - Some of the MFIs also arranged for field visits and interaction with clients for the directors either as part of board meeting or separately. Directors reported significant benefits from meeting with clients and staff. However, such arrangements are few and far between, especially for the rural area-focused MFIs since board meetings are often held in metro cities in the headquarters of MFI or as per convenience of majority directors.

Overall, boards are keen to monitor closely the regulatory compliance; while RBI regulations have been for NBFC MFIs, banks are generally expecting even other MFIs to adopt the rules and norms set out in the regulation. Some of the NGO MFIs like Hand-in-hand have voluntarily adopted the RBI norms and their boards also monitor compliance. The next priority of MFIs is adopting the unified code of conduct of the industry associations. Some of the MFIs such as Utkarsh and EMFIL have expanded the scope of internal audits to capture compliance with RBI regulations and code of conduct aspects. These incidentally cover the CPPs as well.

Box 2.5 MIX analysis

The MIX data on social performance shows that very few MFIs are actually measuring the progress towards their social goals: of the over 600 MFIs who have been reporting to MIX to date, less than 20 per cent of them consistently measure the poverty levels of their clients, the number of enterprises they have financed or the number of jobs that have been created through financed enterprises. According to MIX, a stronger board commitment to measure MFIs' mission achievement would certainly help the industry to better understand how effective microfinance has been in meeting development goals and in enabling improvement wherever the goals are not met.[11]

Source: Micol Pistelli, 2012, How Do We Improve Microfinance Governance? Start By Measuring It, blog, http://microfinance.cgap.org/2012/07/10/how-do-we-improve-microfinance-governance-start-by-measuring-it/ (accessed 7 August 2012).

However, it is not yet common for boards to specifically monitor outcome aspects related to social performance.

The MFI boards are divided on measuring of client outcomes—some point out that the metrics for measurement are not yet agreed upon—whether it is poverty level of clients or the reasonable outcomes that can be expected out of microfinance services. Unlike financial performance indicators, the social performance indicators are not yet internalized at industry level. When left to individual MFIs, each measure and monitor some of the indicators. Boards find that there are issues of costs, competency in measuring social outcomes. Even MFIs adopting PPI require external assistance to carry out deeper analysis of the data. Some MFIs question the need for measuring outcomes as a monitoring exercise in a market where demand exceeds supply by a large margin. As a MFI leader points out, 'the very fact that a client is taking repeat loans from the MFI shows that she is finding the service useful'.

Feedback from the sector brought out a number of aspects requiring board level monitoring on an ongoing basis.

1. Client Profiling (demographic and portfolio): rurality, gender, enterprises (type and size) and client use of services (retention, dropout, distribution of services such as loans and savings, insurance, pension, etc., by demographic

groups); this can be presented for entry-level clients and existing clients

2. Compliance with regulation requirements on responsible finance aspects—issues faced, if any, and solutions
3. Compliance with code of conduct—issues faced, if any, and solutions
4. Credit bureau usage
5. Client exit interview results
6. Client satisfaction surveys and results
7. Outreach and results of credit plus developmental activities
8. Staff training and workshops on improving client friendly practices
9. Staff behaviour, complaints and grievance redressal
10. Any special initiatives taken for client education and welfare
11. Responsible finance aspects contained in external studies, audits and ratings, etc.

Box 2.6 Some good practices in governance and SPM

Issue of appointment letter to board of director setting out his/her roles and responsibilities including fulfilling the social agenda.

Provide the board member an exposure to the MFI operations including field visits prior to joining and periodically thereafter.

Facilitate board interaction with senior management from time to time for understanding how they adopt a client-centric approach.

The board should evaluate its effectiveness, as well as the effectiveness of its individual members, on a regular basis.

Ensuring regulatory compliance, adoption of code of conduct, setting pricing and balanced profits, setting policies and practices based on client-related information can be areas of evaluation of the board.

Boards should also undertake development of the board as a collective effort to grow in ability and unity in leading the institution to achieve its mission and objectives.

Rating of governance by a competent external evaluator from time to time.

In India, as in the rest of the world, the controversies about mission drift, irresponsible lending practices and customer distress on account of over-indebtedness have been attributed to the failure of boards to provide strong leadership and mission aligned direction. Poor governance in some of the MFIs has resulted in reputational damage to the sector.

On interaction with MFIs, it becomes clear that the initial design of the MFI determines the direction and quality of socially oriented performance. The design comes from promoter group and their thinking on board of governance, the business model and staffing. Some MFIs led by their boards have proved that it is possible to balance social and commercial considerations in the midst of sectoral problems. The initial design influences to a large extent the social content in the institution including its governance structure. A board has a key role to play and the kind of persons who are inducted into the board will define the quality of attention to social performance and the extent of detail, which the board will focus on.

Good governance is a challenge for all types of organization—including MFIs. Although no one governance structure is universally applicable to all MFIs, or even to the same MFI at different developmental stages, the board of directors is the pivot on which good governance turns. As Vasudevan, managing director (MD), Equitas, observes, good governance goes far beyond board composition, board of director (BOD) training or the number of meetings held and attendance in the meetings. Many MFIs understand that constitution of the board with appropriate people is an important initial condition. Getting the best out of such boards through adequate reporting to the board, causing periodic reviews at board level and enabling quality discussions on delivery of social performance in the field is a priority for the MFIs. It is equally important for the board, through its practice of good governance, to enthuse the staff of the organization to walk the extra mile beyond financial performance to secure social performance goals.

ANNEX 2.1
CASHPOR microcredit: annual bonus for managing director—scorecard

Objectives and approach

The objectives of the annual bonus for the MD are to motivate and reward him for outstanding work towards the attainment of the vision and mission of CASHPOR. It is agreed that the maximum annual bonus of the MD of CASHPOR Microcredit (CMC) be capped at six months' basic salary.

Scorecard of performance on key objectives

There are at least four key objectives: *(a)* growth of outreach to BPL households; *(b)* institutional efficiency and financial sustainability; *(c)* social impact; and *(d)* stakeholder satisfaction. Each of these has its component dimensions as indicated below. Also shown are the weights for each objective and its components.

			Weights
A.	**Growth of Outreach to BPL Households & Financial Services to them:**		**20%**
	1.	**Net Increase in Active BPL Loan Clients:** % achievement Business Plan annual target—80 to 120	10%
	2.	**Net Increase in Portfolio:** % achievement of annual BP target—80% to 120%	5%
	3.	**Income from Savings & Other Financial Services:** >/= 5%	5%
B.	**Institutional Efficiency and Financial Sustainability:**		**30%**
	1.	**Administrative Efficiency (ACR):** <10%	10%
	2.	**Portfolio at Risk (> 4 wks)**	5%
	3.	**Operational Self-sufficiency (OSS):** between 105 & 110%	5%
	4.	**Capital Adequacy:** >/= 15%	5%
	5.	**Surplus as a Business Correspondent** >/= 5%	5%
C.	**Social Impact, Client satisfaction/Protection**		**30%**
	1.	**New Clients <US$1.5/day/per person (ppp):** —90–95%	5%
	2.	**Mature Clients (5 or more loans) No Longer Poor as Measured by PPI against the International Poverty Line of US$1.5/day/person (ppp):** > 51%	10%
	3.	**Client Protection: % reporting no coercive tactics or harsh words concerning collections:** > 90%	5%
	4.	**Client Retention:** > 80%	5%
	5.	**Client Satisfaction:** > 90% reporting Very Satisfied/Satisfied—> 90%	5%
D.	**Leadership**		**20%**
	1.	**Board & Audit Committee:**	5%
	2.	**Chairman**	10%
	3.	**Direct Reportees**	5%
Totals			100%

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Do products promote responsible finance?*

3
Chapter

A well-designed product that meets the needs of the customers goes a long way in improving customer comfort and enhances the probability of the customer improving the livelihood situation of the household. Access to products and services other than credit enables the customer to reduce risks and invest for lifecycle needs and secure the future. When MFIs design such products or services or facilitate access to products of others, they exhibit their heightened sensitivity to the needs of customers. During high-growth periods, MFIs focused on client addition to the exclusion of other aspects of business including product design. The restrictions imposed by the regulatory framework did not permit offering other products and services like savings and remittances. The MIX, on the basis of analysis of the social performance data submitted by 76 MFIs, finds that large numbers of MFIs offer single loan product; insurance and savings products are offered by one-third of these MFIs. However, there are MFIs who have made significant product design and innovations suiting their client needs and their role in responsible financing that need to be highlighted.

Two basic aspects of responsible finance have been driving the product development and delivery by these MFIs.

First is the designing of the main product, credit, in a manner that is affordable and easy for the customer to use for a variety of purposes. The second is that of offering a range of financial products and services that the customer requires, while conforming to regulatory guidelines. Thus, MFIs need to invest not only in product development but also partner development for those products and services that they cannot offer on their own account. Many MFIs have been able to invest in meaningful partnerships to bring customized products in savings, insurance and pension.

NEED-BASED PRODUCT DIVERSIFICATION

During the initial years, there was not much reason for MFIs to experiment with new products, as there were still vast segments of uncovered market to capture, and the existing microcredit products seemed to be supporting growth sufficiently. Besides, these products had already proved themselves and systems were well set in place to promote, distribute and manage them. New products would entail changes in appraisal and sanction processes, besides modification in MIS and accounting systems. Further, in a market with unlimited demand and limited supply, there was hardly any motivation to develop products from a customer's point of view. The MFIs felt that they were achieving social objectives by virtue of providing loans at lower costs than moneylenders.

Once competition intensified, MFIs paid more attention to product and process design as they wanted to be unique and attractive to clients. Most chose to cut down on loan processing time and rigour rather than redesign their products based on proper market research. However, when saturation began to set in to retain customer loyalty, MFIs began to respond to customer feedback regarding their product offerings and processes. Leading MFIs commissioned market surveys among their graduated customers. Some of the results indicated that while credit was available at reasonable rates

* This chapter was contributed by Berenice da Gama Rose and Alok Misra, MCRIL.

(compared to moneylenders), it was not structured to suit client's cash flows. Product design of equated weekly instalments with no moratorium created cash flow difficulties for clients towards the end of the loan cycle. This resulted in shortages of working capital, often tided over with borrowings from other sources to avoid default to the MFIs. Many MFIs responded to these needs by offering clients 'mid-term loans or top-up loans' after good repayment for at least half the primary loan tenure. These ensured that tiny businesses did not suffer a rundown of capital as the loan outstanding decreased. Such response to client needs triggered a wave of innovations and took MFIs forward in the path towards responsible finance.

With clients demanding suitable products on the one hand and severe competition in the southern and eastern states on the other, MFIs dedicated more resources to product design. Leading MFIs designated product design teams and conducted action research and demand estimation studies to elicit feedback and assess client needs.

While many MFIs have fine-tuned their products to suit client requirements as well as their own institutional priorities, only a few examples have been featured as an indication of the variety of options available for developing a meaningful association with clients.

EMERGENCY LOANS

The MFIs that undertook rigorous loan utilization checks soon discovered that many clients were still approaching moneylenders to borrow small sums of money during emergencies, as MFI loans were not always accessible on demand. Responding to this gap, many MFIs including CASHPOR, Grama Vidayal, GFS, Ujjivan, Janalakshmi and Pudhuaaru Financial Services Private Limited (PFSPL)/Kshetriya Gramin Financial Services (KGFS) introduced emergency loans. Usually available to clients in the second loan cycle onwards, amounts extended are equivalent to 4–10 instalments of a regular loan. Sometimes termed 'seasonal/festival loans', these loans can be used for expenditure incurred on unavoidable social occasions. For instance, Mahasemam Trust offers a wedding loan of ₹15,000 with 10-day tenure, usually repaid from cash gifts received at the wedding.

Table 3.1 Emergency loans

Client-centric practices	Benefits	Caveats
• For health emergencies, disbursements should be made within 24 hours of demand.· • Some MFIs offer such loans free of interest, thereby reducing the burden on clients.	✓ Enables the client to meet his/her exigency without approaching a moneylender. ✓ Allows the MFI to fulfil the client's need and strengthen its relationship.	o Often misused to cover up overdues for 2–3 weeks. o Festival loan is viewed as encouragement to indulge in wasteful social expenditure. o Loan amounts can only cover more than a fraction of costs in a serious emergency.

Source: Interaction with MFIs.

Loans to improve quality of life

The MFIs began to understand that insisting on loan usage solely for income generation purposes was unrealistic. Clients would invariably use part of the loan for business and the rest to pay off earlier debts, children's school fees as per their needs and MFIs wished to offer suitable product for fulfilling these needs. Socially oriented MFIs were keen to offer products that would improve the quality of life and improve the health of the clients such as water and sanitation, solar energy, etc. Thus, loans to improve quality of life were designed. Such loans are available to clients after they have completed at least 1–2 loan cycles with perfect repayment. They are usually given for purposes which would improve quality of life—water connection, water filters, toilet construction, solar lighting, child birth (pregnancy loan) and children's school fees. Friends of Women's World Banking (FWWB) has designed a special product with lending from SIDBI for solar loans and many of the borrowing MFIs are from the Northeast.

Sometimes these are given for purchase of small assets which would indirectly enhance productivity, such as a bicycle or mobile phone. However, while offering these loans, tie-in with an institution's overall mission is important. For instance, Hand-in-hand, whose focus is on women's empowerment, offered a pregnancy loan to cover costs of hospitalization and institutional delivery. Ensuring proper utilization is also important—Ujjivan requires documentary proof for its education loans such as the child's report card or fee receipts. Guardian has strict operational guidelines for checks on loan utilization for water and sanitation. The FWWB's water and sanitation programme (WATSAN) covers eight MFIs/their NGOs.

Loans to graduated clients

With the passage of time, MFI clients graduated through the various loan slabs and required higher loan sizes to support their expanded businesses,

Table 3.2 MFIs providing loans for quality of life

MFIs	Grameen financial services	Guardian	Sonata	SKS
Loans	Loans for water, sanitation, smokeless cook-stoves.	Water, sanitation—new installations and repair.	Loans for bicycles and smokeless cook-stoves.	Mobile phone loan.
Client-centric practices	The MFIs that leverage on in-house or external technical expertise in water, sanitation, health, etc., may perform better in ensuring positive outcomes of such loans, by ensuring purchase of good material and good construction quality.		The MFIs can use their scale of outreach to bargain with tie-up providers for lower prices and better quality. *Tie-ups should be made with well-known and popular brands, with a history of excellent after-sales service.*	
	Grameen Financial Services provides technical support for water connection and toilet installations through its spin-off, Navya Disha Trust.	Guardian leverages on its parent NGO Gramalaya's experience in water and sanitation to provide loans exclusively for a variety of health and sanitation purposes.	Sonata's tie-up with Hero for cycles has removed the distributor's margin, thereby reducing the price for clients as well as saving their time and opportunity cost of buying from a dealer.	SKS has tied up with Nokia for supplying handsets to borrowers at a sizeable discount. Leveraging on SKS's outreach, Nokia has sold over 3.2 lakh handsets to SKS members, spelling a win-win for SKS, Nokia and the clients.

Loans to improve quality life

Client-centric practices	Benefits	Caveats
• Leveraging technical expertise. • Bargaining with tie-up providers for lower prices.	✓ Such products ensure client retention even if competitors offer lower interest rates on regular loans. ✓ These products enable MFIs to meet the actual needs of their clients and to track utilization effectively.	o Being low ticket size products, such loans usually need to be offered as add-ons to regular loans to be cost effective. o A risk of tie-ups is that problems with product quality could result in default or negative image regarding the MFI. o Regulatory norms restrict the overall portfolio allocation for such loans.

Source: Interaction with MFIs.

Box 3.1 A case against purpose-specific loans

Some MFIs feel that it is not necessary to structure separate consumption purpose loans, as money is fungible and clients invariably use a small part of their income generation loans for consumption anyway. The MFIs are wary of emergency loans because they can be frittered away on impulsive expenses. Suresh Krishna, MD of Grameen Financial Services, takes a different view, saying,

> *We are too caught up in ensuring that clients use every rupee productively to generate income. This is unrealistic. Clients also live normal lives and have needs that revolve around family and social events. If an emergency loan is used for a family celebration it is something we have to factor in while designing the loan. Stipulating that all loans must be used for productive purposes only encourages clients to lie or misuse the loan. This is why GFS has structured a separate loan for each of the important consumption needs in addition to income generation loans.*

Source: Interaction with MFIs.

which the other group members were reluctant to co-guarantee. This posed a dilemma to the MFIs—whether to let go of these good clients or to structure new products for them. In response to such needs, MFIs like CASHPOR, SHARE, Spandana, Bandhan and SKS raised their upper lending limits and offered individual loans to their graduated borrowers. Other MFIs designed star borrower programmes and offered business development trainings and hand-holding support. Products for graduated borrowers and middle-income level clients are structured with monthly or daily repayments, based on the nature of business cash flows. Such loans are usually administered by a separate set of staff or even through separate branches.

SOME OF THE MFIs IN THIS SPACE: Satin CreditCare in Delhi was a pioneer of individual lending. The product entailed daily collections at the client's shop and was very popular with traders. Other MFIs such as Spandana, Future Financial Services Ltd and SHARE designated separate branches for 'daily collection loans'. CASHPOR's

bada loan was developed for clients who had successfully repaid the highest permissible group loan of ₹18,000.

Table 3.3 Individual loans

Client-centric practices	Benefits	Caveats
• Detailed appraisal of client businesses to ensure that business volume can support repayments. • Ensure that client also has a savings route by disbursing the loan only in a savings account.	✓ Group clients have an aspirational target to reach, which acts as a good repayment incentive.	o Loan size and repayment period are now constrained by regulatory restrictions leaving very limited scope for flexibility in product design.

Source: Interaction with MFIs.

Box 3.2 CASHPOR's individual loan product

CASHPOR offered its *bada* loan[1] to clients who had successfully completed three cycles over minimum two years. Loan size ranged from ₹15,000 to ₹25,000 and clients were required to open a savings bank account into which the loan amount was deposited. Guarantee by a family member was compulsory and both client and guarantor were insured. Repayments were in 46 weekly instalments over 52 weeks, leaving scope for flexibility in low-turnover periods of the business.

Source: Interaction with MFIs.

Targeting different client segments

The MFIs based on market research and client feedback began to cater to specific target segments, which were completely distinct from the joint-liability-group lending segment. Client segments are defined by socio-economic characteristics. The MFIs identify such groups and structure products to suit their specific needs, constraints or behaviour patterns.

Bhartiya Samruddhi Finance Ltd (BSFL), a pioneer in product development, designed product and processes for lending to groups of male entrepreneurs, farmers and people in remote rural areas by not only designing loan processes to suit their needs (bullet repayments, collections from place of enterprise), but also undertaking livelihood support activities. BSFL also designed extension of crop loans and livestock loans exclusively to farmers, scheduling the repayments as per their cash flows. Similar loans were structured for sheep rearing and purchase of agriculture inputs. Farmers formed joint liability groups (JLGs) of 4–6 members and repaid loans in bullet repayments after 3–6 months, or enjoyed a moratorium of a few months, making monthly payments thereafter. These loans performed very well, even during loan waivers and political campaigns, until the AP crisis.

South Indian Federation of Fishermen's Societies (SIFFs) organizes artisanal fishermen into fish marketing societies to improve their income. Fishermen take loans from market agents to buy usually nets and for working capital and occasionally even boats. Although these loans appear to carry no interest, fishermen have to sell all of their catch to the market agents at a price determined by the buyer. The SIFFS makes an inventory of all the outstanding debts of fishermen and provide fishermen with a 'debt redemption' loan to pay off their loans to fish buyers. Although interest of 12 per cent per year is charged on these loans, fishermen can obtain higher prices by selling their fish in the open market. The Fish Marketing Society (FMS) organizes the collective sale of fish of its members and fishers on an average earn 30 per cent more income from fish sold through the society as compared to the market agents.

Several poor families migrating out of Tamia block of Chhindwara district in Madhya Pradesh as seasonal labour take credit from contractors to meet their migration-related expenses. The contractors in turn force them to work for meagre wages. To remedy this, local MFI Mahila Smriddhi Bank-Pararth Samiti piloted a four-month migration loan with a bullet repayment to enable migrants to earn their full wage—usually amounting to 60–80 per cent more than if they borrow from the contractor. The loan is repaid when clients return; prompt repayment forms a good credit record for accessing finance before the next migratory season.

Mahasemam Trust/SMILE offer a loan product to destitute persons of ₹1,000 payable without interest in instalments decided at the time of the disbursement by the beneficiaries.

The MFIs were largely catering to rural households. Several new MFIs entered the market in late 2000s with well-thought-out strategies for serving hitherto-ignored segments such as the urban poor. While these MFIs met the credit needs of their clientele through standardized group products, they spent considerable effort to understand the other financial needs of their specific target segments. Among these, Swadhaar FinAccess, Arohan, Ujjivan Financial Services and Janalakshmi Financial Services were prominent—all these institutions focused

on the urban poor and developed unique processes and loan products to suit the urban context better.

Asset creation loans

Loans for income generating activities usually range from ₹6,000 to ₹25,000—enough to fund working capital requirements of small businesses. However, MFIs were often requested to extend loans for home improvement, house construction or land acquisition. While most MFIs perceived such loans to be risky because of the large size and lack of incremental income generation, some institutions responded to this need, realizing that better housing would have positive implications on family quality of life and even economic productivity since women's enterprise is largely home based.

SOME OF THE MFIs IN THIS SPACE: BSFL, Swarna Pragati, Shalom Trust, Janalakshmi for housing loans; Margdarshak (livestock loans), Rickshaw Bank (rickshaw loans).

Bhartiya Samruddhi Finance Ltd introduced the Grah Samruddhi product, which was developed in response to demand from rural clients for housing finance. Despite high demand and good product design, the lack of land titles in rural areas proved an obstacle. BSFL then piloted its Rahen Sahen Samruddhi product, developed in association with Micro Home Loan Solutions (MHLS), in Mangolpuri and Sultanpuri colonies in Delhi. Forty-five clients having appropriate monthly cash flows and the original land allotment slips[2] from Municipal Corporation of Delhi were selected for the pilot. Bhartiya Samruddhi Finance Ltd collaborated with ACC cement to conduct workshops on building structure norms. Bhartiya Samruddhi Finance Ltd also tied up with Baliga Trust, which had been working in the area for 30 years, to promote the product and educate customers on terms and conditions. Loan sizes ranged from ₹50,000 to ₹300,000. Technical assistance was provided by MHLS, including the building plan and construction norms. Clients were charged a 3 per cent technical assistance fee and 3 per cent processing fee and are paying 27 per cent interest per annum. Loan tenure was fixed at five years, with monthly repayment and an offer of 2 per cent interest rebate for timely loan closure. Following the AP crisis, the loan has been discontinued.

Shalom Trust has offered a housing loan for new house construction, which also carries incremental disbursements, made on completion of the foundation, walls, roofing and plastering. To give clients enough scope to pay off the loan without facing income constraints, Shalom designed the loan with a 10-year term with moratorium for six months, supported by guarantee of fellow group members. To ensure that clients do not resell or rent the new house, Shalom only extends the loan to clients currently living in very poor quality housing and demands that clients and their families render not less than 50 hours of labour in construction of the house. Loans are also given for renovation and repairs and sanitation/electrification.

Box 3.3 Friendly housing loans

One of the key observations of the NABARD Committee on Rural Habitat is that there is a need to cater to the housing requirements of the very poor, who prefer to undertake house construction in incremental stages, for which appropriate financing products need to be designed. The committee has recommended that short duration incremental housing loans for different components such as laying foundation, tiled roofing, flooring, fixtures, etc., should be provided in a modular funding model at different points of time. Swarna Pragati has introduced such incremental housing to ensure that progressive upgradation/construction of a house is financed in modules of ₹10,000–20,000. Loan amounts average ₹40,000–80,000 released in small modules, with loan terms ranging from 36 to 48 months. Borrowers complete the construction of their homes through a series of loans.

Source: Interaction with MFIs.

Responding to a severe shortage of good quality urban housing, Janalakshmi Social Services (JSS, the parent institution of Janalakshmi Financial Services [JFS]) promoted Janadhar Constructions Pvt Ltd (JCPL), a company exclusively engaged in construction of low-cost housing. Janadhar Constructions Pvt Ltd tied up with builders having core competencies in low-cost design to build low-cost apartments for families with monthly income of ₹15,000–25,000. The loans extended by JFS are up to 80 per cent of the cost of the apartment (₹6–7 lakhs) at 12.5 per cent interest per annum for a tenure of 15–20 years. Janadhar Constructions Pvt Ltd has enabled many lower income families to own a home by selling the apartments at cost price and arranging for financing through JFS. The project is being scaled up, and JFS is in talks with National Housing Bank for funding.

Realizing that many families which owned just one milch animal faced problems during its lean period, Margdarshak recently piloted a 'Second cattle financing' loan of ₹25,000. Clients who have

completed a year of good repayment and already own one milch animal are eligible; the loan aims to compensate loss of milk yield during the lean period of the first animal. Loans are extended jointly to husband and wife as both are intended to participate in the livestock upkeep and milk sale. Technical training is provided by Margdarshak's expert livestock officer. Livestock are insured at ₹1,700 for the two-year repayment period. Through this loan Margdarshak has not only ensured that income from milk sales is continuous, but has also ensured maximum productivity through technical training and coverage of risks through insurance.

Another unique example of catering to client needs is Rickshaw Bank, which enabled a large number of rickshaw pullers to invest in efficiency-enhancing rickshaws, so that they could own the vehicle in 18 months instead of making daily rental payments to owners. Rickshaw pullers were also able to enhance their income as the superior design of the re-engineered rickshaws increased their efficiency and speed, enabling them to fit more trips into a day.

Table 3.4 Loans for assets

ASSET CREATION LOANS		
Client-centric practices	**Benefits**	**Caveats**
• Tie-ups with construction companies/technical service providers are essential for housing loans, as both clients and MFI will benefit from superior asset creation or maintenance. • It is essential to insure the asset as well as the key breadwinners of the family against death and accidents. • Proper appraisal must be done to ensure that clients can repay instalments on such loans without undue burden; payments can be structured over a longer term if necessary.	✓ Such loans offer aspirational value to existing group clients and also act as a good selling point for attracting new members. ✓ Asset financing can be provided far cheaper by MFIs than by other non-bank providers.	o Loan sizes are constrained by the RBI guidelines, so home loans will fall out of the priority sector lending norms. o Such loans may be at high risk if underlying asset quality is not good. In situations where fake titles to land are produced, MFIs may face risks later. o Sudden loss of income source for the client or key breadwinners in the family may severely affect the repayment rate.

Source: Interaction with MFIs.

OTHER FINANCIAL SERVICES

Although MFIs are constrained by regulation and are not yet able to offer their own savings, insurance and investment products, tie-ups with other providers may be of relevance to customers. The MFIs have a better awareness of customers' requirements and could provide useful product design inputs for large-scale providers. Third-party providers would consider making product tweaks if the MFI has the capacity to generate sizable business volumes. For example, CASHPOR leveraged its extensive outreach in Uttar Pradesh (UP) and Bihar to bargain with insurance companies to get a higher coverage for their clients without paying a higher premium. 'Other financial services' described in this section include savings through BC arrangements, and pensions and insurance through tie-ups.

SAVINGS - Janalakshmi has leveraged its parent organization JSS to enter into a BC arrangement with Axis Bank. Clients can save weekly, fortnightly, monthly and even on demand. Janalakshmi Social Services staff operate from JFS branches at marginal incremental cost. Staff are equipped with Axis Bank's point of sale (POS) terminals to do real time reporting of collections, directly synced to Axis Bank's core banking solution (CBS), thereby preventing any fraud. Janalakshmi Social Services has so far overachieved on its target accounts per month. Eighty per cent accounts are active with an average balance of ₹450–500. Only 20–25 per cent of savings customers are existing JFS clients, which opens up a large potential pool of new relationships for JFS.

INSURANCE - PFSPL (KGFS): Pudhuaaru Financial services Private Limited provides its clients tie-up products for Personal Accident Insurance (2.4 lakh policies), Term Life Insurance (0.76 lakh policies) and Livestock insurance at reasonable rates. What sets PFSPL apart from other MFIs is that its insurance products are entirely voluntary and that its compulsory credit life insurance for loan clients is not charged to the clients but paid for by PFSPL itself. All PFSPL unsecured loan borrowers aging 18–60 are protected through a credit-life insurance with Kotak Life Insurance (premium paid by PFSPL, outstanding loan covered). Health insurance and weather insurance tie-ups are being explored.

PENSION – Janalakshmi, through a tie-up with UTI Investment India Micro Pension Services (IIMPS), has offered its group loan clients the option of investing ₹100, 200 or 500 per month in a micro-pension scheme with minimal exit charges depending on time of redemption. The product has 40 per cent uptake among JFS's loan clients (70–80 per cent uptake in the southern and western states). Clients can call a 24-hour toll free number to seek clarification on product terms, balances, returns, etc. Bandhan has enrolled 1.41 lakh customer families in the New Pension Scheme as at the end of

Box 3.4 Insurance for the poor

National Insurance VimoSEWA Cooperative Ltd (VimoSEWA) is registered under the Multi State Cooperative Societies Act 2002. At present, the insurance services are carried through three variants—*(a)* under VimoSEWA, *(b)* under SEWA and *(c)* under mutual model. VimoSEWA's legal form as micro-insurance agent allows it to retail insurance products of only one life insurer and one non-life insurer and also prohibits it from carrying underwriting risk. While operating under SEWA allows it to have tie-ups with more than one insurer, under the mutual model it also carries part of the underwriting risk. VimoSEWA has engaged with insurance companies to influence their product design to suit low-income members. Since inception in 1992, the product range has become comprehensive, covering credit life, life, endowment, hospitalization, health and assets. Considering the preference of the poor for bundled products, combination products covering health, life and asset are also being offered through the mutual model. As per extant Insurance Regulatory and Development Authority (IRDA) guidelines, agents like VimoSEWA cannot charge any additional premium while distributing insurance products and have to cover their costs through commission received from the insurance company. For a stand-alone micro-insurance agent like VimoSEWA, these regulations make viability difficult.

Source: Interaction with MFIs.

July 2012. Kshetriya Gramin Financial Services has enrolled 28,000 customers and has made it a part of its product basket. Similarly, several other MFIs too are enrolling their customers under NPS Lite.

REMITTANCES – Some MFIs now offer international remittance facilitation by acting as agents of Western Union Money Transfer. With the proliferation of CBSs, domestic remittances have become easier through direct deposits in beneficiary savings accounts, which can be withdrawn from any ATM at the destination point. However, doorstep services for remittances are as yet a distant prospect.

APPROPRIATE PRODUCT DESIGN

An important part of the harmonized code of conduct is 'Appropriate Product Design'. The sector's critics point out that microfinance products had been most inappropriate for the poor, in terms of high price, short duration and inflexible repayment terms. In response, several MFIs are restructuring their products, revising their collection practices and writing off interest and suspending group guarantee. The RBI guidelines brought in wide ranging norms directed at customer protection including interest rate and margin caps, loan ceiling and repayment options, which will indirectly curtail possibilities for innovation. The MFIs are constrained to operate within the regulatory guidelines; they may not yet be able to structure their products to suit client needs and demands completely.

The regulatory norms in some aspects run counter to social performance principles; a very narrow income norm for customer selection excludes several households that can potentially benefit from microfinance loans; the narrow income norm entails dropping of long-standing customers that improve incomes beyond the threshold, compulsory longer

Table 3.5 External tie-ups

OTHER FINANCIAL SERVICES		
Client-centric practices	**Benefits**	**Caveats**
• MFIs with extensive outreach can bargain hard with service providers for the most beneficial deals for their clients.	✓ Providing such tie-ups builds several links between the clients and MFI, forging a deep relationship and ensuring client retention.	o Explanation of product terms and conditions has to be done very carefully, as misunderstanding may lead to default on loans, which remain the primary driver of earnings for MFIs.

Source: Interaction with MFIs.

Box 3.5 Advisory service from Janalakshmi

In July 2012, Janalakshmi launched its new initiative JanaOne, a one-stop shop providing a bouquet of 'customized financial advisory services' with appropriate, customized products to existing customers of two-year vintage and successful repayment record over minimum two group loan cycles. The services included are *(a)* individual loans of ₹50,000–200,000 *(b)* medium term savings through endowment products, *(c)* insurance products to cover a variety of risks (through tie-ups) and *(d)* micro-pension services through tie-ups. JanaOne staff will take a client through a detailed financial mapping exercise to advise them on the most suitable products for their needs.

Source: Interaction with MFIs.

repayment period interferes with the financial planning of borrowers and introducing tight margin caps on larger MFIs restricts expansion to underserved and remote areas. The hardwiring of interest, size, term and customer segment in the regulatory norms severely limits the scope for innovative product design, especially in loans for longer term maturities. When evidence of more responsible lending and field conduct becomes available, the regulator should ease restrictions on MFIs and enable them to offer more varied and appropriate products by removing some of the customer-unfriendly restrictions.

SCOPE FOR EXPANDING SERVICES IN THE CURRENT REGULATORY ENVIRONMENT

The Microfinance Bill indicates that MFIs can offer insurance, pension products and remittance services to their clients. This bodes well for MFIs as it gives them an opportunity to move towards more comprehensive provision of financial services. However, it must be noted that while institutions like VimoSEWA have made great strides in providing insurance to the low-income groups, their experiences have remained isolated islands of excellence which few other MFIs have sought to emulate due to the regulatory restrictions involved. The IRDA strictures on community-based/mutual insurance models remain restrictive. The IRDA has recently publicized its intention to devise guidelines for the Indian micro-insurance segment. The new Swavalamban Scheme[3] offered by the Pension Fund Regulatory and Development Authority (PFDRA) is a valuable opportunity for low-income individuals and MFIs would do well to market this product among clients. When the bill becomes law, hopefully MFIs will be in a position to offer a basket of customer relevant products and fully meet their needs.

Box 3.6 Innovation with a customer focus—the case of KGFS

The KGFS model is a deliberate strategic shift away from maximizing product sales and towards maximizing the financial well-being of households and enterprises within a community. It was developed to understand and address customer's needs as they evolve. Different providers of financial products and services were meeting requirements of the household on a piecemeal basis, but the customers wanted reliable, flexible, convenient and continuous services, but these needs were not being met. Kshetriya Gramin Financial Services sought to remedy the situation by keeping customers at the centre of their operations. Core principles of KGFS include: *(a)* a localized institution focusing on a limited geography is best suited to account for differences in culture, demographics, availability of local infrastructure and other such constraints; *(b)* village-based brick-and-mortar branches to ensure easy access and build trust; *(c)* a 'shift to an advice-based framework of wealth management' ensures that the burden of taking optimal decisions does not rest with the client. The physical presence of the KGFS branch and Wealth Managers (WMs) in a village makes it easy to really know the financial life of each customer and their family. The ongoing dialogue of WMs with KGFS customers ensures that KGFS is there to observe, and at times pre-empt, actual and potential threats to each customer's financial well-being.

Low-income households need to have the ability to move their resources between lean times and flush times, to protect their income from risk and to diversify their assets. Wealth management, encompassing a complete suite of financial products, addresses this need. KGFS offers group loans, gold loans, retailer loans and salary loans. Insurance (credit-life, life, accident, livestock); savings, pensions and remittance facilities are offered through tie-ups. The wealth management process is designed to systematically improve the financial well-being of households and enterprises. The process is engineered to help people plan for future responsibilities, to grow the resources they already have, to protect themselves from unnecessary risks that would stifle that growth and to diversify themselves out of their local economy.

The WMs collect information about each member of the enrolled household, including assets, liabilities, income and expenses along with goals to which the household aspires. The WMs use the data to present the client with a diagnostic, auto-generated report that details the state of the customer's financial well-being. A WM is permitted to sell a product to a customer only if it contributes towards improving the customer's financial well-being. In order to prevent wrong advice being given, WMs are not incentivized on product sales.

An interesting aspect of KGFS's products is that there has always been a focus on what the client needs, and how to provide this in a cost-effective,

efficient way. While MFIs shied away from gold loans, KGFS recognized that a large proportion of customers wanted a cheaper alternative to the pawnbroker. Kshetriya Gramin Financial Services provides gold loans in its operational area at lower cost than competitors—the product has been a resounding success.

Kshetriya Gramin Financial Services follows a continuous and systematic effort to deepen the understanding of its clients and integrate it into its evolving products and processes. Kshetriya Gramin Financial Services' robust customer management system acts as an online centralized warehouse for all household and enterprise data and enables it to conduct client-level analysis and identify trends and patterns. This analysis leads to insights that change products, processes and other aspects of the model. Feedback from staff and customers is taken very seriously and feeds into new product development.

The CEO of PFSPL (formerly Pudhuaaru KGFS) says, '*Innovation is core to our business model, we strongly believe that any financial inclusion model should be based on innovation and suitability—understanding the needs of the customer and providing products/services which satisfy those needs, by making best use of technology*'.

Source: Interaction with MFIs.

SUMMING UP

The MFIs in India have historically displayed mixed enthusiasm in experimenting with new products on account of their own imperatives as well as regulatory limitations. However, many MFIs have powered innovations within the regulatory ambit to offer enterprise loans, asset creation loans, loans for consumption needs and non-financial services. The AP crisis and renewed focus on clients would ideally have served as a platform for more innovation, but while the RBI regulations and proposed Microfinance Bill have recognized MFIs role in India's financial inclusion landscape, regulatory restrictions also have restricted the freedom to design appropriate products. With 'loan business' regulated and margins thinner than before, MFIs need to search for new avenues to serve customers whilst maintaining their own sustainability. While responsible finance requires design of good, customised products, good products establish the positive intent of the MFIs and can drive the social performance agenda. Although MFIs have been reluctant to move away from their specialization of financial services delivery, it would be useful to explore provision of non-financial services that are crucial to their operational area, especially to their key client segments. Not only will this build loyalty and a lasting relationship with their clients, it may also positively impact repayment rates as the quality of life of clients and their families improves. In doing so, MFIs would also protect themselves from being viewed as moneylenders and opportunists.

NOTES AND REFERENCES

1. The product was discontinued in compliance with RBI guidelines but will be reintroduced with appropriate changes in the near future.
2. Though the allotment slips constitute a non-enforceable guarantee as the property is non-transferable, people fear losing it as it signifies their title to the land.
3. 'Swavalamban', a co-contributory pension scheme for workers in unorganized sector, has been launched in September 2010. The central government shall contribute a sum of ₹1,000 per annum to the workers in unorganized sectors who contribute a sum of ₹1,000–12,000 per year in their pension accounts during the financial year 2010–11, are not in regular employment of the central or the state government or any of their entities or not covered by any of the social security scheme.

Beyond the business of finance[1]

4

Chapter

A closer look at many of the MFIs tends to suggest that the negative image of MFIs not being social enough comes from the behaviour of few MFIs and also from unverified opinions of many commentators and journalists in the sector. For the purpose of this report, a review of the activities of MFIs to improve customers' livelihoods and their welfare was carried out. The review covered non-financial activities carried out either directly or dedicated groups entities or through third parties. The analysis shows that most MFIs do not stop with financing their customers; they are active in helping customer households in health, education, skills training, housing, marketing and a variety of other aspects. This chapter provides both study-based and anecdotal information on what can be construed as socially oriented performance that makes a difference to lives of customers and their households.

NON-FINANCIAL SERVICES

While some institutions sought to retain client loyalty by providing their existing client base with these services, others tried to build bridges with the community at large. A few MFIs have ploughed back part of their profits in the form of support to destitute and ultra-poor, who need food subsidies, vocational training, income-generating assets and quality education to rise out of poverty. While providing crucial aid to the poorest, MFIs also view this as investment in a potential future market segment.

Focusing on quality of life, some MFIs have sponsored scholarships for clients' children, funded medical treatment for clients and their families or organized health camps. In rare cases, non-financial services such as business development training or aid in sustainable farming practices have been restricted to the best borrowers as an incentive for good repayment.

A few MFIs have structured non-financial services to complement their financial relationship with clients by designing financial literacy programmes, which are undertaken in-house or by third parties. By recognizing that financial services are not a panacea for all ills and responding to non-financial needs, MFIs have begun to engage with clients and the community on a variety of issues. Such interventions result in positive outcomes for beneficiaries, whilst strengthening MFI–community relationships and providing for future stability.

Many MFIs have set up a separate entity with clear social and welfare objectives in a non-profit form for delivering non-financial services to customers and their families. Some of them directly take up programmes with a clear social content. The content of programmes differs from MFI to MFI, though education and health seem to be fairly common aspects of focus, perhaps responding to the intensity of customer needs.

Table 4.1 gives the summary of such non-financial services offered by some the MFIs. The list is not exhaustive but only a sample of the non-financial services provided by MFIs.

Education and literacy

Mostly the initiatives are aimed at making the children of the customer household attend school and run specialized coaching to enable the children to do well in their studies. While some MFIs run coaching centres, some have opened schools. Some other offers scholarships for children to pursue studies. Hand-in-hand (HiH) focuses on school dropout adolescents and educates them in a residential bridge school and later enrols them in a regular school as part of a child labour elimination

Table 4.1 MFIs and their non-finance activities

Name of MFI	Name of group entity	Nature of activities in the SPM space
Bandhan	Bandhan Konnagar	Ultra-poor uplift, health, education, employment, livelihoods
Gramin Financial Services	Grameen Koota, Navyadisha Trust	Education, socio-economic development, financial literacy, water, sanitation, health care, housing
Janalakshmi Financial Services	Janalakshmi Social Services, Janaadar Constructions	Financial inclusion, literacy, JanaOne advisory services, low-cost housing, youth skill training
Ujjivan	Parinaam Trust	Health, vocational training, education, water, financial literacy, ultra-poor uplift
Equitas	Equitas Development Initiatives Trust	Health, education, skills training, job placement, environment, food security, pavement dweller rehabilitation, market linkages
Hand-in-hand	Direct and covers clients of Belstar, NBFC, a group company	Education, health, water, sanitation, environment, enterprise development, skills training, livelihoods
SKDRDP	Direct	Rehabilitation, education, environment, and women empowerment
ESAF Microfinance	ESAF Trust	Education, Health, environment, water and sanitation, disaster relief, enterprise development
Anjali Microfinance	Direct	Education, sanitation, skill development, enterprise development
Grama Vidiyal	Direct	Disaster relief, health care, empowerment
Smile	Direct	Health, education, legal-aid
CASHPOR		Education, health care, skill development
Sonata	Direct	Health camps
Suryoday		Functional literacy, disaster relief, enterprise development
SKS microfinance	SKS foundation	Ultra-poor uplift
IDF financial services	IDF foundation	Livelihoods of landless, improved agricultural practices and livelihoods, enterprise promotion
BISWA		Water, Sanitation, education, grain banks, health
BASIX		Water, livelihoods, skill training
Guardian		Water, sanitation
Indur Intideepam MACs	Direct	Financial literacy
Bagnan Mahila Co-operative	Direct	Vocational trainings, awareness programmes
Utkarsh	Samutkarsh Welfare Society	Vocational training for self-employment, financial literacy trainings

programme. Bandhan had opened 65 preparatory schools to prepare children (both preschool children and those who dropped out at an early age) to join regular schools. Equitas has opened two full-fledged schools named Gurukul with all facilities where admission is restricted to the customers' wards. Apart from this, it runs tuition centres for the children of customers in many locations. Parinaam Foundation reimburses the interest paid on education loans provided by Ujjivan; in deserving select cases, scholarships are provided for continuing higher education for poor students. ESAF runs 14 childcare centres in Jharkhand, which it plans to ramp up to 300 over time. Several other MFIs have their own models of supporting education and bringing children to school, restoring dropouts to school with funding coming from the MFI and also sourced from donors.

Financial literacy is also a theme for many MFIs. While customized courses are designed and delivered to the customer groups (as in the case of Ujjivan), innovative means are also adopted by others. Grameen Koota uses a virtual person Jagriti to write a letter to the members on functional literacy themes, which are read out in the group meetings by the field officer.

Box 4.1 A firsthand account of 'Jagruti' at work*

At the end of the group meeting, the loan officer read a letter of Jagruti, which is a fictional person telling stories to the group. In each meeting Jagruti is sharing her experiences with the clients. It is astonishing to see how the women listen with full concentration. They see Jagruti as a true friend. This week the story is about Jagruti's visit to a private hospital. Her child fell down and she needed medical help. Jagruti is complaining about the terrible circumstances in the hospital, particularly the lack of hygiene. Her friend tells her she should visit the public hospital. Jagruti argues why she visited the private clinic but after the conversation with her friend she realizes she can better go to the public hospital next time. The stories of Jagruti bring social cohesion to the group and also have an important educative objective. The women tell me they would like to meet Jagruti.

* Theo Brouwers, MD, SNS Impact Investing, blogging on a field visit in May 2012.

Health

In case of health, there are different ways in which MFIs have gone about supporting their customers. The first is that of health camps for screening of customers and their families periodically and dealing with cases that need further treatment. The second is that of taking up programmes such as malnutrition prevention, anaemia care on a long-term basis. The third method is to tie-up with clinics and hospitals for treatment of illnesses for customer families at a concessional rate negotiated by the MFI. In these cases, treatment might be sometimes subsidized by the MFI. The fourth is to establish health care programmes that have the features of a mutual insurance scheme, linked to in-house or third-party hospitals. Some MFIs have set up hospitals or clinics for the use of their customers. Of all the different social measures, coverage of customers is the highest in health care. The health camps linked to follow-up on treatment in cost effective hospitals have been a boon to several customers. Nineteen MFIs had covered 3.8 million customers (more than 20 per cent of the customers on their books) under their health care programmes according to a recent study.[2] Equitas reported having covered about 7 lakh households under health camps. While most MFIs provide health education to customers, some (such as BWDA, Gram Utthan, Community Development Society and Bandhan) employ health volunteers and distribute health products. A few MFIs have entered into contract with hospitals. While Mahasemam trust has a mobile clinic, Equitas has telemedicine project through which patients can have real-time pathological tests and access the best doctors in designated hospitals. Grameen Koota through a group institution offers a hybrid mutual health insurance at very reasonable rates for nearly 1 lakh clients through tie-up with hospitals for both out-patient and hospitalization treatment of the clients and their household members.

Skills training

Many MFIs offer vocational skills training to their customers to improve the livelihood situation through better employment or higher income opportunities in their enterprise activity. The skills ranged from traditional activities such as making ethnic food, agarbattis, tailoring, embroidery, baskets, bags, dolls, etc., to non-traditional areas such as making soap, phenyl, repairing cycles, repairing mobiles, skills of beautician, etc. In some cases, MFIs hired dedicated master trainers to train the customers and in others there were tie-ups with institutions that provided such training. Some MFIs provided special easy loans to customers to meet training costs, where the training was expensive, but many offered the training at no or nominal cost. There was also an attempt on the part of MFIs to either place the trained persons in jobs or provide loans to them to help start an enterprise.

Enterprise development

Some MFIs also offer enterprise skills training to their customers and finance their enterprises. Support through incubation of the budding enterprises is also offered in some cases. While MFIs have to provide income generating loans, the access to viable markets for products and services arising from such activities will improve the financial position of the customers.

Hand-in-hand has a two-stage training for enterprise promotion for the SHG members borrowing from HiH as well as Belstar, NBFC: initailly the enterprise promotion awareness training is provided and thereafter interested women are trained in specific enterprise/vocation. On the basis of enterprise promotion training, HiH groups the further needs of women into six categories and arrange for specific interventions.

Marketing support is extended by a number of MFIs to help their customers sell their produce at fair prices. Madura Microfinance, ESAF microfinance, Bandhan, IDF Financial Services and Equitas are some among the many MFIs that report establishing market linkages for their customers.

Box 4.2 ESAF market linkage

ESAF Microfinance through (EMFIL) ESAF Retail Ltd arranges for marketing of customers' products. Locally produced food and consumables, manufactured by its group members are marketed under the Swasraya Bazar brand through six stores in Thrissur, Kerala. Products are sourced from primary producers; price benefit is passed on to consumers. ESAF's team inspects product quality and also provides training in packing, branding, grading, etc., thereby ensuring that locally sourced products are made saleable in mainstream retail stores. Group members who are successfully linked are trained to increase production capacity for economies of scale.

Water and sanitation

Ensuring access to safe drinking water and improving sanitation facilities have been priorities for a number of MFIs. Setting up potable safe water plants where ground water is unsafe, provision of water filters and spreading awareness of improving water quality are some of the steps taken by MFIs. In the case of sanitation, apart from awareness building events, more efforts have been through loans for construction of toilets. Water.org has been a partner for many MFIs in this space, helping them to structure loan products coupled with technical inputs on safe, low-cost technologies. The MFIs have also made use of CSR projects of other institutions to bring down the costs and access state-of-the-art technologies. Ujjivan provides interest free loans to customers for water filters. Ujjivan has also covered more than 3 lakh households in a water awareness programme named Jalamitra and provided interest free loans to buy water filters to 0.44 lakh households.

Rehabilitation of ultra-poor

Some MFIs have been engaged in working with hard core poor that are not bankable with a view to bring them to a level where they can pursue their livelihood activities with confidence and be able to access services from mainstream institutions. While SKS Microfinance was an early entrant in this initiative, Bandhan, Ujjivan and Equitas are active in this space. While Bandhan has a large programme covering more than 50,000 beneficiaries with support from Axis Bank, the others have a smaller scale. These programmes select extremely poor families and provide them initial support for food security and livelihood assets, training and handholding so that the income level improves. With sustained support over a period of two years or more, the households seem to be able to stabilize in their livelihoods. A brief write up on Bandhan's hard core poor programme is given in Annex 4.1.

Box 4.3 The hard-core poor programme of Bandhan—a case study

Mafusa Begum was enrolled in the 'Targeting the Hard Core Poor' programme of Bandhan in August 2011. Her husband has been suffering from tuberculosis. She has five daughters and two sons. She has been identified through PRA and Wealth Ranking conducted in the village by Bandhan staff. She has been provided an initial training for selection of an enterprise as per her capacities. She then selected selling of cosmetic and decorative items for the household, which she sells in the village. She was provided with goods worth ₹7,063 for the enterprise (in three instalments) and a subsistence allowance of ₹140 per week for seven weeks (45 days) for household consumption. With savings from the support for consumption, she bought 10 hens and is growing vegetables in her kitchen garden. She has also bought a second-hand cycle from her income and now goes to the village in the cycle with the help of her younger son to sell the goods. Mafusa Begum's confidence to undertake such activity and continue it lifelong was evident through the discussions during the visit to her home. There are around 8–10 such beneficiaries in each of the villages where Bandhan has provided the grant and training to undertake such an activity, which has helped them not only to sustain themselves but also to instill confidence in their own ability to undertake such an activity and live a life of dignity in their village.

While Bandhan prioritizes women-led households, Equitas focuses on pavement dwellers and rehabilitates them into living a normal life under certain housing conditions in low-rent accommodation.

Box 4.4 Bird's nest of Equitas

Dealing with pavement dwellers—step by step approach:

a. Seed the idea of moving into a house into the minds of those living on pavements.
b. Map their current livelihood patterns and the amount of money they are earning.
c. Identify skills which they can learn and then teach them those skills.
d. Help in market linkage enabling them to earn money out of the skills they learn.
e. Identify houses (mostly in nearby slums) and pay the security deposit on their behalf.
f. Equitas pays the first six months' rent on their behalf to the house owner.
g. Equitas provides them groceries worth ₹750 per month free for the first six months.
h. During these six months, ensure that the skill they have learnt is being used by them and through market linkage, they start earning higher levels of income.
i. From the seventh month, they start paying the rent and buy groceries on their own, which should be possible because of higher earnings of the family.
k. They are handheld for the next one year, viz., seventh to eighteenth month to help them stabilize in their new environment and consistent and continued earning capacity.
l. The beneficiaries are encouraged to pay the first six months' rent back to Equitas, at their convenience, though not strictly pursued.

About 100 families have so far been moved from pavements in Chennai into houses under this scheme and 90 families have completed more than six months. The challenge is to ensure that after the first six months, when they have to start paying rent, they do not go back to the pavement. All the 90 families have stayed on in the houses. Also, the first set of families which have completed 18 months have started repaying the rent for the first six months paid on their behalf. With facilitation from the project, these rehabilitated families have received their Voter ID cards, which is the first step towards their joining the mainstream.

Leveraging human resources

The MFIs that are able to leverage their own resources and operations network can provide non-financial services in the course of microfinance operations. Credit and Saving for the Hard Core Poor has demonstrated this quite successfully. Centre Managers[3] in select branches provide 15 minutes of health education for clients in each centre meeting after conducting their regular loan transactions. Fifty-seven per cent clients have been covered till date. The CMs have been trained by CASHPOR's training department with inputs from Freedom from Hunger and the Micro Credit Summit Campaign. In partnership with Healing Fields Foundation (HFF), CASHPOR has also trained 90 clients for six months to become a full-fledged Community Health Leaders (CHLs). Each of such 90 CHLs provides health intermediary services to 300 client households, thereby reaching a population of around 135,000. Credit and Saving for the Hard Core Poor hopes to improve health seeking behaviour, hygiene and dietary habits and increase awareness of healthcare programmes offered by the government to reduce incidence of preventable diseases over 2–4 years.

Samhita realized the benefits of financial literacy training from the overwhelming client response to its pilot programme; financial literacy modules were subsequently integrated in the pre-enrolment training to nascent groups. Samhita has gone a step further and tied up with the New Pension Scheme (NPS) Lite pension product, after customers became aware of the benefits of pension and began demanding the service. Responding to lack of client awareness regarding rights and responsibilities on a variety of issues, Grameen Financial Services has also undertaken a client education initiative, covering health, sanitation, gender issues, combating alcoholism and many other relevant topics through a weekly letter written from a fictional client 'Jagriti', read aloud by field staff at the centre meetings.

To conclude, a deeper examination of the MFI landscape and their efforts in the field indicate that the MFIs are not soulless entities that invest in business models with profits as the only motive.

Box 4.5 Comment by Praseeda Kunam of Samhita

Praseeda Kunam of Samhita says, '*Financial literacy is absolutely essential for microfinance clients. Our agenda as MFIs should be to empower the poor with awareness to secure and build on the little money they have, not just to lend to them*'.

Table 4.2 Non-financial services

Client-centric practices	Benefits	Caveats
• Non-financial services must be designed by the MFI in response to the client base or community's needs and not arbitrarily undertaken merely to portray itself in a good light. • MFIs need to analyze their competencies and internal resources before deciding whether to provide such services directly. Sometimes, third parties are better equipped to provide these services on behalf of the MFI. • The MFIs may either apportion a part of the year's profits for non-financial activities or raise grants independently.	Non-financial services help to cement the relationship between the community and the MFI. Local people should be able to identify the MFI's social mission rather than perceive it as just a cheaper alternative to the moneylender.	o Over burdening of field staff should be avoided. o Partnership with third parties should be established carefully to avoid inappropriate product marketing by partners among customers.

There have been significant actions in various socially desirable aspects of customers' lives. The MFIs have made efforts to design suitable initiatives that meet the needs of customers in education, health, employment, enterprise development and functional literacy. The intensive programmes on improving the lives of hard-core poor are good examples of MFIs putting professionalism to work.

The continuing support of promoters, donors, government and other organizations through their CSR activities has been critical to the work of MFIs in the non-financial services that take the extra step towards social performance. Going forward, the MFIs should seek to learn from the projects that are underway and apply learning to expand coverage and forge stronger partnerships with other corporates and government agencies. By doing so, the MFIs will be able to alter the current negative image and show themselves to be responsible and socially relevant.

ANNEX 4.1
Bandhan's programme for graduating hard-core poor[4]

Bandhan Konnagar, the NGO, launched Targeting Hard-core Poor (THP) pilot in 2006 to reach out to those below the scope of regular microfinance. The pilot covered 45 villages in Murshidabad, in north-west West Bengal and ran up to September 2011. Bandhan has scaled up its programme to 10,181 households with its own funding and with support from the Ford Foundation, the Michael and Susan Dell Foundation in urban areas. This is an ongoing programme of Bandhan rolled out in four states, viz., West Bengal, Bihar, Assam and Tripura. During the year 2011–12, the total expenditure was entirely provided by Bandhan.

Bandhan has, with the funding support of Axis Bank, a foundation which is named as Axis Bank Bandhan Holistic Assistance (ABHA) Program that started in 2011–12 where Axis Bank Foundation is a partner and contributes 75 per cent of the programme costs. The intention is to reach 55,000 households in Murshidabad and South 24 Parganas, West Bengal, by March 2015.

Bandhan targets beneficiaries with the following criteria:

Inclusion criteria:

1. The household must have at least one active woman capable of undertaking some enterprise
2. Primary source of income should be informal labour or begging
3. Land holdings below 10 decimals
4. No ownership of productive assets other than land
5. No able bodied male in the household
6. Having school-aged children working rather than attending school

Exclusion criteria:

1. Access to microfinance
2. Subsidies from the government

Identification of households

To identify households satisfying these criteria, Bandhan uses a multiphase process. The initial task of identifying poorer hamlets is accomplished by consulting with local branch managers (of Bandhan's regular microfinance programme) who are familiar with the economic conditions in these villages. Thereafter, Bandhan conducted participatory rural appraisals (PRAs) in the identified villages with 15–25 participants in each PRA. Households from various religions, castes and social groups are encouraged to attend. The PRAs comprises of social mapping and wealth ranking. Social mapping is done to establish the locations

of participating households with respect to prominent village landmarks like temples, mosques, rivers, etc. The wealth ranking categorizes the households into distinct groups based on their assets (including land ownership) and occupational profile.

Each household is assigned a rank on a scale from one to six depending on its category, with lower ranks corresponding to better off households. Following the PRA, Bandhan selects 30 households assigned to the lowest few ranks. Thereafter, a Bandhan employee visits these households to administer a short questionnaire that pertains to the selection criteria for ultra-poor households. Based on the information collected in this survey, the list of potentially ultra-poor households is narrowed down to 6–10 per village.

Package of services

Consumption support: Bandhan provides consumption support in the form of a small cash stipend of approximately ₹114 per week. The duration of the support is customized to the participants' livelihood choices (15 weeks for small trade and 40 weeks for agriculture).

Livelihoods: The basic criteria for allocating an asset to a graduation client are that the enterprise has to be: *(a)* economically viable; *(b)* easily manageable; and *(c)* socially acceptable. Generally, a client's family members and her neighbours are consulted by the project team before deciding upon the particular asset to be transferred. Bandhan offers a variety of enterprises/livelihood options to graduation clients, viz.,

- farm-based enterprises – Livestock (cow, goat or pig rearing), fish selling, vegetable vending; and
- non-farm enterprises – Bamboo work, grocery store, stationery shop, tea stall and other similar activities.

Bandhan's budget for assets can vary between ₹3,000 and ₹8,000. After deciding upon the asset type that is to be allotted to a particular client, she undergoes initial training to help her acquire the skills needed to run the enterprise. The initial training takes 3–6 days depending upon the chosen enterprise.

Financial service: To inculcate the savings habit, Bandhan encourages graduation clients to save a minimum of ₹10 per week during the tenure of the stipend. The savings are held by Bandhan and can be withdrawn anytime to meet emergency needs.

Additional services: Bandhan provides a shed and veterinary services for the livestock. Bandhan also helps participants to access government health services (e.g., provision of sanitary latrines, hospital visits) and extended livestock services (e.g., artificial insemination).

Bandhan is of the belief that the success of the THP programme depends on community involvement and participation. To that end, it has formed Ati Daridro Sahayak Committee (ADSCs) comprising of village elites. The objective of ADSCs is to extend support and cooperation to the THP clients and act as guardians of such families during and after the completion of the programme. The functions of the ADSCs range from fund raising to help a THP household get over a health crisis or other emergency needs to solving household disputes which threaten to disrupt a client's participation in the programme. The ADSCs also liaise with local panchayat members to get voter and ration cards for graduation clients.

The programme team provides continuous hand-holding to the beneficiaries through weekly home visits to all the beneficiaries for their enterprise follow-up, financial literacy, basic literacy savings habits, health, sanitation, children's education, immunization, family planning and housing condition, etc., and conducting group meetings of the beneficiaries where they are made aware of certain social issues like child marriage, nutrition, afforestation, communicable diseases, etc.

Graduation of members

The following criteria were used by Bandhan for graduating the clients from the Ultra-poor Program to their mainstream microfinance programme:

- at least two income sources;
- monthly income over ₹1,750;
- savings of ₹500;
- at least two meals a day;
- two fruit/vegetable trees;
- safe drinking water and housing;
- hygienic conditions;
- child immunization;
- access to healthcare; and
- children in schools and basic literacy.

Graduation rate

	Year	Number of clients reached	Graduated
Pilot	2007–09	300	98% (294)
Bandhan THP	2009–12	2,723	98% (2,674)
		2,000	– (ongoing)
ABHA	2011–12	5,158	– (ongoing)

The graduated participants can take microfinance loans from Bandhan financial services as well as from any other microfinance institutions.

Unit cost for graduating an ultra-poor

The estimated cost per beneficiary is ₹20,000, including assets, consumption stipend, training and programme management expenses.

Pilot Phase Impact

- Monthly consumption per capita in the target households higher by ₹82.78 (14.3 per cent) and ₹70.68 (10.5 per cent) at Endline 1 and Endline 2, respectively.
- Expenditure on dairy, meat and eggs increased in both Endlines.
- By Endline 2, both adults and children in target households less likely to have skipped meals in the last 12 months.
- On an average, households had 1.52 more goats, pigs and sheep, 0.42 more birds, and 0.4 more cows than other households (most of which received through the programmes).
- Households had ₹594.21 (992.2 per cent) higher income from livestock in Endline 2.
- There was no statistical difference in business income at Endline 1. However, in Endline 2, TUP households had ₹262.26 (47.7 per cent) higher business income than other households.
- Formal saving was generally higher in Endline 2—₹279 in TUP households and ₹233 in other households. Asset ownership was significantly higher at Endline 2 in TUP households.

NOTES AND REFERENCES

1. This chapter was developed with significant contributions from N. Srinivasan.
2. *Integrated Health and Microfinance in India* commissioned by Freedom from Hunger, Indian Institute of Public Health and Microcredit Summit Campaign 2012, India.
3. Equivalent of loan officers.
4. This note was prepared by Sudipto Saha, Access Assist.

Fair treatment of clients, code of conduct and institutional response—intense scrutiny?*

5
Chapter

Indian MFIs took their early lessons from experiments of Grameen Bank in Bangladesh in the late 1970s; and Bank Rakyat Indonesia (BRI) in Indonesia and Prodem in Bolivia in the 1980s. These interventions demonstrated that alternatives in lending to the poor are possible and viable. The core of these initiatives was offering customized products, substituting physical collateral with social collateral and delivering services at the doorstep of clients.

While savings was largely ruled out for Indian MFIs because of regulatory restrictions, credit delivery was largely through the joint liability model with a one-year loan repayable in weekly instalments. Customer focus was evident in design as low-income borrowers found it easier to pay smaller, more frequent instalments compared to monthly repayments of formal loans. Social co-guarantee obviated the necessity for existing physical assets or extensive documentation. The MFIs demonstrated strong viability and riding on their success, banks sought to lend to the 'bottom-of-the-pyramid' segment not only out of compulsion to meet priority sector lending targets but also because they recognized a large, untapped, resourceful set of customers to whom they could extend their outreach.

Initially the cost of service delivery was high, as providing low-ticket-size services at the doorstep and engaging in high person-to-person contact in the form of group meetings entailed higher operating costs. However, higher interest rates were excused since MFIs were perceived to be delivering customized services and building a symbiotic relationship with their borrowers rather than engaging in purely financial transactions. This tolerance for higher costs in credit delivery also factored in the assumption that microfinance would cater to the poor and unbanked population.

LOSING CLIENT FOCUS—NEGATIVE OUTCOMES OF HIGH GROWTH

In the rush for growth, what started as a client-focused service delivery model was reduced to a cookie-cutter template, which was replicated across states, irrespective of appropriateness to the local context. The original group loan concept became the sole innovation. The growth phase also saw practices such as competing in saturated markets, hijacking groups mobilized and trained by other MFIs so as to reduce pre-lending operating costs, misaligned staff incentives making them dispense with rigour of trainings and outsourcing of group-building activities to agents within the community. In all this, clients were relegated to outreach statistics—the focus was on lending to them, primarily to fuel the target achievements rather than inclusive finance to the poor.

Along with the focus on outreach, MFIs also had to ensure good repayment rates in order to maintain their flow of funds from banks and investors. A popular catchphrase of the time was 'zero tolerance for default', which placed tremendous pressure on staff to ensure 100 per cent collections. Inevitably, lapses in repayment led to an exchange of words between staff and clients, with demands on group members to make good the shortfall. Coercive behaviour from some of the staff was resented by defaulting clients and their families, resulting in unfortunate exchanges and incidents, some of which drew the attention of district authorities, religious groups and the media.[1] If MFIs had been evaluated

* First deaft of this chapter was contributed by Berenice da Gama Rose and Alok Misra, MCRIL.

on Client Protection Principles in 2009–10, severe lapses would have emerged:

1. Most MFIs had failed to avoid over-indebtedness, by entering already saturated geographies citing contiguity of operational areas, and extending outreach to existing clients of competitors, justifying that clients had capacity to absorb higher levels of credit.
2. Industry-wide, pricing had not been revised in tandem with increased efficiencies. Benefits were not being passed on to customers; instead, they were being accumulated to fuel further expansion, or were being passed on to investors and promoters.
3. Transparency had been relegated to the background by a few MFIs, which bundled compulsory credit-life insurance products with loans, often earning margins far in excess of what could be considered ethically permissible.[2] By recovering operational costs from insurance margins, these MFIs could afford to cut interest rates on loans, thereby increasing their competitive advantage at the expense of client welfare.
4. Even basic processes were being strained by growth—staff had begun to cut corners on training and spent less time at group meetings in order to serve greater numbers of clients.
5. Fair and respectful treatment of clients was severely compromised during repayment shortfalls, as MFI staff sought to protect their own incentives by pressurizing clients to repay.
6. Appropriate product design was relegated to the background in the light of excessive margins on insurance products and plain vanilla credit offerings.[3]

It is important to remember that the phenomenon of irrational and exuberant growth had manifested itself in other countries as well, with similar outcomes, as detailed in a paper published by CGAP, covering microfinance crises in Nicaragua, Bosnia-Herzegovina and Pakistan.[4] The microfinance industry in each of these countries experienced significant stress resulting from high growth rates and leading to local or national mass delinquency crises.

CRACKS ON THE SURFACE AND CRISIS

As client welfare was compromised further, cracks began to emerge in the Indian microfinance industry. In 2006, the Collector of Krishna district in AP shut down 50 branches of two leading MFIs, alleging that they were burdening borrowers with more debt than they could handle, and indulging in coercive recovery practices. In 2009, religious groups in Karnataka instigated a mass default in Kolar and Ramnagaram districts, citing humiliation of their community members by MFI staff accompanied with irresponsible lending practices and usurious rates of interest charged by most MFIs in the area.

Research revealed that the zero delinquency culture and group guarantees of microfinance loans had created an unfavourable environment by not allowing MFI staff the flexibility to negotiate or reschedule repayments even when clients were in distress. The common practices of sitting outside clients' homes till the payment was made good, encouraging group members to exert pressure on the defaulting client or insisting that they pay on her behalf had backfired and community leaders called for a mass default citing religious reasons.[5] The lending and recovery policies, operational processes and field staff behaviour came under criticism. The sector responded by designing a Code of Conduct (CoC) and also providing tools such as Social Rating to ensure that MFIs remained true to their mission in delivering services responsibly to clients.

BUILDING A CODE OF ETHICS

With emphasis on growth and repayment targets, client welfare was being neglected. Recognizing the dangers of such a trend, industry association Sa-Dhan released a CoC[6] in 2007 and urged its members to comply in letter and spirit. Given that this code was framed before the outcomes of MFIs' high growth became manifest, Sa-Dhan's foresight must be appreciated. While Sa-Dhan's Code was well drafted and covered the critical aspects of microfinance operations, it was pitched as a voluntary code or an aspirational guideline to MFIs. While most members signed the code, implementation levels were difficult to assess as these were based on self-report using a brief format developed by Sa-Dhan. Many member institutions reported that they were 'in process' of implementation; some reported the same levels of progress for 2–3 years consecutively. Due to the multiplicity of legal forms of MFIs, it was initially difficult to bring all institutions under a common code as NBFCs were governed by the RBI whilst others came under the ambit of other regulatory bodies.

Microfinance institutions network, the industry association of NBFC MFIs, was formed in 2009. Some institutions were members of both Sa-dhan and MFIN. Microfinance Institutions Network structured a CoC for its members in 2010 and compliance was made mandatory for its member MFIs. While it incorporated important elements from Sa-Dhan's

Code, it also added a few important clauses to deal with key concerns at the time, viz., over-indebtedness and poaching of staff across MFIs.

However, adherence to the CoC was not strictly enforced by these associations. The MFIs were encouraged to report on compliance levels, but reporting and enforcement were weak. However, the tenets of these codes were accepted on paper, while ground level operations reflected a different reality.

The various CoCs drew from international resources in client protection, SPM and ethical practices in microfinance while incorporating aspects which had emerged as challenges specific to the Indian context.

Association of Karnataka MFIs (AKMI) designed their own CoC.[7] The AKMI's Code of Conduct was devised as a response to the Kolar–Ramnagaram repayment crisis. It aimed to promote coordination and cooperation between all MFIs (irrespective of constitution and operational model) operating in Karnataka to ensure that they did not engage in unethical competitive practices or compromise their responsibility to clients by over-lending. The AKMI Code incorporated aspects of the Sa-Dhan and MFIN Codes of Conduct. Member MFIs undertook to provide their clients formal and informal feedback channels to elicit suggestions for building competencies to serve them better. The AKMI's members also started conducting district-wise monthly meetings to discuss operational issues and problems in the particular district, to seek information on staff/clients and inform other MFIs about operation of agents, fraudulent practices detected and imminent default risks in any locality. Such monthly meetings facilitated exchange of information and resulted in a few agents and fraudulent Centre leaders being eliminated from their positions of control. An Ethics and Grievance Redressal Committee was constituted by AKMI to address any unresolved inter-MFI issues.

A CLOSER SCRUTINY OF CONDUCT—ANDHRA PRADESH CRISIS AS THE TRIGGER

Many of the MFIs had not learnt their lessons from the earlier crisis in Kolar and Krishna. Warning signals of these two crises were brushed off as one-off incidents and the increase in client outreach with near-perfect repayment rate continued to be touted as evidence for soundness of the business model. It was argued that if services were not client-centric, it would be impossible to maintain near-perfect recovery rates in collateral free lending. However, not all were convinced that these proxies substituted client focus and a few voices in the sector warned that simplification of client–loan officer relationship to mere financial transactions, outsourcing client acquisition to external agents, lending in saturated markets, lack of product innovation, non-transparent pricing and insistence on zero delinquency were likely to push the sector towards crisis.

In October 2010, the AP state government promulgated an Ordinance, which severely curbed the operations of all MFIs and paralyzed recoveries state-wide. The state government used its powers under the Moneylenders Act and justified its action on grounds of coercive recovery practices, indiscriminate lending and usurious interest rates charged by MFIs. Though much debate has taken place on the demerits of the action and the intention behind it, the fact that MFIs had, by their field conduct, invited strong state action cannot be denied. In the months that followed, there had been grudging recognition of unethical practices such as hijacking groups of clients for disbursement, poaching staff and lending despite knowledge of prior debt levels of clients. However, the halt of operations gave ample opportunity to institutions across the country to do some introspection and take stock of where they had gone wrong. Field visits undertaken during and after the crisis by senior management of India's leading MFIs revealed evidence of severe gaps in operating systems, most of which were attributable to uncontrolled growth. Often, top management of large institutions had distanced themselves from the field and were unaware of the regressive and coercive practices which had been employed by their staff. Many realized the shortcomings of their incentive structures, which first rewarded staff for uncontrolled client acquisition and then severely penalized them for shortfalls in repayment. Most MFIs concluded from their post-crisis introspection that in the race for growth whilst maintaining impeccable repayment rates, they had lost their focus on client needs, client satisfaction and responsibility to clients.

The MFIs seem to have realized that in dealing with bottom-of-the-pyramid clients, outreach and access alone are insufficient; rather, the highest standards of client protection are needed.

POST CRISIS—INDIAN SCENARIO TO BRING BACK THE CLIENT FOCUS

The Malegam Committee[8] was set up by the RBI post crisis to investigate various operational and financial practices adopted by MFIs in India and it presented its report and recommendations in January 2011. Amongst the recommendations were

Box 5.1 Are MFIs serious about codes and standards?

Though there were multiple codes, none of them were implemented with the urgency or seriousness they deserved prior to the AP crisis. As the codes were voluntary adoptions and dependant on interpretation and initiative of MFIs, they remained more as information on display than as part of MFI's systems and practice. After the Kolar crisis, MFIN's capping of number of loans and maximum amount was implemented fairly strictly with respect to new disbursements. Some MFIs began submitting their data to credit bureaus in an effort to cooperate on limiting over-indebtedness. However, aspects of transparency, realistic assessment of repayment capacity and fair treatment of clients were more difficult to implement and compliance was harder to assess. Most MFIs responded that they were 'in the process' of complying with these requirements and that it would require time for designing new documentation and training of vast numbers of field staff.

references to the microfinance industry CoC, to which all MFIs would have to comply, failing which they would be penalized by the industry association concerned. Banks were also advised to ensure compliance with these Codes of Conduct by MFIs they lent to.[9] It became mandatory for MFIs to display either the Sa-Dhan or MFIN Code of Conduct at all their branches and to conduct detailed training in aspects of the codes for all operational staff. The MFIs were also encouraged to inform their clients about specific aspects of the Code(s) of Conduct so that clients could seek redressal for MFIs' non-fulfilment of obligations.

Flexibility of MFIs in aspects such as product design and pricing (which had been included in the CoCs of both industry associations) was indirectly curtailed with the release of the RBI Guidelines for MFIs, which came into effect in June 2011, and were further amended in December 2011 and August 2012. The guidelines were framed to regulate MFIs by ensuring that their products, processes and pricing did not place undue pressure or burden on their clients and that profiteering motives were curtailed. The guidelines are listed in the table below.

Table 5.1 The RBI guidelines for NBFC MFIs

Conditions	RBI policy announcement—from priority sector lending perspective
Annual income limit for eligible borrowers	Rural: ₹60,000; Urban ₹120,000
Loan size (maximum)	First cycle: ₹35,000; subsequently ₹50,000
Indebtedness of borrower	Limited to ₹50,000
Tenure	24 months for amounts exceeding ₹15,000
Loan use criterion	Minimum 75% of MFI portfolio for income generation loans
Repayment frequency	Weekly, fortnightly or monthly—at the choice of borrower
Margin cap	For MFIs with assets < 100 crore - 12%; and MFIs with assets > 100 crore - 12% (difference between borrowing cost and lending rate) + processing fee, 1% (not included in interest or margin cap) + processing fee, 1% (not included in interest or margin cap)
Collateral and group mechanisms	No collateral, individuals as well as SHGs and JLGs
Conditions	**RBI policy announcement—general guidelines**
Insurance products	No commission or excess of premium can be collected from clients
Other charges	No penalty can be charged on delayed payment. The NBFC MFIs should not collect any security deposits from borrowers
Indebtedness and due caution in loan approval	Not more than two MFIs can lend to the same borrower. Sanctioning and disbursement of loans is to be performed at a central location with involvement of more than one individual from the MFI
Transparency	Guidelines specify a standard format of loan agreement and loan card, reflecting charges and terms and conditions in a transparent manner in the vernacular language appropriate to the area
Fair treatment of clients	Non-coercive methods of recovery are emphasized

Source: RBI circulars RBI/2011–12/290, DNBS.CC.PD.No. 250/03.10.01/2011–12, dated 2 December 2011; RBI/2011–12/470, DNBS.CC.PD.No. 266 /03.10.01/2011–12, dated 26 March 2012; and RBI/2012–13/161, DNBS (PD) CC.No. 300/03.10.038/2012–13, dated 3 August 2012.

Compliance levels are to be checked by lending banks through a chartered accountant's certificate confirming that stipulations are met, qualifying loans to MFIs as 'priority sector'. However, the quality of adherence cannot be checked through documentation alone. Some MFIs have sought assessment of adherence levels in the field by appointing independent agencies to collect field data and compare it with documentation and reporting. 'Project Sameeksha'—an effort by Swayam Krishi Sangam (SKS) Microfinance to check adherence to RBI guidelines—covers a sample of 1,000 clients across 5–6 states with recent disbursements. Client profile and loan terms and conditions, credit bureau results and loan utilization are cross-checked and reported on.

UNIFIED CODE OF CONDUCT

The need to adhere to a common CoC in keeping with the RBI guidelines was met with a joint effort—by Sa-Dhan and MFIN, with support from International Finance Cooperation (IFC) and Dell Foundation. The result was the Unified Code of Conduct (UCoC), which was released at the ACCESS Microfinance India Conference on 14 December 2011. This code combines the most important elements from the earlier versions by Sa-Dhan and MFIN as well as inputs from the CPPs of the SMART Campaign, RBI's Fair Practices Code for NBFCs and clauses from the RBI guidelines. Most of the CPPs have been covered, while issues specific to the Indian microfinance environment such as staff recruitment practices have been given adequate importance. Client protection and good governance are emphasized specially, as these were identified as the two stumbling blocks which precipitated the crisis in 2010.

RBI FAIR PRACTICES CODE

The MFIs operating as NBFCs first adopted principles detailed in the RBI Fair Practices Code (2006)[10] and later adopted the RBI Fair Practices Code for

Table 5.2 Important provisions under the Unified Code of Conduct

Subject	Summarization of provisions
Values	Integrity, Quality of Service, Transparency, Fair Practices, Privacy of Client Information, Integrating Social Values into Operations, Feedback and Grievance Redressal Mechanism
Integrity and Ethical Behaviour	✓ Appropriate policies and operating guidelines to treat clients and employees with dignity; transparent and professional governance system to ensure that staff are trained to put this code into practice; education of clients on the CoC and its implementation.
Transparency	✓ The MFIs must disclose all charges and terms and conditions to the client for all services offered, in accordance with the RBI guidelines and Fair Practices Code. ✓ All terms and conditions for all products offered to clients must be communicated to clients in the official regional language or a language understood by them. ✓ The MFIs must communicate all charges in writing, and interest and fees must be mentioned as an all-inclusive Annual Percentage Rate (APR) and equivalent monthly rate. ✓ Formal records of all transactions must be maintained.
Client Protection	✓ Fair Practices: The MFIs must ensure that the provision of microfinance services to eligible clients is as per RBI guidelines and must obtain copies of relevant documents from clients, as per standard KYC norms. Products should not be bundled, except credit life, life insurance and livestock insurance products, with explicit consent of clients. ✓ Avoiding Over-indebtedness: Proper due diligence to assess repayment capacity of client, sanction of loans only in keeping with prescribed limits under RBI guidelines or central/state government laws. ✓ Appropriate Interaction and Collection Practices: The MFIs must have clearly defined guidelines for employee interactions with clients and must ensure that all staff respect clients by using courteous language, respecting cultural sensitivities and refrain from indulging in any threatening, coercive or inappropriate behaviour. Valid receipts must be provided for all repayments. Board approved processes will be employed in default cases. Collection shortfalls will not be made good from employees, except in the case of proven fraud. ✓ Privacy of Client Information: The MFIs must keep personal client information strictly confidential. Client information may be disclosed to a third party subject only if client has given permission in writing for such disclosure or it is legally required to do so or if it is done by MFIs in a closed-group reciprocal basis (for a credit bureau).

(continued)

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Subject	Summarization of provisions
Governance	✓ The MFIs must incorporate a formal, transparent and professional governance system, by appointing persons with good and sound reputation as members of board and ensuring that independent persons constitute at least one-third of its members. ✓ The Board must be actively involved in all policy formulations and other important decisions and must have an independent audit committee with an independent director as Chairperson. ✓ The MFIs should have a Board approved debt restructuring product/programme for providing relief to borrowers facing repayment stress. ✓ The MFIs must ensure transparency in the maintenance of books of accounts and reporting and disclosure of financial statements by qualified auditors and must put in best efforts to follow the Audit and Assurance Standards issued by the Institute of Chartered Accountants of India (ICAI). ✓ The MFIs must file a compliance report with respect to the CoC, specifically indicating any deviations and reasons, therefore, at the end of every financial year.
Recruitment	✓ Staff may be hired from other MFIs by legitimate means in the public domain. ✓ Whenever an MFI recruits from another MFI, it will be mandatory to seek a reference check from the previous employer, after an offer is made. The request must get a response within two weeks. ✓ The MFIs must honour a one-month notice period from an outgoing employee. ✓ No MFI shall recruit an employee of another MFI without the relieving letter from the previous MFI employer, except in instances where the previous MFI employer fails to respond to the reference check request within 30 days. ✓ Whenever an MFI recruits from another MFI, at a level up to the Branch Manager position, the employee shall not be assigned to the same area he/she was serving, for a minimum of one year.
Client Education	✓ The MFIs must have a dedicated process to raise clients' awareness of the options, choices and responsibilities vis-à-vis financial products and services available. ✓ New clients must be informed about the MFIs' policies and procedures to help them understand their rights as borrowers. ✓ Awareness and understanding of key terms of products availed should be checked through regular monitoring.
Data Sharing	✓ The MFIs will agree to share complete client data with all RBI approved Credit Bureaus, as per the frequency of data submission prescribed by the Credit Bureaus.
Feedback/Grievance Redressal Mechanism	✓ The MFIs must establish dedicated feedback and grievance redressal mechanisms to correct any error and handle/receive complaints speedily and efficiently with respect to operational matters or compliance on CoC. ✓ Clients must be informed about existence of such mechanisms as well as their right to approach the grievance redressal mechanism established by the industry.

Source: Condensed by M-CRIL from Unified Code of Conduct document, http://www.mfinindia.org/mfin-code-conduct

NBFC-MFIs (2012).[11] The RBI Fair Practices Code[12] for NBFC-MFIs focuses on providing transparent information to borrowers at the time of application, issuing receipts for all payments and written information to borrowers regarding loan terms and conditions as well as costs involved. Strong emphasis is placed on communicating costs and terms and conditions to borrowers in the vernacular language and in the most transparent manner possible. Guidelines are given for interest-rate setting so that institutions do not overcharge customers. Post disbursement supervision is strongly advised in terms of anticipating and addressing borrowers' repayment difficulties and providing a fair chance to borrowers to repay before seizing collateral or imposing penalties. The code has a separate section for NBFC-MFIs, requiring them to train borrowers adequately prior to loan disbursement and protect them from over-indebtedness through appropriate checks. It gives detailed guidelines for transparently communicating all terms and conditions to clients on the loan agreement and loan card. It adopts a stern position on coercive methods of recovery, stating that harassment of any kind is unacceptable. The code makes the Board of Directors responsible for making necessary organizational changes to ensure compliance. The UCoC has to take into account the requirements of the fair practices code of RBI, which sets out the regulatory minimum expected of MFIs.

ADHERENCE OF CODE OF CONDUCT BY INDUSTRY ASSOCIATIONS

With the release of the Unified Code, MFIs irrespective of their legal form or profit orientation have a common set of field practices and standards of staff behaviour. This has helped banks and investors too, in verifying adherence of MFI partners to a certain, known set of requirements, covering key aspects of responsible financing. All member MFIs of Sa-Dhan and MFIN were required to sign the UCoC within a specified time frame. Verifying compliance on this code has remained the responsibility of Sa-Dhan and MFIN.

The MFIN even as early as 2010 made it mandatory that the Boards of all member MFIs approve and supervise implementation of the CoC—however, self-reporting was relied on for establishing this. A 'scorecard' was devised and sent out to MFIs soon after the AP crisis, consisting of a series of objective questions to be answered by MFIs, based on which they were scored by MFIN. Around 80 per cent of MFIs got high scores in the range of 80–90 per cent. The scorecard was revised when the RBI guidelines were introduced and later adapted to include new aspects covered in the Unified Code. It also includes a section on data sharing with credit bureaus, which MFIN enforced among its members. The MFIN has taken steps to educate all member MFIs on the interpretation of various clauses in the Unified Code and RBI guidelines to foster a shared understanding and obviate confusion. A good indicator of compliance is in its Enforcement Committee (EC), which frequently receives and resolves complaints from MFIN members against each other for intentional and unintentional violation of CoC norms of RBI guidelines.[13]

Though all member MFIs of the two networks have become signatories to the Unified Code, exact levels of compliance have not been established yet as most MFIs are still in the process of revamping their systems. At a documentation and staff-training level, genuine efforts have been made by almost all leading MFIs. However, effectiveness in the field can only be established by independent assessments.

CODE OF CONDUCT ASSESSMENTS

Microfinance consultancy and support agencies in India have designed tools[14] to assess levels of compliance with the Code(s) of Conduct[15] as a response to the CoC assessments commissioned by Sa-Dhan and SIDBI. This task has been complex as the code is to be adhered to in spirit, and it is often difficult to assess this in a short time frame with a limited sample of clients and staff. However, with rigorous methodology, these difficulties have been minimized and there are now robust tools to evaluate compliance levels. The various assessment formats have included the following broad parameters:

- Integrity, Governance and Strategy
- Compliance with Regulatory Guidelines (targeting, pricing and product terms)
- Market entry and Competition
- CPPs
- Client Orientation and Education
- Client Data Security
- HR Issues and Staff Conduct
- Integration of Social Values into Operations

These aspects have carried different weightages, determined by each assessing agency in accordance with its perspective on the degree of importance attributable to that parameter. A comparison of the various CoC Assessment tools and reporting structures[16] designed by different agencies in India is given in Table 5.3.

Three CoC assessments were commissioned by Sa-Dhan and 13 by SIDBI, respectively. Not surprisingly, there has been very minimal demand for CoC assessments from commercial banks, as most of them were highly averse to taking any exposure in the microfinance industry given the events in AP and rumour of incipient instability in other states. The CoC assessment results are given in Table 5.3.

Limitations in code of conduct assessments

- **Subjectivity** - Since some of the CoC assessments were done when MFIs were in the process of introducing improved practices, rate of observance was low, but this did not reflect substantially in the scores assigned,[17] perhaps because the assessment teams took into account the fact that these were new policies. Institutions charging low rates of interest were penalized for communicating to the clients on a flat rate basis but not given any points for pricing their products more competitively than other institutions.
- **Rater bias** – Being the first round of assessments, the scores seemed to be influenced by rater biases on what constitutes best and worst performance and what scores should be awarded therefore. Scoring standards have to be evolved for adoption by raters so that even if multiple raters do the assessments, comparable scores result.

Table 5.3 Results of code of conduct assessments

Agency	Institutions covered/Period of assessments	Actual score/ Grade[18]	Percentage equivalent of grade	Legal form
SIDBI assessments				
m2i	1. Arohan Financial Services Pvt Ltd	100	**80.6**	NBFC
	2. Shree Kshetra Dharmasthala Rural Development Project (SKDRDP)	90	**72.6**	Trust
	3. ASA International India Microfinance Pvt Ltd	108	**87.1**	NBFC
	4. Bharatiya Samruddhi Finance Ltd	104	**83.9**	NBFC
	5. Equitas Micro Finance India Private Ltd	110	**88.5**	NBFC
	6. Cashpor Micro Credit	94	**75.8**	Sec. 25 Co.
	7. Bandhan Financial Services Pvt Ltd	105	**84.7**	NBFC
	8. Ujjivan Financial Services Pvt Ltd (September 2010–May 2011)	108	**87.1**	NBFC
M-CRIL	1. Madura Microfinance Ltd (MMFL)	β+	**66.5**	NBFC
	2. SHARE Microfin Ltd (August–September 2011)	β+	**67.3**	NBFC
iMaCS	1. SKS Microfinance Pvt Ltd	7.1	**71.0**	NBFC
	2. Future Financial Services Ltd (December 2011–January 2012)	6.6	**66.6**	NBFC
ACCESS Assist	1. Saija Finance Pvt Ltd (November 2011)	3.08	**77.5**	NBFC
Sa-Dhan Assessments				
M-CRIL[19]	1. Share Microfin Ltd	**NA**	**Under non-disclosure agreement**	NBFC
	2. Spandana Sphoorty Financial Services Pvt Ltd	**NA**		NBFC
	3. SKS Microfinance Pvt Ltd (October—November 2011)	**NA**		NBFC

Source: SIDBI Code of Conduct reports. Available online at http://www.sidbi.com/micro/codeofconduct.html

Learnings from code of conduct assessments

A review of the COCAs so far carried out had been commissioned by SIDBI to understand the utility and functionality of COCA. The review (excerpts in the following box) finds COCAs to be useful and suggested wider use by all lenders.

International initiatives on assessment of SPM

International initiatives were plenty, which focused on devising frameworks and tools for benchmarking, measuring and reporting on various aspects of social performance and responsible financing. These include the CPPs of the SMART Campaign and the USSPM of the SPTF. There is also the shift from credit and financial ratings to Microfinance Institutional Ratings, which give a balanced report on an MFI's operational, financial, managerial and social performance capabilities.

SOCIAL RATINGS—COMPREHENSIVE ASSESSMENT OF SPM OF MFIs

Social Ratings,[20] which evaluate an MFI on its efforts to implement and practice its social mission, were pioneered by M-CRIL in 2005–06 in India. This tool has gone through changes in methodology and nomenclature, from being termed as 'Poverty audit' to 'Development Rating' and finally to 'Social rating'. The significance of this initiative was the realization that social performance—which has client protection at the core—is as important as financial viability for the success of microfinance initiatives. Given that MFIs cater to a segment normally excluded from formal financial services, it is necessary to ensure that they are achieving 'responsible' financial services—i.e., that access to financial services are provided with good intent and are complemented with appropriate product design and

Box 5.2 What do we learn from COCA?

The COCAs has so far established the following:

- The MFIs are keen and focused on adoption of code and conduct.
- Customer protection concerns have become important in MFIs—right from the field to boards of governance.
- The staff have been trained on field behaviour as also organizational policies relating to interface with customer.
- The MFIs have achieved high scores in aspects relating to disclosure, staff behaviour with customers, grievance handling and process of recovery of defaults.
- The MFIs have had problems in quickly responding to changes in regulation and require time.
- Documentation of COC in operations manual and audit manuals will improve the quality of compliance and level of customer protection.
- Loan appraisals should take in to account client circumstances more elaborately than in the past to ensure compliance with RBI regulations.
- The MFIs should design processes by which client relationship is strengthened and their feedback actively taken in to account.

Though the 13 MFIs are located in different geographies, there are common features in their conduct of business. The COCAs found that:

- The MFIs' boards have increased their attention on code of conduct issues.
- Setting up appropriate disclosure norms that inform customers well has become a priority.
- Pricing transparency and interest rate cap compliance have been absolute, though proving difficult in a dear money environment.
- Inclusion of different elements of the COC in the process manuals and internal audit manuals is the most effective way of ensuring that COC is implemented and monitored as part of the internal processes of the MFIs.
- Staff training and documentation of processes have a significant influence over actual conduct in the field; hence, the MFIs should ensure that there is a clear written guidance on COC available to staff and followed by training.

Way forward

The COCA is an assessment at a point of time. It needs to be repeated at regular intervals. The findings, especially on areas of weaknesses and future actions, should be pursued and institutions asked to respond on the action taken from time to time. In some aspects causing concern, repeated visits should be undertaken to ensure that quality of compliance reaches a satisfactory level. When over a period COCA becomes fully established, there may be no need of external monitoring. Eventually COCA should become the responsibility of boards of governance of MFIs. The initial COCAs have been funded by SIDBI. A number of technical service providers have been brought in to carry out the assessments in order to have a wide and deep resource pool that is now available. If lenders pay attention to COCA findings and demand improvements, institutional response from MFIs, which are already keen, will improve.

The COCA represents a significant step forward in bringing customer protection agenda to the centre stage. Through a structured approach, it makes the sector pay attention to specific elements of policy, governance, operations, field behaviour, products and grievance handling. This approach is well suited to understand and inform the MFIs and others in the sector on the extent to which customer is being taken seriously. While code of conduct compliance is a necessary part of the MFI operations, incentives to those institutions that perform exceptionally well will go a long way to raise the bar in customer service and protection standards. SIDBI should engage the stakeholders in the sector to encourage wider use of COCA, set up benchmark scores based on a review of a number of assessments, incentivize exemplary performance and pass on the responsibility of actions based on COCA to the MFIs over time.

Source: Analysis of COCA assessment reports commissioned by SIDBI.

delivery systems to enhance the resources and capabilities of clients. It was hoped that double bottom line assessment would enable MFIs to remain true to their mission. The Social Rating pathway assesses the effective translation of an institution's mission into practice in line with accepted social values[21] and the framework incorporates insights from ImPact's work in SPM and inputs from the SPTF. The rating draws from an MFI's stated mission and traces its internalization across organizational hierarchy and implementation levels in operational processes and reporting systems. Fair treatment of staff and responsibility towards community are also assessed, while outcomes on relevant social indicators are reported. Social Rating demand has been limited to requests from a few social-minded investors.

Microfinance Institutional Rating: While social rating remains an in-depth tool for assessment of social performance, recent events have clearly shown that certain aspects of social performance such as client protection also have a bearing on institutional and financial sustainability. Integration of key social issues into the rating framework also addresses public policy concerns on institutional practices in lending to the poor. Realizing this, microfinance rating agencies such as M-CRIL worked on a global initiative during 2011, supported by the Ford Foundation and Rating Initiative, to refine the existing financial/credit rating product by integrating key areas of social performance. Initially termed 'Responsible Finance Rating' during the pilot phase, it has been renamed as Microfinance Institutional Rating (MIR) based on industry feedback and experience gained during the pilot. The MIR expands the holistic assessment framework used by specialized rating agencies as opposed to pure financial evaluations used by mainstream rating agencies. In addition to the risk aspects covered in a traditional financial or credit rating, MIR incorporates the CPPs, alignment of practices with stated social goals and responsible financial performance, thus providing a holistic opinion on the long-term sustainability and creditworthiness of MFIs.

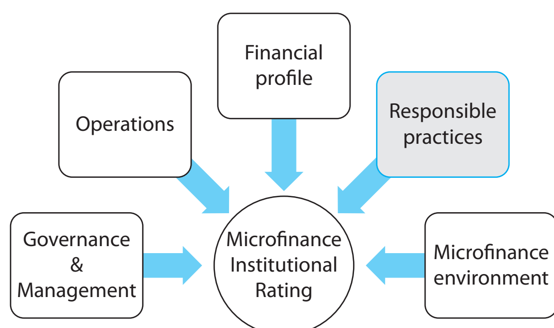

Figure 5.1 Microfinance institutional rating framework

Source: M-CRIL Microfinance Institutional Rating process document.

SMART CAMPAIGN'S CLIENT PROTECTION PRINCIPLES

In response to a strongly recognized need to assure safe and responsible treatment of their clients, microfinance industry leaders from around the world came together in 2008 to agree on a set of CPPs to guide the microfinance industry. They recognized that when financial services are delivered in accordance with these principles, clients are enabled to use financial services well and providers build a foundation for healthy operational framework for years to come. To put the principles into action, the SMART Campaign was launched in October 2009. Today it is a global effort with over *3,000* signatories and endorsements from over 850 microfinance institutions serving more than *40 million clients in 130 countries*. The campaign is being led by the Centre for Financial Inclusion (CFI) with seed funding from ACCION International.

Box 5.3 The client protection principles

1. Appropriate product design and delivery
2. Prevention of over-indebtedness
3. Transparency
4. Responsible pricing
5. Fair and respectful treatment of clients
6. Privacy of client data
7. Mechanism for complaint resolution

Source: Information from SMART Campaign/ACCION representative, Hema Bansal.

The campaign works with industry support organizations (like CGAP, the SEEP Network, the specialized rating agencies, etc.) and with many of the 140 investor groups that have endorsed the CPPs. It collaborates with MF Transparency, which provides guidance on pricing transparency and works closely with the SPTF, which helps in integrating the CPPs into a broader framework of SPM and reporting for the microfinance industry. The campaign also collaborates with MIX Market in contributing the client protection indicators on its portal. It has also ensured that industry Codes of Conduct in various countries incorporate the CPPs. Microcredit Summit's Seal of Excellence initiative has aligned with

the campaign to build upon established principles and standards.

The SMART Campaign in India works with major players in microfinance who are committed towards making client protection an integral part of the industry. In 2010, the campaign established its first partnership with SIDBI. With seed funding and endorsement from SIDBI, it was able to engage with SIDBI's partners at a deeper level to build a consistent understanding of the CPPs. In July 2011, the SMART Campaign received grant funding for two years from IFC to build greater awareness on adherence to the CPPs—as reflected in the UCoC. Under the project, the campaign is identifying the state of practices on client protection by assessing a range of Indian MFIs to create India-specific benchmarks on CPPs. The campaign has partnered with MFIN, Sa-Dhan and ACCESS-ASSIST to help with its efforts in this direction. The campaign is also disseminating knowledge and building capabilities amongst microfinance stakeholders by training them in Client Protection Assessments (CPAs). Till date, the campaign has conducted 10 CPAs in India under its SIDBI–IFC Project, covering client outreach of over 7.5 million clients. The assessments covered mainly select NBFC-MFI partners of SIDBI and IFC, based on criteria of size, geographic location, models and products. Learnings from CPAs are presented in the following table.

Table 5.4 Learnings from client protection assessments

CPP 1 - Appropriate Product Design	• Multiple or flexible product design is a challenge that few MFIs are able to meet. Most cite MIS issues or regulatory and operational challenges. • Severe pressures on financials compel small MFIs to offer more standardized products.
CPP 2 - Prevention of Over-indebtedness	• Both High Mark and Equifax are fully functional and have covered majority of the MFIs in India. Challenges are limited to specific regions, where a few MFIs are still in the process of contributing data due to MIS issues. • Most MFIs have put in place a credit bureau check as part of the loan appraisal process. • As SHG borrowers are not covered, the effectiveness of the credit bureau is affected. • Across MFIs, incentive structures have also been largely rationalized to avoid excessive emphasis on client acquisition or portfolio size. • With RBI specifying the debt threshold, majority of the MFIs indicate compliance. There is potential for training field staff in eliciting reliable information, especially on informal borrowing sources and levels. Majority of the MFIs are basing repayment capacity assessments on Grameen methodology and self-declared household income. Only a few MFIs use household surplus to determine the repayment capacity and the loan size. Internal audit checks on repayment capacity analysis need strengthening.
CPP 3 - Transparency:	• In order to comply with regulatory requirements, MFIs have taken steps to simplify their pricing structure and have revised their loan cards to reflect declining balance method of interest application and quote fees and insurance charges separately. While MFIs meet the regulatory pricing requirement norms, some MFIs were not communicating the APR or total loan cost to the customers. • The MFIs are educating clients on the interest rates at different points during the credit process. While most MFIs prefer to explain the loan pricing during pre-loan training, some have provided leaflets, used innovative games and reiterate the loan pricing information and insurance charges during disbursements. • Loan passbooks and contracts are in local language and outline the loan pricing and terms; however, there is scope to enhance client's understanding on pre-closure options available. • While introducing micro-pensions or insurance products that require clients to save for longer periods, MFIs need to carefully explain the amount of returns and the lock in period thereof.
CPP 4 - Responsible Pricing	• All MFIs assessed after introduction of pricing regulations had complied by revising pricing in a band of 24–26%.

(continued)

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CPP 5 - Fair and Respectful Treatment of Clients	• The industry has responded with seriousness to implementation of this principle—MFIN and Sa-Dhan conduct independent investigations in case violations are reported. • Most MFIs assessed have included acceptable and unacceptable behaviour as part of the induction training provided to all staff. Some MFIs have made it compulsory for staff to pass CoC test as part of the induction process. • Sanctions for any behaviour violations are not always included in HR policies, but staff is aware that unethical behaviour would be viewed unfavourably. With MFI's increasing tolerance of defaults, staff field behaviour in recovery of loans has improved. • The MFIs still need to work at defining staff values and ethics in a manner that can be imbibed and monitored as part of staff performance. The MFIs could recognize and reward field staff for maintaining high standards of ethics while handling clients.
CPP 6 - Privacy of Client Data	• Most MFIs assessed did not have a client data privacy policy. This does not imply that client data privacy was compromised by MFIs. Their IT systems are secured, with responsibility based controls on access to data. • When using third-party services, most MFIs ensure that they include a clause on not permitting sharing of client-related information. However, this is not always consistent and requires MFIs to have standard formats for ensuring that client information is not shared. • While sharing client information with credit bureaus, MFIs as part of regulatory compliance were found to be procuring client information in the loan contracts. However, clients were not always aware of this. • Use of client photographs in promotional material requires greater attention. Currently, very few institutions obtain explicit approval from clients for using their profiles as part of publicity material.
CPP 7 - Mechanism for Complaint Resolution	• Most MFIs have started working on a grievance redressal policy or framework that requires customer's complaints to be seriously investigated and resolved in a timely manner. • Many MFIs have provided a toll free number for customers to access to take up grievances. However, most MFIs have observed that majority of complaints are addressed at field level and have therefore begun establishing human channels at the branch level. • Dissemination of toll free numbers during CGTs and disbursements have shown a remarkable increase. However, not all clients are aware of how and when they can use the toll free numbers. • Complaints have been too few to warrant any changes in products or policies.

Source: Information from SMART Campaign/ACCION representative, Hema Bansal.

SMART Certification: Since January 2010, the SMART Campaign has been working with the microfinance industry (through a task force of over 30 experts) to develop a Client Protection Certification Program. The Certification Program will enable financial institutions worldwide to demonstrate their adherence to the campaign's core CPPs as verified by third parties. During 2012–13, the four global microfinance rating agencies will be the certifying agencies. In India, M-CRIL will be undertaking pilot certifications during the pre-launch phase until the end of 2012.

SOCIAL PERFORMANCE TASK FORCE

The CGAP, Argidius Foundation and Ford Foundation brought together leaders from various social performance initiatives in the microfinance industry to develop a common social performance framework and an action plan to move social performance forward.[22] The SPTF was constituted to set standards for social performance and design tools for implementation of SPM in MFIs worldwide. The SPTF has pioneered design of social performance assessment tools, conducted trainings and framed

action plans for institutions to incorporate SPM in their activities. It has developed standards for social performance over the years, involving a global team of practitioners, funders, networks, technical service providers, rating agencies and researchers. In June 2012, SPTF has released its USSPM for MFIs, which establish clear guidelines on SPM integration in strategy, operations and reporting. The process involved obtaining feedback from over 1,300 members of the SPTF as well as external experts. The USSPM have been incorporated by specialized microfinance rating agencies in their rating frameworks and the MIX market social performance reporting template for MFIs. The standards are based on the following metrics.[23]

Box 5.4 Universal standards in SPM

1. Define and monitor social goals
2. Ensure board, management and employee commitment to social performance
3. Treat clients responsibly
4. Design products, services, delivery models and channels that meet client needs and preferences
5. Treat employees responsibly
6. Balance financial and social performance

MULTIPLE CODES, ASSESSMENTS AND RESULTING CONFUSION

After the AP crisis, the microfinance industry has moved from neglect of social performance to an overdrive with multiple codes, guidelines, standards and benchmarks. This inevitably led to confusion around which is the best practice for MFIs to follow and what would be assessed or certified. Recognizing an overlap and convergence around general principles and values of client protection and drawing on this convergence, EDA Rural Systems has developed a straightforward and relatively short guide[24] that sets out the RBI guidelines as well as UCoC within the framework of the CPPs. Using this guide, MFIs can plan modification around products and processes in compliance with regulatory requirements, CoC and CPPs together without having to refer to multiple documents.

But the MFIs still should navigate their way through different assessments, ratings and certification processes. With investors and lenders endorsing different frameworks for adoption, MFIs may have to get a certificate on client protection from one institution, Social rating from another and report information to a third platform, etc. In a stagnant business, the effort spent on multiple initiatives that go towards the same final objective could be fatiguing and the costs debilitatingly high. If the external actors that carry out these narrow-focus assessments come together and set up a single rating instrument such as the MIR referred to earlier, the MFIs will be able to breathe easier. The example of MFIN and Sa-Dhan coming together to unify the CoC for MFIs is worth emulating.

WAY FORWARD: CRACKING THE CODE

Compared with the government's attitude of benign neglect in the early stages of the MFI sector's growth in India, regulation has been intense following the AP crisis. Jolted by the paralysis of microfinance in the birthplace of India's biggest MFIs, the Government of India and RBI have sprung into action. Indian and international institutions have engaged in assessing compliance with Codes of Conduct, promotion client protection and social performance.

Given the increased pressure on MFIs to ensure efficiencies by lowering operational costs, it will be difficult to comply with the multiplicity of guidelines, principles and Codes all at once. Enforcement and implementation may prove daunting for MFIs as they struggle with operational difficulties like fund shortages and demotivated staff. However, steps have been taken to establish a clear path for MFIs in the form of the UCoC, using RBI guidelines as a yardstick and weaving other important aspects around them. The Microfinance Bill under the consideration of the parliament provides for industry associations (such as Sa-Dhan or MFIN) to supervise the observance of CoC of members. The MFIs are at present putting in place systems to be RBI regulation and fair practice code compliant and at the same time ensuring that the UCoC aspects are also adhered to.

Inclusive finance can only be ensured if institutions focus on maintaining the fine balance between financial sustainability and client needs. Codes, guidelines and regulations can only provide guidance; however, internalization of the canons of responsible finance by MFIs is critical to their survival. Responsible finance with client focus is the only way forward. The keen interest shown and steps taken by external stakeholders in MFIs' code of conduct compliance and social ratings should be strictly seen as a handholding exercise in the initial period

leading to orienting MFIs towards the proper direction. Third-party assessments like that of CoC assessments will lend credibility to the efforts of MFIs who have suffered reputation risk. Such assessments will provide comfort to lenders and social investors about the MFIs they are partnering with. However, over a period of time, the urge to do assessments from outside should be balanced/replaced by helping the MFIs carry out the same internally as part of their normal review and governance processes. Over time, the MFIs should take care of their customers' interests in order to protect their institutional sustainability. The MFIs must view adherence to the code as a means of ensuring sustainability, a tool for strengthening relationships with their clients and a safeguard against external risks posed by political, religious and social establishments.

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13. For instance, in the initial days of the credit bureau, limited data from MFIs led to a green signal for some disbursements, which resulted in some MFIs unintentionally becoming the third lender to clients.
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15. Assessment tools were designed separately for the Sa-Dhan Code (for assessments commissioned by Sa-Dhan) and for a combination of Sa-Dhan and MFIN Codes (for assessments commissioned by SIDBI). Some of the agencies also incorporated RBI guidelines for assessments performed after June 2011.
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Lenders, investors and donors—are they responsible?

6
Chapter

Indian MFIs have largely relied on commercial sources of financing such as equity, subordinated debt and bank loans. Holding the purse strings of funding to the MFIs, both lenders and bankers can lead the change in client focus of the MFIs. However, post crisis there has been a dearth of fund flow to the sector. The liquidity crunch faced by several MFIs worsened during the year with bank financing slowing down and equity investments being made largely in a select few proven institutions.

According to a CGAP survey,[1] despite the microfinance crisis in the state of AP, India had 19 investment deals amounting to over US$88 million in 2011 compared to 10 deals that amounted to over US$45 million in 2010. The composition of investors in India included a mix of commercial banks, MIVs and Development Financial Institutions (DFIs), but most of the funding (74 per cent) came from DFIs in a few transactions. India attracted the second highest volume of all capital flows for any country. As per the report, many of the MFIs that attracted capital in 2011 had distressed portfolios, especially in AP, and this led to reduced valuations. Globally also, the key benchmark for equity valuation in the microfinance private equity (PE) market dropped to an average of 1.4x book value from a high of 1.7x in 2009. The lower valuations and increased social investor interest augur well for customers and responsible finance agenda. The pressure on high returns will be low on account of the low enterprise valuations for pricing equity. Social investors will support and ensure that responsible finance practices become mainstream in MFIs.

Contrary to the perception in some quarters that investors would be happy with minimal regulation in which MFIs could post good returns, the investor community welcomed progress towards a more stable regulatory framework. They are keenly following with hope the passage of Microfinance Institutions Bill currently under discussion. Though the business climate is gradually improving, the overall picture is not comforting and investors continue to be hesitant to invest in the sector. As per an industry insider, the investments that have been made so far are company specific where the investors are convinced of the depth of management, their proven record. Investors are still uncertain about the prospects of the sector.

Box 6.1 CEO of Tier-1 MFI

There were a lot of Private Equity (PE) investors who were active in the sector, but now most of them have disappeared, increasing our dependence on social investors. Investors are now much more conscious and insist on legal agreements to ensure client protection and governance principles. They enquire about the actual implementation of these principles on an ongoing basis.

Investors are developing internal guidance on aspects such as growth, returns and executive pay. The RBI's pricing guidelines and margin caps have restricted the profits that MFIs can earn. Investors and lenders have been concerned about the viability of the Tiers 2 and 3 MFIs and would like their business models to be revisited. While in an economic sense, closure of unviable entities may be recommended, from a social point of view closure of smaller institutions in remoter locations would cause considerable discomfort to poor and financially excluded people.

Investors are no more willing to accompany high growth projections; they look for calibrated growth

in diversified geographies and efficient models. A social investment fund manager observes,

> Two years ago we could find 50 MFIs for potential investments but today there are less than 10. When pricing restrictions are applied, many of them are not profitable any more. Underlying assumptions of the business model has changed. We all made a mistake by over estimating the market and profitability. In hindsight, we realise that even the market potential is limited.

SOCIAL ORIENTATION IN INVESTING

Many social investors and microfinance-focused funds have strengthened the process of understanding the vision and quality of the investee company and its leadership. Screening Environmental Social and Governance (ESG) factors, including client protection measures, is gaining strength. The focus of the efforts varies from a narrow focus of adoption and implementation of client protection principles to broader and comprehensive efforts in social performance management. Oikocredit, a large global social investor, has rejected applications for equity to MFIs that were charging excessive interest rates, providing exorbitant executive remuneration or lacking a strategy to avoid borrower over-indebtedness, according to its 2011 social performance report.[2]

Some of the social investors have always been more 'social' than others and have been thorough with their examination of the social goals and objectives of the investee MFIs.

Dia Vikas chooses partners that are serving difficult to reach areas and/or clients and also in developing localized institutions. But to balance portfolio and risk diversification, some of the large MFIs in the south have also been chosen. Dia's investments have been at par value. Investments are made based on mission alignment and financial capability. Michael and Susan Development Foundation has an urban poverty focus. These investors had avoided iconic MFIs but invested more in smaller institutions including start-ups. While they did not take up any new equity positions during the year, they supported their partners through technical assistance for improving SPM.

The SIDBI has launched the India Equity Microfinance Fund of ₹100 crores, which is perpetual in nature. The fund is being utilized for extending equity or any other form of capital, viz., quasi-equity or subordinated debt to Tier-2 and Tier-3 MFIs, with a focus on smaller socially oriented MFIs/NBFCs in underserved parts of the country. The basic eligibility norms are largely operational and financial in nature; however, the desirable features for which additional weightage will be given while selecting the MFIs include several features that reflect responsible lending practices and the social goals of the MFIs. The SIDBI expects an overall internal rate of return of 15 per cent. The SIDBI has committeed ₹80 crores out of the fund so far and is expecting full disbursement of funds by March 2013.

Maanaveeya Development and Finance Pvt Ltd, Oiko Credit's Indian subsidiary, believes in supporting more of community-owned institutions and has very few equity investments. Maanaveeya has equity investments in only two MFIs[3] and has lent to 105 MFIs;[4] it has developed appropriate financial instruments for lending to MFIs, especially those involved in enterprise promotion. During the year, Maanaveeya has continued providing repeat loans to its existing MFI clients with good recovery record. The organization has had a selection system which integrates social and financial parameters.

- The institutions to be supported are rated on ESG score card, which is a comprehensive assessment tool, for first loan as well as repeat loan. The aspects rated are: *(a)* outreach and poverty targeting; *(b)* client benefit and welfare, which integrates client protection principles; *(c)* governance; *(d)* environment; *(e)* responsibility to community and staff. Institutions scoring low on these aspects are not considered for support.
- Institutions where the CEO salary was more than 20 times that of field officer are also not considered for support.
- Preference in lending to smaller institutions which integrate livelihood development and financial services since Maanaveeya finds that only through intensive livelihood development, customers can be better served.
- Preference is for institutions that serve women and where women have an opportunity to participate in governance.
- Maanaveeya is concerned about ecology and environment as well and lending is not permitted for purposes that create hardship to animals or harm environment.[5]

Lok Capital, a social and development finance firm, has not made new investments after 2010. Lok Capital mentions that it strengthened its due diligence in selection of partners from 2009 to 2010. Multiple aspects of intent and capacities and performance of the MFIs is checked as part of due diligence.

- The intent of the promoter in the business and her/his design in ensuring benefits to clients and improving share holder value.
- Board constitution, especially of diversity of qualifications and experience, and representation of women.
- Policies and practices in hiring of staff so that they have adequate family time, leave and other benefits.
- Policies on hiring of women staff, especially at field level to improve client relationship since the clients are women.
- Intent and capacity in providing a range of financial services and also product development suiting the needs of clients.

Responsibility social investment fund considers five aspects while investing—empowerment (focus on women and rural poor), efficiency (interest rate and operating cost ratio), financial inclusion (ability to offer savings services), poverty (level of poverty in the country) and outreach (number of households reached and average loan size). The Responsibility Development Effectiveness Rating (RADER) tool enables the five dimensions to be evaluated, monitored and managed at the portfolio level.

Blue orchard measures an MFI's social performance along five dimensions (intent and outreach, client protection, human resources, governance and CSR and impact measurement). Blue Orchard uses Social Performance, Impact Reporting and Intelligence Tool (SPIRIT), a proprietary social scorecard. The SPIRIT is fully integrated in Blue Orchard's due diligence process and is used in annual reviews of MFIs. The MFI's social performance score is part of the credit committee document and is discussed in investment/credit committees and influences the final decision making processes of Blue Orchard's investment and credit decisions.[6]

Thus the social investors have developed their own tools, which integrate CPPs and other social parameters in not only selection of clients but ongoing monitoring of the clients as well.

ENFORCING THE SOCIAL PURPOSE

Investors are seeking to ensure ongoing mission orientation by introducing conditions in agreements and working with like-minded investors. The SPM practices of the equity investors have also evolved with experience gained. In the transactions made during the last year, the specific social aspects to be achieved are part of the shareholder agreement, which are monitored. Incofin term sheets have standard language covering social performance and client protection.

Some of the investors now stipulate that MFIs follow good governance practices. The agreements also reflect some of the client friendly measures such as proportion of profits to be allocated for customer welfare, development initiatives through NGOs and other creative structures. The term sheets and investment agreements have started reflecting the social purpose of the investment as well. Investors are insisting on MFIs joining industry associations, reporting to credit bureau and in a few cases also reporting to MIX market.

Smaller social funds are also changing their strategy to ensure social goals are achieved in investee institutions where commercial investors are co-investing. Since buy-in from existing and larger shareholders can be an issue, Lok now takes a larger shareholding in the MFIs (25–30 per cent) so that social aspects can be driven.

Box 6.2 Reflections of social investment fund managers

'Our thoughts have evolved … we have made some mistakes … Some of the MFIs who we had invested in, we may not partner now. Our criteria have become more selective—we want to invest in MFIs which are more social in intent.'

> Today in saturated markets like Tamil Nadu or Karnataka we may not invest unless they work in deeper rural areas and have more products to offer which suit client needs. We are not looking for pan India MFIs who skim the surface. Today what would excite us is regional players willing to go deeper offering a variety of client centric products and services.

BALANCED RETURN EXPECTATIONS AND RESPONSIBLE EXIT

The valuation and return expectations of investors have toned down post crisis and RBI regulations. The growth, profit guidance from MFIs show restraint and are reasonable as compared to three years ago. The investors realize that the return expectations have to be more moderate now since they have to be seen as social and client welfare oriented. The recent investments have been at about two times the book value with a financial return expectation of 15–20 per cent.

Box 6.3 Return expectations of a social investment fund

The return expectations of our fund from MFIs have never been high; even before the crisis our guidance has always been 15%. We are willing to accept lower return where social values are high. But our share holders will expect at least 12% overall return.

There is more focus among social investors on how to achieve 'responsible exit'. While the second round buyers from social investors are likely to be commercial investors, many social investors would prefer to find buyers that have a sound understanding of the microfinance business and can at least be counted on to sustain responsible practices. Fund managers mention that they do and will take considerable care at exit, since reputation will play a key role in the success of their future funding rounds. However, to date, there have been few MFI exits. Michael and Susan Dell Foundation (MSDF) had invested in urban MFIs and is now keen to exit the portfolio of some of them since the purpose of establishing sustainable urban focused MFIs is achieved.

There are also investors like Dia Vikas (Opportunity International) who are not in a hurry to exit 'As long as the MFIs want we will stay invested'. Manaveeya has a time horizon of 25 years for its investments. They expect nominal returns. However, such investors are very few.

The investors' social intent should be demonstrated in two aspects—willingness to stay with the MFI for a long term and accept modest returns. The MFIs with clear social objectives want institutional investors to stay invested for 10–20 years and be satisfied with returns of 10–12 per cent per annum. Consultations on the PIIFs and SPTF universal standards are progressing towards setting benchmarks for social investing in microfinance, though a consensus is not in sight. There are a few difficult areas eluding a consensus, such as defining returns that balance the interests of clients, MFIs and investors.

SOCIAL RETURNS—UNIQUE INITIATIVES

Often investors talk about social returns apart from the financial returns generated. However, very few definitions exist of what is social return. The metrics are usually in terms of outreach to marginalized and vulnerable households, poorer districts, etc. As a social investor, Opportunity International, through its Indian subsidiary Dia Vikas, carried out a Social Return on Investment (SROI) analysis on EMFIL in which Dia Vikas has invested. As part of a SPM strategy, Opportunity International is looking at ways of assessing social impact.

Social Return on Investment is a framework for measuring and accounting for social, environmental and economic benefits. Social return on investment puts a value on the extent of change (impact) that takes place as a result of the programme and looks at the returns to those who contribute to creating the change. It estimates a financial value for this change and compares this value to the investment required to achieve that impact, resulting in an SROI ratio. It takes standard financial measures of economic return a step further by capturing social as well as financial value created by the investment. An analysis of investor social returns in the case of EMFIL showed that for the equivalent of every ₹1 invested in EMFIL, ₹3.19 is returned in social value.

This is a unique and innovative way of measuring social impact. While this is a pilot assessment and there are bound to be further refinements in the methodology and value attribution, this initiative of Dia Vikas is laudable.

SUPPORT FOR IMPROVING SPM

Some of the investors are providing funding support for improving the social performance of their partners. The IFC has been taking industry-level, institution-level and client-level initiatives for promoting Responsible Finance. The IFC convened Responsible Finance Forum with representation from lenders forum, donors and industry experts, which worked with both the industry associations for unification of code of conduct. The IFC's advisory services arm provides Technical Assistance to its investee MFIs. The terms of reference are tailor made for each institution but responsible financing is included as one of the core areas. The IFC has Performance-based Grants Initiative for Access to Finance under which grants are provided to MFIs operating in low-income states and Northeast for implementing specific projects. The IFC encourages these MFIs to bring in external experts to carry out assessment of responsible finance practices in the organization, identify gaps and then put in place systems and processes to address those gaps. The IFC has supported Ananya Finance for Inclusive Growth to mainstream SPM practices in some of their partners. The IFC has also been supporting financial literacy of clients of partners of MFIs.

Dia Vikas has commissioned the services of EDA Rural Systems for providing technical assistance to 16 MFIs, for improving their MIS for social performance reporting. EDA is working with the partners many of who are small Tier-3 institutions but also with some of the large MFIs like CASHPOR, RGVN, for capturing client level information, analyzing and using the data for improving products and services and for measuring progress of the clients. EDA has developed a one-page comprehensive data collection format that captures know your client (KYC) data, PPI data and other client-level data, which the MFIs require for later measurement and comparison. Since Opportunity International is strongly focused on social returns and wants to measure progress against a few of the millennium development goals, these indicators are also included. EDA finds that since Dia Vikas is committed to social performance reporting, it has convinced the partners to work on this core area. Dia Vikas has enabled six of its partners to become distributers of National Pension Scheme product (of PFRDA) and the partners now facilitate subscription to pension scheme by the clients. Dia Vikas also believes that once the financial operations are sustainable, other development initiatives such as health, water and sanitation, clean energy can be undertaken by the MFIs.

Michael Susan and Dell Foundation has commissioned MicroSave to partner with three MFIs for improving the SPM metrics development including implementing PPI as poverty measurement tool, poverty profiling of the clients and client need-based product development; MicroSave provides technical assistance and the institutions also receive need based grant for implementation. Lok capital has supported Suryoday for disseminating a relevant social message in the monthly centre meetings through a small mobile-sized equipment. The device ensures uniform communication. Ujjivan's financial literacy programme has been largely funded by Lok. However, Lok considers client education as part of business practice.

Manaaveeya invests in capacity building of its partners; though the institution suffered financially due to the crisis, it still allocated funds for capacity building of partners. During the year, partners were trained in client protection principles in collaboration with Accion. Limited external technical assistance was also provided for improving SPM practices. Manaveeya on the basis of its score card assessment of MFIs also facilitates action planning for improvement; this is carried out through internal staff who are well trained. Norwegian Micro finance Initiative (NMI) Funds support and make available training with respect to SPM issues through the NMI professional assistance (PA) Facility and other industry resources to their MIV managers as well as MFIs they have invested in.

INFLUENCING THE GOVERNANCE AND BUSINESS OF THE MFIS

Investors, entering with significant equity holding, have the right to participate in governance but only some of the investors take board positions. Some appoint staff and others nominate external professionals to the MFI boards. Investor board representatives should have an idea of how the institution should be run and should deliberate on how the business should be modelled, what kind of customers MFI should acquire, how fast the MFI should grow, what products and services should be offered and what level of profit MFI should aim at. As an equity investor, the board member should be raising the right questions and setting right directions for the MFI. However, in practice the board is dependent on the management for information and recommendations. As an investor points out,

> we are totally dependent on the entrepreneur manager for information. Demand for transparency was seen as an allegation of mistrust on top management. After the crisis the senior management had to depend on the investors for advise and further capital. This has brought about changes in sharing of information in the board.

However, by asking appropriate questions and insisting on adequate information, the investors could have got the boards to review social performance and responsible finance aspects. In reality, most investors have not been mindful of their responsibility towards customers till their investments were threatened after the AP crisis. Monitoring social performance is a recent responsibility taken by many MFI boards. Generating appropriate information and presenting to the board in a suitable form are aspects in which several MFIs have yet to gain competence. The investors can take a lead in developing capacities in the MFIs in this regard.

MONITORING SOCIAL PERFORMANCE

Some of the investors have developed internal systems and monitor the same usually on a periodical basis whereas others advise the partners to report to industry-level databases such as MIX market. Apart from the collection of data based on MIS of MFIs,

Box 6.4 Different monitoring approaches

Lok capital measures the outreach of the partners (women, marginalized such as SC/ST, rural and urban, under banked districts) as well as staffing (gender diversity and attrition).

Dia Vikas has developed a comprehensive reporting framework (Annex 6.2), which includes apart from financial performance data membership profile including poverty data, sector-wise loan distribution, other financial services such as savings, insurance, pension, developmental initiatives, staffing, board review of SPM and developmental indices such access to education of school children, access to water and sanitation, etc.

Manaveeya has quarterly monitoring in place that includes aspects such as poverty profile, purpose wise loan portfolio and products and services offered.

The NMI follows a pragmatic and flexible approach which considers the circumstances and capacities of each MIV Manager and MFI and allows for the gradual implementation of SPM and reporting in accordance with their respective circumstances and capacities.

some of the investors also carry out annual qualitative analysis.

There is a general consensus among investors that adoption and monitoring of the social performance and client protection practices has to be internally driven in MFIs. Outreach- and products-related practices are easy to monitor. An equity investment fund manager observes,

> If the promoter and senior management want to adopt good practices they will. In MFIs the social orientation has to be ensured upto the level of credit officer and their behavior has to be monitored. Unless the promoter believes in this it is not possible. There is little an investor can do to push unwilling MFI managements if they believe in just ticking the monitoring format; we have to then take a call to quit.

Overall, the reporting to board and external investors on SPM is still a nascent practice in many of the institutions. The indicators, yard sticks and benchmarks for measuring performance are still evolving.

What then are the responsibilities of investors when they invest in a company that has vulnerable poor for customers? The perception that the investors' responsibility ceases with selection of good MFIs for making their equity investment has been proved erroneous. The investing community is searching for answers that would not only satisfy the customers but also protect their reputation and investments. Investors look at commercial opportunities as they commit funds to equity. A robust business model, loyal clientele and a solid reputation are in the interest of investors apart from return on investment. While most investors do not pursue short-term returns over long-term sustainability of the MFI (which would fetch better valuation for the equity at the time of divestment), there are cases where the investors have been influenced by promoters. The promoters' vision for the organization can at times be highly infectious if it entails high growth and profits. The investors should resist the temptation of succumbing to such grand visions and insist on the promoters to pursue realistic business targets.

LENDERS

As per the Bharat Microfinance Quick Report 2012,[7] estimated bank fund flow to MFIs during the year is ₹6,700 crores, which is lower than the disbursements for the previous year, which was at ₹7,328 crores.[8] The MFIs and technical service providers have observed that bank loans to MFIs have slowed down to a trickle. Banks lent to only large MFIs, with non-AP portfolio, during the year. Reportedly, medium and small MFIs could not raise adequate funds, which has led to reduction in financial services to their clients thus hitting both social and financial bottom lines of these institutions.

Heightened risk perception of state action on MFIs and underlying customer protection issues have been reasons for the drastic fall in bank lending. The AP crisis is still not resolved; the MFIs have not been able to operate in the state and the repayments have reduced to single digit. What has been deterring banks is the risks related to similar action by other state governments. The bank boards required assurance on regulation of the MFIs and that the states will not act in such a way as to make their portfolio risky.

The second concern has been the customer protection-related issues. With several reports surfacing on over-indebtedness, ill-treatment of clients, coercive recovery practices, opaque pricing policies, etc., banks wanted reassurance on responsible financing practices of MFIs. The lenders had limited

manpower to carry out extensive field visits and satisfy themselves on the practices on the ground. Banks need independent and external assessments on the fair practices adoption by MFIs. A senior banker observes, 'We will ask MFIs to follow Responsible financing practices. Other aspects of social performance are good to have but not necessary for influencing lending decision'.

ENSURING REGULATORY AND CODE OF CONDUCT COMPLIANCE

Lenders' forum worked with both the associations and other stakeholders to bring about the unified code of conduct for MFIs, which facilitates adoption of a set of codes by all MFIs. Apart from MFIs' adhering to code of conduct, lenders' forum has also been insisting on the following measures to improve transparency and responsible lending practices:

- Uniform data to be given to all lenders by the MFIs; at present, these are largely financial data from the MIS of the MFIs.
- The MFIs to subscribe to credit bureaus and verify debt levels of borrowers through the bureaus. This will enable MFIs to avoid over-indebtedness of clients to a reasonable extent.

The SIDBI had commissioned the CoC assessments for 18 larger MFIs and plans to carry out 25 more such assessments during the year, which will cover Tiers 1 and 2 MFIs predominantly. The SIDBI is funding Sa-Dhan to carry out similar exercise for their partners, which will cover the Tier-3 institutions through a concise and suitably adapted version of the tool. An objective assessment of MFI's compliance to the CoC should provide assurance to lenders and investors about the field level responsible finance practices of the MFIs. While industry associations carry out checks of compliance of the code by their member MFIs, such assessments have to be carried out by third parties in the initial years.

The SIDBI has harmonized the CoC grades assigned by different assessing agencies and is also keen to develop benchmarks against which the performance of the MFIs will be measured. The SIDBI will need to work for standardization of the tool for use by any assessing agency. As next steps, the lenders forum has to deliberate and agree on the benchmarks and resultant lending decisions. Well-performing MFIs will also need to be incentivized through rebate of interest. The not-so-well-performing ones have to be given capacity building support to comply with CoC. Lenders have to stop lending if the MFIs continue to perform poorly.

IMPROVING REPORTING AND TRANSPARENCY

The SIDBI has signed an agreement with MIX Market, a global, web-based microfinance information platform, for developing a MIX market tailored for India. The India Microfinance Platform (IMFP) will disseminate information on the Indian MFIs. The MFIs would be required to submit financial and operational data, including remuneration expenses, in a standardized format agreed upon by the Lenders' Forum, thus enabling higher degree of transparency/disclosures. Lenders can advise the MFIs to report on SPM indicators to the IMFP apart from financial data. The platform will need to work on the SPM data and indicators more suitable to Indian context. Analytical reports can be made available which can guide the lenders and investors on the social performance of MFIs.

Standard Chartered bank promoted transparent communication of pricing by supporting Microfinance Transparency for collecting information on pricing of products from MFIs and hosting comparable and understandable annual percentage rates of the MFIs on the web.

CAPACITY BUILDING SUPPORT TO MFIs

Banks have been supporting unique initiatives of the MFIs in social performance management; AXIS bank foundation has allocated ₹75 crores to Bandhan for expanding its hard core poor programme. The SIDBI provides capacity building grants to MFIs out of a project funded by KFW and some of the grants have been utilized for strengthening capacities of both SIDBI and partner MFIs in responsible financing and CPPs of Smart Campaign.

DENIAL OF FUNDS TO SMALLER MFIs—IS IT RESPONSIBLE FINANCE FROM BANKS?

Small localized institutions, especially community-owned institutions, have been found to be more client-centric in their products and services; these institutions have been hit badly in the crisis and have largely not received fresh loans from banks. Though the regulatory norms were prescribed for NBFC MFIs, banks are insisting that all MFIs follow these

norms. The smaller institutions were worse off in the hands of banks though they often worked in remote areas with very poor people. Both rating agencies and banks perceived higher risks in dealing with them. Banks tended to deny or restrict loans, raise the interest rates, insist on higher collateral and ignore the good work done by these institutions. The SIDBI had commissioned a study[9] on the interest rates on costs and margins of MFIs during 2011 with the overall objective of conducting a detailed analysis of interest rates, costs and margins of SIDBI-assisted MFIs. The report has brought out that the long-term sustainability of Tiers 2 and 3 MFIs will be affected by the interest and margin caps. Key recommendations included among others investing in technology to improve efficiencies, differential interest rate caps across geographies and scale of the MFIs, improving responsible financing practices and improving client awareness through financial literacy.[10]

Compliance to regulatory norms has also added to the costs of operations of MFIs. The MFIs have had to incur additional costs in training the staff, introducing new loan application-related forms and in getting auditor's certificates for compliance. Unless industry level initiatives are taken to promote technological solutions to reduce costs, the operations may not be viable. Reportedly during 2011–12, many MFIs reported losses which can jeopardize their chances raising bank loans and serve their clients. Sustainability of these MFIs is in question.

Box 6.5 Advice—good or bad?

We were a NGO forming and linking self help groups with banks since 1996 in poorer districts of UP. We had to take up micro finance operations since banks were not lending adequately and timely and we could not cover our cost of providing maintenance support to SHGs. Five years ago we were told to transform to NBFC since banks and DFIs believed that for-profits would be better governed, managed and also would enable growth. We received technical assistance who asked us to abandon SHG model and shift to JLG for its efficiency. We grew modestly as per our plans. Today we are a tier 3 institution and barely viable. Banks are not willing to lend to us. The advice we get is to back to SHG model and be a BC of bank by becoming a NGO. The BC model is yet to be viable and policy on BCs changes every 6 months. Is it not the responsibility of the regulator and banks to have a consistent approach for financial inclusion? What do I explain to my clients?

—CEO, NBFC functioning in northern states

Box 6.6 Travails of community-based MFI

Indur Intideepam MACs federation functioning in Nizamabad in AP has maintained an excellent repayment record with the banks despite the crisis. Two factors have contributed to high repayment levels—the repayment ethics driven by the community leaders and sense of ownership among members—'it is my institution and it should not fail'. Since 2010, no fresh bank loans have been sanctioned and disbursed to this institution. With shrinking portfolio, the institution is struggling to keep afloat and provide services to its members.

EXPECTATIONS FROM BANKS

However, the sector is expecting much needed liquidity support from banks. With the regulatory framework getting tightened and industry-level and MFI-level initiatives being taken to improve ground-level practices, banks should now exhibit more confidence and support the sector. Their lack of support and inaction will lead to the closure of several well-functioning MFIs, especially the Tiers 2 and 3 MFIs, many of which had been client-focused.

Industry watchers find that bank boards have not been supportive of further credit exposures to the sector. Boards are not convinced that the political risks have been fully addressed. Who will be the first mover within the bank to convince the management and board to lend to the sector is a concern.

The MFIs find that bankers require training on RBI regulations on MFIs. Several of them are not fully aware of the changes in the sector and hence are becoming risk averse. The MFIs also find that bankers do not often visit the field to understand the measures taken by the MFI in terms of transparency and ethical practices. The trust can be rebuilt only through such field visits.

Vineet Rai, of Aavishkaar, observes, 'the Andhra crisis has impacted the lending psychology of the banks and it will take years to repair … At the same time, when the sector does come back, it will have the ability to produce much better results on the development index'.[11] But the outcome of the bankers' reluctance is that there may not be many MFIs existing to create development impacts.

Many industry watchers predict that if the situation continues, only about 15 MFIs would survive. 'Closure of mid sized and small MFIs is a tremendous loss of institutional and social capital built painstakingly over years. Competition brings in efficiencies and clients will ultimately benefit.'[12] If

Box 6.7 Viewpoints of some bankers

A senior bank observes, 'Though we believe some of the smaller institutions in non NBFC form are creating better value to the clients, their viability is at risk—how do we lend to them?'

> Can we take personal risk of challenging the thinking within the bank and push the management to lend to the MFIs? I am not in a position to assure that 'I have assessed every aspect, nothing will go wrong, let us lend'. The recommending official will be questioned deeply if there is any downturn.
>
> We are trying to build confidence internally—we will pick up MFIs who have gone through the crisis period with least damage; we will do profiling of MFIs, especially their governance, internal processes and then lend to MFIs; from risk management perspective, we have comfort in larger MFIs. Banks are concerned about the financials of MFIs. Their depth of poverty targeting, client centric products and services are desirable features but not necessities.

'There are very few uncertainties about the sector. Only bill is remaining; Regulator has done their bit; MFIs have done, the needful. Bad press has largely stopped. Now we have to take a call.'

'We need an intermediary; we do not have a model to service millions of clients. SHGs have their limitations and so we need MFIs. But we are not sure who will survive and who will not.'

only a handful of institutions survive, the industry situation will be such that too much money will chase too few institutions, which can lead to the sector growing in well-endowed regions and remote areas being neglected.

The MFIs have been providing financial services to a segment which the banks have not been able to service and the clients have found the MFI services useful. Efforts should be to solve the attitudinal and other issues which are deterring banks from lending. In the absence of availability of credit from the MFIs, the ultimate borrower is facing acute challenge of sustaining the livelihoods. Otherwise several millions of MFI clients have to go back to the moneylenders.

The regulator, government and banks have to appreciate the fact that

> MFIs are carrying out the mandate of the banks in providing small ticket loans to poor and low income households. MFIs use the banking infrastructure and utilize predominantly bank loans in carrying out their operations. MFIs in a way are an extended arm of the banks. Taking the sector ahead is the joint responsibility of banks, RBI and not just the MFIs.[13]

The policy ambivalence on whether MFIs have a role in the financial inclusion and how they could play such a role has to be settled fast.

CONCLUSION

As the major funders of the sector, banks and investors should lead the change in MFIs for delivering social performance and adopting responsible finance practices. As for investors, convergence around a single global standard for acceptable growth or profitability is unlikely. However, investors should play a key role in the sector's efforts to build consensus on tough issues, where possible and appropriate.

The shortage of Indian equity funding has to be dealt with. The SIDBI's experience in this space should be used and the IMEF should be expanded with contributions from banks and investors so that small and medium MFIs are able to access equity. Limited fund flow to MFIs would be a major setback for the drive by banks to promote 'Responsible Finance' among MFIs. In case the liquidity issues are not addressed soon, the MFIs will have to scale down their operations further and this might drive clients back to the moneylenders. In AP, studies show that many microfinance clients had to source high cost loans from informal sources after the MFIs stopped lending.[14] If for want of bank funding, people face disruptions to the only financial service that they had access to, then the actions of the banks cannot be deemed socially responsible. The interest cap has been found to be unworkable by some MFIs. Instead of removing the cap, RBI could have influenced the banks to take reasonable price decisions, considering the evidence of high portfolio quality. Apart from requiring the MFIs to be responsible, lending banks can make it possible for them to lower the rates of interest by competitive pricing of their loans to MFIs.

While investing in equity or providing loan funds, the funders are clearly aware that the MFIs deal with the poor and they should be prepared to ensure that the ultimate customers' interests are protected. In their relationship with the MFIs, the investors and funders can ask questions of the MFIs and demand socially relevant and responsible performance. But with the external world, the investors and funders have to answer such questions along with the MFIs. Currently one does not see this happening enough. Securing social performance is not the job of MFIs alone, but of the investors and funders too.

ANNEX 6. 1

ESG score card of Maanaveeya (Oikocredit)

	A: OUTREACH AND TARGETING (20%)				
1	**Poverty screening**	provide information in support of the score given			
2	**Rural orientation and agricultural focus**	provide information in support of the score given			
3	**Reaching women and/or disadvantaged groups**	provide information in support of the score given			
		Maximum points:	6	Section total:	0
	B: CLIENT BENEFIT AND WELFARE (40%)				
1	**Prevention of client over-indebtedness**	provide information in support of the score given			
2	**Client feedback**	provide information in support of the score given			
3	**Code of ethics and staff compliance**	provide information in support of the score given			
4	**Transparency about costs to clients**	provide information in support of the score given			
5	**Effective interest rate**	provide information in support of the score given			
6	**Non-financial products and services**	provide information in support of the score given			
		Maximum points:	12	Section total:	0
	C: GOVERNANCE (25%)				
1	**Vision/mission and strategic plan**	provide information in support of the score given			
2	**Strategic plan: growth**	provide information in support of the score given			
3	**Monitoring Results**	provide information in support of the score given			
4	**Salaries/remuneration and incentives**	provide information in support of the score given			
5	**Women representation**	provide information in support of the score given			
6	**Diversified ownership base**	provide information in support of the score given			
		Maximum points:	12	Section total:	0
	D: ENVIRONMENT (5%)				
1	**Organizational exclusion policy**	provide information in support of the score given			
2	**Environmental education and promotion**	provide information in support of the score given			
3	**Active focus on environment-friendly techniques**	provide information in support of the score given			
		Maximum points:	6	Section total:	0
	E: RESPONSIBILITY TO COMMUNITY & STAFF (10%)				
1	**Staff feedback and grievance procedures**	provide information in support of the score given			
2	**Staff appraisal and incentives**	provide information in support of the score given			
3	**Community projects**	provide information in support of the score given			
		Maximum points:	6	Section total:	0
	Total ESG score	**0.00%**			

COMMENTS: What is your own opinion of the MFI/Organization in terms of its social performance?

<45%	**Very Weak.** Negligible attention to social performance
45%–54%	**Moderately Weak.** Initial efforts underway to address SP issues
55%–64%	**Average.** Covers minimum standards and key issues for SP but clear needs for improvement
65%–79%	**Strong - Very Strong.** Shows strong social orientation and addresses all SP areas, clearly reflects attention to double bottom line
80% and higher	**Excellent.** A clear leader in social performance showing many best practices

ANNEX 6. 2

Some of the aspects monitored from a SPM point of view by Dia Vikas

MEMBERSHIP PROFILE (Number)		Male /Female		
		SHG	JLG	Individual
3.1 Schedule Caste	Urban			
	Rural			
3.2 Scheduled Tribe	Urban			
	Rural			
3.3 Other Backward Class	Urban			
	Rural			
3.4 Others/General	Urban			
	Rural			
3.5 Religious Minority	Urban			
	Rural			
3.6 Members with daily income of < US$1.25 or BPL Client				
	Urban			
	Rural			
3.7 Members with daily income of < US$2				
	Urban			
	Rural			
3.8 Members with daily income of > US$2				
	Urban			
	Rural			
SECTOR WISE LOAN DISBTRIBUTION			**No/Amt**	
4.1 Agriculture and Agri Allied	Nos. and % share			
	Amount and % share			
4.2 Dairy/Animal Husbandry	Nos. and % share			
	Amount and % share			
4.3 Manufacturing	Nos. and % share			
	Amount and % share			
4.4 Trading	Nos. and % share			
	Amount and % share			
4.5 Debt redemption	Nos. and % share			
	Amount and % share			

(*Continued*)

(*Continued*)

SECTOR WISE LOAN DISBTRIBUTION		No/Amt
4.6 Health	Nos. and % share	
	Amount and % share	
4.7 Education	Nos. and % share	
	Amount and % share	
4.8 Services	Nos. and % share	
	Amount and % share	
4.9 Consumption and Household needs	Nos. and % share	
	Amount and % share	
4.10 Others	Nos. and % share	
	Amount and % share	
OTHER FINANCIAL SERVICES (Monthly update)		**Outreach (no.)**
5.1 Remittance		
5.2 Insurance		
5.2.1 Voluntary	Health	
	Life	
	Accidental	
5.2.2 Compulsory	Health	
	Life	
	Accidental	
	Agri	
	Asset	
5.3 Savings services	Banking correspondence	
	Other linkages for savings	
5.4 Cash deposit maintained with MFI, if any		
5.5 Investment products		
5.6 Pension Services		
OTHER INITIATIVES		**Outreach (no.)**
6.1 Agriculture Farming		
6.2 Other Livelihood/Business Support		
6.3 Financial Literacy		
6.4 Other Interventions For Client Education		
6.5 Preventive Healthcare (Including health education)		
6.6 Other Healthcare		
6.7 Any other (mention)		

(*Continued*)

(*Continued*)

STAFF		**For the Quarter**		
		Male	**Female**	
7.1 Head Office	No. of staff			
	% of total staff			
7.2 Branch staff other than loan officer	No. of staff			
	% of total staff			
7.3 Loan officers	No. of staff			
	% of total staff			
7.4 Staff recruited during the period				
7.5 Staff left during the period				
7.6 Total staff (end of period)				
INTERNAL AUDIT				
8.1 No. of staff in the department				
8.2 Frequency of internal audit (please tick)			Monthly	
8.3 Internal Audit Department reports to (please tick)			Operations Manager	
Board review of SBP target matrix				**Yes**
9.1 Please Tick in the appropriate box				
Additional Indicators for SPM	**Rural**	**Rural**	**Urban**	**Urban**
10.1 School attendance	**Number**		**Number**	
Households with girl children of school age				
Households not regularly sending girl children to school				
10.2 Female Headed Household	**Number**		**Number**	
Female headed households				
10.3 Drinking Water	**Number**		**Number**	
Clients without access to own drinking water/improved water source				
10.4 Proper Sanitation	**Number**		**Number**	
Clients without access to toilet (own or community shared)				

NOTES AND REFERENCES

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2. Oiko Credit, 2012, Social Performance Report 2011. Available online at http://www.oikocredit.org/documents/Social%20Performance%20docs/PDF/oikocredit-social-performance-report-2011-english.pdf?&hit=no (accessed 1 July 2012).
3. Both EMFIL and Shalom are head quartered in Kerala.
4. Out of these MFIs, 20 per cent cooperatives, 30–35 per cent are NGOs, rest are NBFCs.
5. For example, hardship to animals is not tolerated and so while lending to MFIs and community-owned producer collectives, poultry farming is not financed since the birds have to stand in cages throughout their lives. Similarly, cultivation of bacillus thuringiensis (BT) cotton is not supported since this does not help poor.
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7. Sa-Dhan, The Bharat Micro Finance Quick Report 2012 (New Delhi, India: Sa-Dhan, 2012).
8. Srinivasan, N. 2011, *State of the Sector Report Micro finance, 2011*, commissioned by Access Development Services, Sage publications, New Delhi.
9. This study was part of a larger project titled 'Scaling up Sustainable and Responsible Microfinance Project' supported by World Bank and implemented by SIDBI.
10. SIDBI and Access Development Services, 2011, Study on Interest rates and costs of MFIs. Available online at http://www.sidbi.in/Micro/IMAGES/Final_SIDBI_Report.pdf (accessed 10 June 2012).
11. http://www.csfi.org/files/Microfinance_Banana_Skins_2012.pdf (accessed 10 July 2012).
12. Neeraj Verma, World Bank, Personal Communication, 31 July 2012.
13. Y.C. Nanda, ex-Chairman, NABARD, Personal Communication, 26 July 2012.
14. MicroSave has carried out an access to finance study of microfinance borrowers of AP in 2012 and the results show that in the absence of MFIs, 70 per cent respondents mentioned SHG as a source of credit and 57 per cent borrowers mentioned that they are forced to borrow from money lenders at 3–5 per cent. Microsave, Access to financial services in AP – 2012, preliminary findings, draft report (Lucknow: MicroSave, 2012).

Outreach—are the needy served?*

7
Chapter

'Outreach' of microfinance services has deservedly been the most critical determinant of both social and financial performance. Within the larger dimension of outreach, its 'breadth' and 'depth' have been used to understand the quality of performance. 'Breadth' of outreach refers to the scale of operations and commonly reported as number of clients being served. These are measured as the numbers of clients or accounts that are active at given point in time (rather than cumulative number of loans made or clients served). 'Depth' of outreach describes the nature of clients served that relates to specific target group/s of the MFI or the microfinance practice in general. Since many MFIs have poverty reduction as an objective, depth of outreach is most commonly determined by the proportion of poor and vulnerable being served.

Direct measurement of depth (poverty) through income or wealth is difficult. Simple, indirect proxies for depth are sex (women), location (rural), education (low level), ethnicity (minorities, tribes), housing (flimsy, small) and access to public services (lack of access is preferred). Geographic locations, within rural, can be further identified or classified as remote, tribal dominated, backward, hilly, disaster prone, conflict affected, etc., and MFIs may choose work in such locations as a strategy to serve populations with specific vulnerabilities.

Breadth and depth of outreach are at times considered inversely proportional, since focus on depth is likely to be difficult because poorer markets are difficult to penetrate and more costly to service and generate relatively lower gross revenues. This also relates to the debate between maximising sustainability, outreach and scale and targeting 'the poor or the poorest'. Not only does sustainability allow the commercialization of microfinance, thus increasing both its professionalism and outreach, but the scale commercialization brings also means that, in absolute terms, more poor people are reached. However, for many of the advocates of 'targeting the poorest', it is the move towards sustainability and commercial funding that results in 'mission drift', with the MFIs focusing increasingly on the non-poor as their preferred clients.[1] It is evident that there are trade-offs in both these approaches, and it is essentially a choice of each institution—its promoters and investors—to assess these and agree on an institutional strategy for growth and targeting. Schreiner[2] proposed a framework for outreach—the social benefits of microfinance for poor clients—in terms of six aspects: 'worth to clients' (willingness to pay), 'cost to clients' (sum of price costs and transaction costs), 'depth', 'breadth', 'length' (time frame of supply) and 'scope' (number and types of financial contracts supplied). The poverty approach assumes that great depth can compensate for narrow breadth, short length and limited scope. The self-sustainability approach assumes that wide breadth, long length and ample scope can compensate for shallow depth.[3]

BREADTH OF OUTREACH

The data on trends of breadth is most readily available. The Sa-Dhan Bharat Microfinance Report estimates that the total client base of MFIs has declined to 26.8 million in March 2012 (31.8 million in March 2011) of which NBFC-MFIs account for 87 per cent.

* This chapter was contributed by Radhika Agashe, ACCESS-ASSISST.

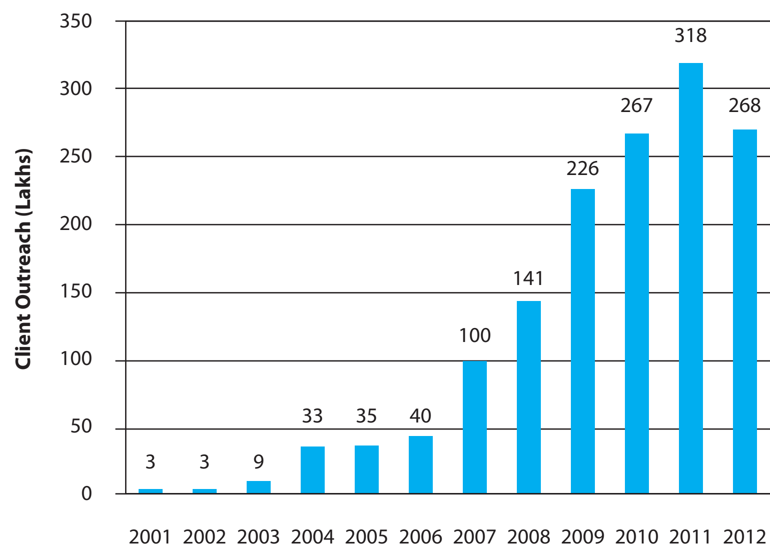


Figure 7.1 Bharat Microfinance Report 2012

Source: Bharat Microfinance Report 2012, Sa-Dhan, New Delhi.

However, the outreach (number of clients) of NBFC-MFIs declined by 17 per cent during the year, while those of non-profit and cooperative institutions increased by 4 per cent. This decline is mainly due to the reduced fund flow from the banking system to MFIs. The emphasis on avoidance of excess debt also led to some existing customers being dropped for the next loans as they were found having multiple loans.

DEPTH OF OUTREACH

The MFIs continue to focus on women clients with 94 per cent of total clients being women, while only 28 per cent MFIs ranked women's empowerment/gender equality as a top development goal as per MIX SPM data. Rural clients constitute 52 per cent of the total client outreach, while outreach to rural areas was the stated goal for about 90 per cent of India MFIs. In terms of geographical outreach across regions, 50 per cent of clients served are in south, with east contributing 25 per cent share. Western (7 per cent), central (10 per cent), northern (4 per cent) and north-eastern (4 per cent) regions are still underserved. Southern region has witnessed 19 per cent drop in client outreach, west and east experienced 25 per cent and 14 per cent, respectively, with marginal increases in north and north-eastern of 1 per cent each.

In order to further analyze depth of MFIs in terms of geography, a short survey covering 46 MFIs was conducted as part of this study. The data on presence of sample MFIs in districts was compared with the list of 155 Backward and Left Wing Extremism (LWE) affected districts[4] of the country identified by the Government of India. This shows that MFIs are present in 92 of these 155 districts covering 27 states. The details of presence of sample MFIs in BW districts and the client outreach is provided in Annex 7.1. The data MFI are present in 60 per cent of total BW districts, only 12 per cent of clients in these states are from BW districts. This percentage is higher in states with higher number of BW districts. These include Bihar (70 per cent), Madhya Pradesh (35 per cent) and West Bengal (32 per cent). Data of individual sample MFIs indicates that Bandhan (all-India), Sonata (UP), Margadarshak (UP), Samhita (MP), NEED, Bhartiya Microcredit (UP), Mahashakti (Orissa), Nirantara (Karnataka) and Intellecash have over 25 per cent of their clients in these BW districts, with smaller organizations such as CDOT (Bihar) and Saija (Bihar) serving 90–100 per cent of their clients in these districts. However, by virtue of its scale (breadth), the outreach of Bandhan in BW districts is much more than the total client outreach figures of other sample MFIs.

In the sample of 46 MFIs (Sample description in Annex 7.2), 44 institutions reported targeting women as a clear strategy, while the others reported targeting of clients in rural or urban/semi-urban locations (Table 7.1). Specific segment targeting such as Youth, minorities, or any other category of community with specific features was very limited.

Table 7.1 Target market

Target market	No. of MFIs
Women	44
Adolescents and youth	4
Indigenous people and ethnic minorities	10
Clients living in rural areas	35
Clients living in urban/semi-urban areas	32

$n = 46$

Source: Small sample study conducted by ACCESS-ASSIST for the purpose of this report, July 2012.

The Annual Social Performance Survey 2012 of Lok Capital has reported on outreach and targeting of five investees—Ujjivan, Janalaskhmi, Suryoday, Satin and Asirvad—as one of the key SPM components. It reports that all these MFIs have a strategy for targeting customers defined by income level, locality, occupation and demographic profile. However, the system for monitoring the outputs from these strategies is weak in some MFIs. Ujjivan and

Janalakshmi regularly review MIS reports to analyze their client profile to ensure that they are staying true to their target populations. Janalakshmi has a dedicated team called the Clients Insights Group that looks at client data month on month to profile customers.

A surrogate indicator used for depth of outreach is loan size per borrower, assuming that lower loan sizes correspond to poorer clients. Sa-Dhan reports that the per borrower loan size has gone up a little this year to ₹6,400 as compared to last year, but it is still significantly lower than the figure of ₹9,766 in 2010. However, the assumption that lower loan sizes correspond with poorer clients is flawed. Regardless of the status of the borrower MFIs have a low first cycle loan and ration the loans within pre set caps so as to increase outreach and reduce risk. There is no evidence to suggest that the subsequent cycle loans are determined by the status of the customers. Hence, it is difficult to use size of the loan to determine the depth of outreach to poor.

In the present context, selection of target clients is driven by the RBI guidelines that prescribe the income limits in rural and urban areas as ₹60,000 per annum and ₹120,000 per annum, respectively, as one of the criteria for qualifying assets. Need for compliance to these criteria has led many MFIs to discontinue collection of other client-level details that served as proxy for 'poor' or 'vulnerable'. These income limits define microfinance clients and do not in any way facilitate the measurement of depth of outreach to the poor. The MFIs have to collect information on client status to monitor their poverty outreach.

SCOPE OF OUTREACH

Scope of outreach refers to the diversity of services and products being availed by active clients. This includes variety of loan products as well as other financial services such as insurance, pensions and savings. The sample of 46 MFIs reported reaching out to clients with a mix of loan products (Table 7.2), which have been categorised into: *(a)* microenterprise (including income generating, general loan, JLG loan, etc.; *(b)* agriculture and allied (including crop loan and dairy loan); *(c)* housing; *(d)* water and sanitation; *(e)* emergency; *(f)* medical; and *(g)* education; and *(h)* miscellaneous. Data suggests that microenterprise loan is offered by all MFIs and is available in all districts having microfinance outreach.

Indian MFIs, except cooperative institutions, are not allowed to directly collect savings from clients. Some MFIs registered as non-profits (Section 25 Company, Society, Trust) are offering savings collections as BCs of banks, while some NBFCs are doing this through their affiliate non-profit organizations. Sa-dhan reports direct savings mobilization by member institutions (cooperatives and LAB) from 8 lakh clients, which is a very small proportion of outreach of microfinance in India. The Sadhan report also indicates that total clients covered under MFIs' micro-insurance programme stood at 163 lakhs as of March 2011. Of this coverage, 76 per cent is for credit (life) while 24 per cent is for health.

Table 7.2 Loan products

Loan products	No. of MFIs
Microenterprise loan	44
Agriculture & allied loan	8
Housing loan	7
Water/sanitation loan	7
Emergency loan	3
Medical loan	2
Education loan	5
Gold, staff, welfare, festival	9

n = 46

Source: Small sample study conducted by ACCESS-ASSIST for the purpose of this report, July 2012.

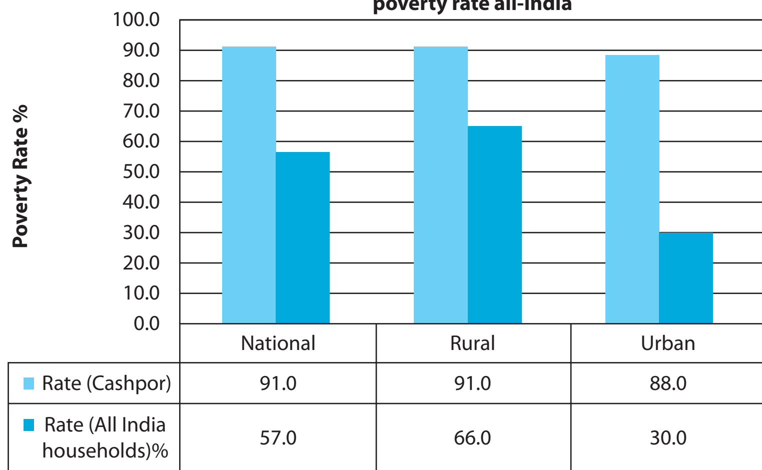
The present RBI regulation restricts 70 per cent (earlier 75 per cent) of the portfolio to lending for income generating activities (which includes microenterprise loan and agriculture and allied loan product categories above), thus limiting the possibility of other expansion of other products by MFIs.

POVERTY MEASUREMENT

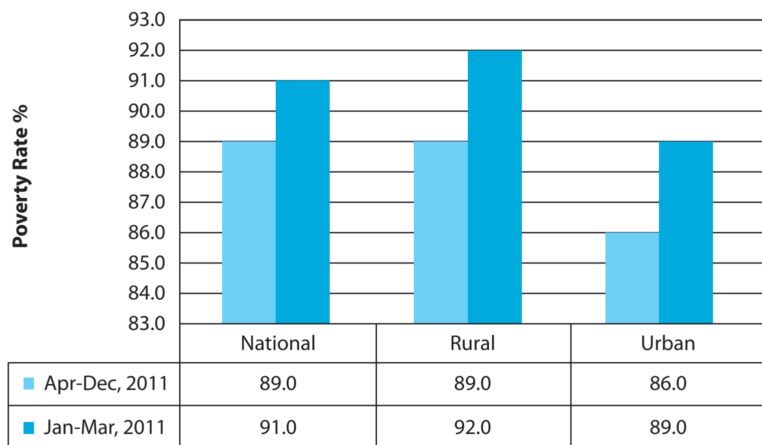
The most significant indicator of depth of outreach that has been discussed and analyzed in recent initiatives is outreach to the poor. Efforts of measuring poverty of microfinance clients have led to development of some standardized tools including FCAT of FINCA, MPAT of IFAD, Cashpor Housing Index (CHI) of Cashpor Microcredit, PPI of Grameen Foundation and PAT of USAID. The benefits of poverty measurement for MFIs explained in the MicroSave Focus Note[5] include tracking of depth of outreach and thus alignment to mission over time, benchmarking MFI poverty outreach to poverty levels of respective state and country, product development for poor, client segmentation for better decision-making on policies and procedures and targeted client selection. The acceptability of these tools is rising in India; the PPI is used by 17 MFIs, mainly for benchmarking and tracking, with at least

two MFIs (including CASHPOR) using the tool for client screening/selection.[6]

Last year's report provided a detailed narration on CASHPOR's targeting through two levels of screening of clients—first through the in-house CHI and second through the PPI. Once a client qualifies CHI, targeting is validated using the PPI. CASHPOR has objective of serving poor people and makes sure that minimum 90 per cent of its clients are below $1.5/day/person PPP poverty line. Until last year, PPI cut-off score used by CASHPOR was 34, which CASHPOR decided to reduce to 24 since January 2012 because a household with 24 or less PPI score has 90.2 per cent probability of falling below $1.5/day/person PPP. Results (Figures 7.2 and 7.3) show that with change in the cut-off, CASHPOR has been able to provide loans to more poor clients during last quarter of the FY 2012 (January–March).



	National	Rural	Urban
Rate (Cashpor)	91.0	91.0	88.0
Rate (All India households)%	57.0	66.0	30.0



	National	Rural	Urban
Apr-Dec, 2011	89.0	89.0	86.0
Jan-Mar, 2011	91.0	92.0	89.0

Figures 7.2 and 7.3

Source: CASHPOR Microcredit PPI results for 2011 and 2012.

While the use of PPI for poverty measurement has been acknowledged internationally, its use as a targeting tool is controversial. However, CASHPOR finds PPI as the most convenient tool for poverty estimation available in the present context. CASHPOR management also believes that PPI score is a proxy for ensuring adherence to income guidelines of the RBI since client with a score of 24 or less will most likely be below the income criteria laid down in the guidelines. In addition to targeting, CASHPOR is tracking poverty levels of its active clients on a monthly basis.

Grameen Koota is another initial user of the PPI tool. The PPI report of Grameen Koota for March 2012 (Annex 7.3) provides poverty likelihood of GK clients over time (2010, 2011 and 2012). The analysis enables the MFI to keep track of the poverty levels of the overall portfolio as well as analyze poverty levels of new clients and dropouts and any other dimensions such as urban and rural, etc.

In preparation for a large-scale analysis of the state of poverty measurement in the industry generally, MIX has been conducting interviews with MFIs from all over the world about their poverty measurement activities.[7] The MFIs report very similar benefits and drawbacks of the PPI. The most obvious, and perhaps most important benefit, is the ease of implementation and use. As MFIs already have a number of forms that loan officers must fill out with prospective or renewing clients, the PPI becomes 'just another form' in the stack. Furthermore, the objective nature of the scorecard's questions (which are mostly asset or education-related) makes it easy both for loan officers to complete the PPI and for managers and other supervisors to go back and verify a given client or household's score. In other words, very high levels of 'quality control' are possible with the tool. On the negative side, some institutions remark that significant investment in loan officer training is required to properly administer the PPI but none seem to view this extra training as a major obstacle or deterrent.

Where the ease of the PPI appears to break down is in the realm of MIS integration. With the important exception of GK, which adopted Grameen Foundation's open source Mifos MIS around the same time it adopted the PPI, all Indian PPI implementers cited MIS integration as problematic.

MOVING BEYOND THE PPI

All of the Indian MFIs that MIX has interviewed are serious about poverty measurement and, more broadly, about understanding their clients' lives—probably to a greater extent than the bulk of Indian

MFIs. They express qualified approval for the PPI as a tool but, tellingly, none of them rely exclusively on it to assess client poverty or well-being. The very things that recommend the PPI—its ease of implementation and use, standardization, etc.—also limit the value it can bring to an institution that is serious about adapting its products and services to the needs of its clients: the advantage of simplicity is also a drawback. No Indian MFI that MIX interviewed reported significantly changing either strategies or product/service offerings on the basis of PPI data, although that is not the case everywhere.[8] All of the Indian PPI users that MIX has spoken with supplement PPI measurements by collecting other data on clients. Among these, Anjali represents the extreme case: a small MFI serving previously excluded clients in West Bengal, Anjali was founded with a vision of total client tracking and understanding. Working from the PPI as a base, Anjali created its own social index that captures information ranging from what a client is eating (not just *that* a client is eating) to the types of fuel she uses to whether her children are in school (and if not, why not).[9] This data subsequently informs everything Anjali does, from the types of loan products it offers to its decision to focus heavily on health insurance provision.

Such high levels of individual client knowledge are probably unfeasible for every MFI. It should be noted, however, that these costs have not prevented Anjali from maintaining an operational sustainability above 100 per cent in fiscal year 2011.[10]

RELATIONSHIP OF CLIENT POVERTY LEVELS WITH DEMOGRAPHIC CHARACTERISTICS

Grameen Foundation aggregated PPI data of 470,548 clients from 14 MFIs operating across 16 states in India collected during 2010–12, along with the demographic information of clients to analyze trends between these.[11] The data suggests that in three states, rural MFI clients have a higher poverty level than the poverty concentrations in these states, while in four states, urban MFI clients of the sample have higher poverty concentration than the states they operate in. In other states, MFIs are reaching out to poor clients in lower proportion than the state poverty levels revealing the gap between objectives and performance in targeting.

Indian MFIs continue to have different approaches that have potential to maximize outreach to poverty pockets or backward regions of the country. Smaller MFIs deploy niche targeting of geographical areas in order to serve the poor, while larger MFIs are serving clients in poor areas by virtue of their large scale of operations.

Despite the popularity of poverty reduction as a goal for Indian institutions, targeting poor and poverty outcome tracking are still to gain traction.

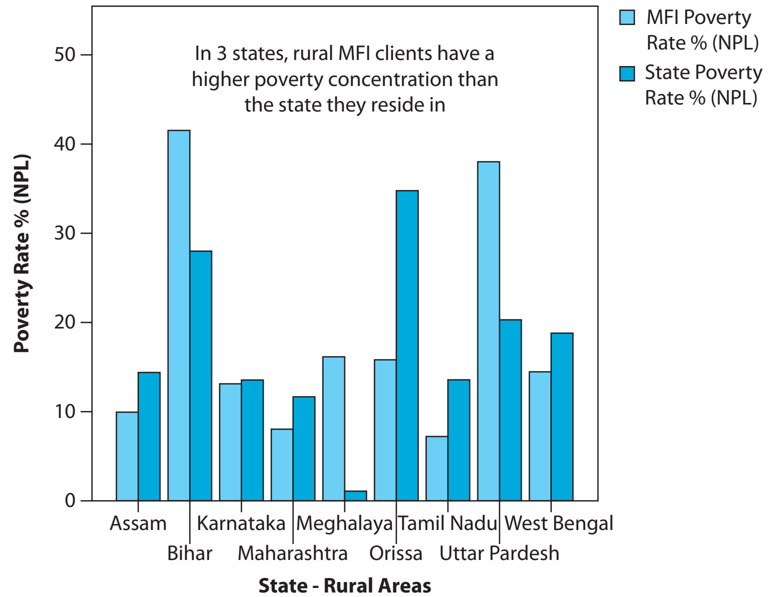


Figure 7.4 MFI poverty concentrations compared with the actual poverty concentrations in rural areas

Source: Analysis conducted by Grameen Foundation for the purpose of this report.

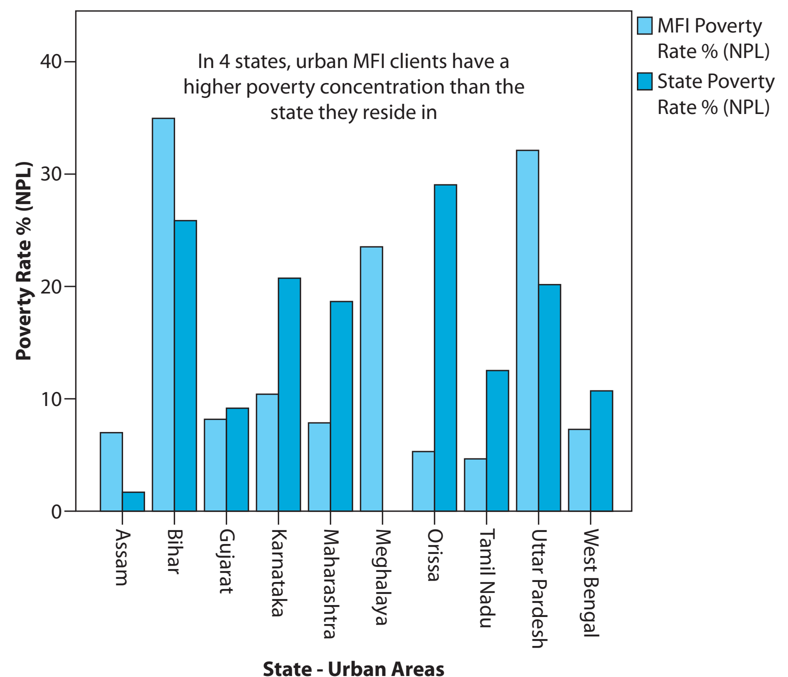


Figure 7.5 MFI poverty concentrations compared with the actual poverty concentrations in urban areas

Source: Analysis conducted by Grameen Foundation for the purpose of this report.

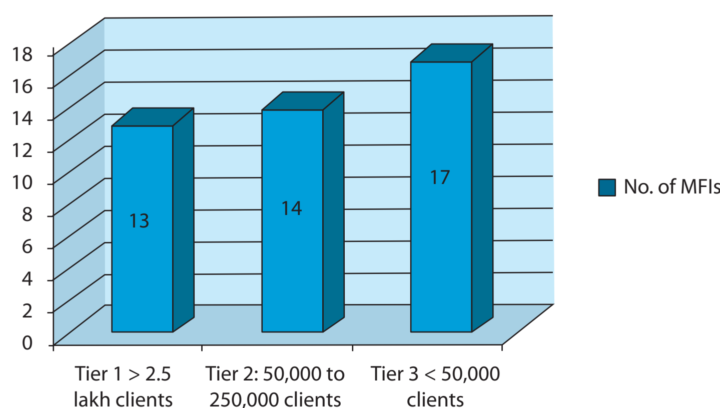
Nonetheless, some Indian MFIs have started monitoring clients' poverty and well-being and using this information to refine their strategies, products and services. These institutions rely on a wide variety of tools to accomplish this aim. The RBI guidelines on customer selection tend to take the focus away from targeting and persuade the MFIs to carry out the regulatory minimum diligence on customer status. The requirement of providing not less than 70 per cent of loans for income generating purposes erodes the flexibility of MFIs to respond to customers' needs, which in case of the poor is mostly for consumption. Outreach to poor is not a mere issue in targeting and identification of tools but a larger issue of policy and institution design. After selection of customers with a clear target, whether MFIs have the right products and appropriate processes to fulfil their needs is a question that should be answered.

ANNEX 7.1
Details of presence of MFIs in backward districts in sample study of 44 MFIs

Sl. no.	State	No. of backward districts	No. of BWDs with MFI outreach	% of BWDs with MFI outreach	No. of MFIs with outreach in BWDs	Total no. of clients (lakh)	Total no. of clients in BWDs (lakh)	% of clients of sample MFIs in BWDs
1	Andhra Pradesh	1	**1**	100	**1**	2	0.31	13
2	Arunachal Pradesh	2	**0**	0	**0**	0.01	0.00	0
3	Assam	4	**2**	50	**2**	8	0.05	1
4	Bihar	27	21	78	13	6	3.98	70
5	Chhattisgarh	4	1	25	1	0	0.02	7
6	Dadra & Nagar Haveli	1	1	100	1	0	0.01	100
7	Gujarat	2	0	0	0			
8	Haryana	3	1	33	1	5	0.37	8
9	Himachal Pradesh	3	0	0	0	0		
10	Jammu & Kashmir	3	0	0	0	0		0
11	Jharkhand	11	7	64	2	7	0.59	9
12	Karnataka	3	3	100	8	37	1.29	3
13	Kerala	2	1	50	2	5	0.24	4
14	Madhya Pradesh	24	17	71	9	2	0.78	35
15	Maharashtra	12	10	83	5	7	1.10	15
16	Manipur	1	0	0	0	0	0.00	0
17	Meghalaya	2	0	0	0	1	0.00	0
18	Mizoram	2	0	0	0	0	0.00	0
19	Nagaland	2	0	0	0	0	0.00	0
20	Orissa	8	3	38	2	5	0.16	3
21	Rajasthan	4	3	75	2	8	0.02	0
22	Sikkim	3	2	67	1	0	0.04	50
23	Tamil Nadu	2	2	100	5	27	0.06	0
24	Tripura	2	1	50	2	2	1.00	55
25	Uttar Pradesh	20	11	55	10	9	1.14	13
26	Uttarakhand	1	0	0	0	1		0
27	West Bengal	6	6	100	6	24	7.75	32
	Total	**155**	**93**	60	–	**155.55**	**18.89**	**12**

ANNEX 7.2
Sample description of outreach survey conducted for the report

Number of MFIs – 44



Lending methodology*	Number of MFIs
Self-Help Groups	12
Joint Liability Groups	37
Individual	14
Others	6

Note: * Some MFI for have multiple lending models.

ANNEX 7. 3
PPI report: Poverty likelihood of Grameen Koota

1. This report is based on the most recent PPI instances available on MIFOS (of Grameen Koota Clients), data as of 31 March 2012. 'Total number of PPI scores available' for the following segments of clients is as below:

Segment	No. of PPI instances
Active Clients	
Latest PPI Instances	276,728
2 PPI Instances	80,906
3 PPI Instances	21,753
Dropouts	
Latest PPI Instances	155,387
Both Earliest and Exit PPI instances	50,567
New Clients (FY12)	41,178

2. 'Poverty line values' defined in this report:

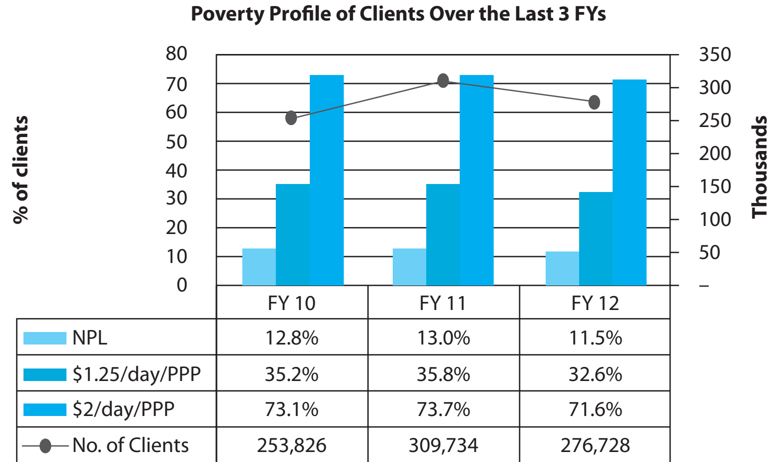
	Poverty line value (₹/household/month)	
Poverty line *Corresponds to…*	**Rural**	**Urban**
National	3,070	4,180
$1.25/day/PPP	4,610	4,610
$1.5/day/PPP	5,530	5,530
$2/day/PPP	7,370	7,380

3. 'Analysis of Active Clients' (latest PPI instance of each client)

a. All 'Active Clients' as of March 2012:

Portfolio	Base (Nos)	Below NPL	Below \$1.25/day/PPP	Below \$2/day/PPP
All Active Clients	276,728	11.5%	32.6%	71.6%
National Rates, All-India	–	17.0%	42.6%	74.9%

b. The poverty likelihood of Grameen Koota Clients over a period of time is as below:



	FY 10	FY 11	FY 12
NPL	12.8%	13.0%	11.5%
\$1.25/day/PPP	35.2%	35.8%	32.6%
\$2/day/PPP	73.1%	73.7%	71.6%
No. of Clients	253,826	309,734	276,728

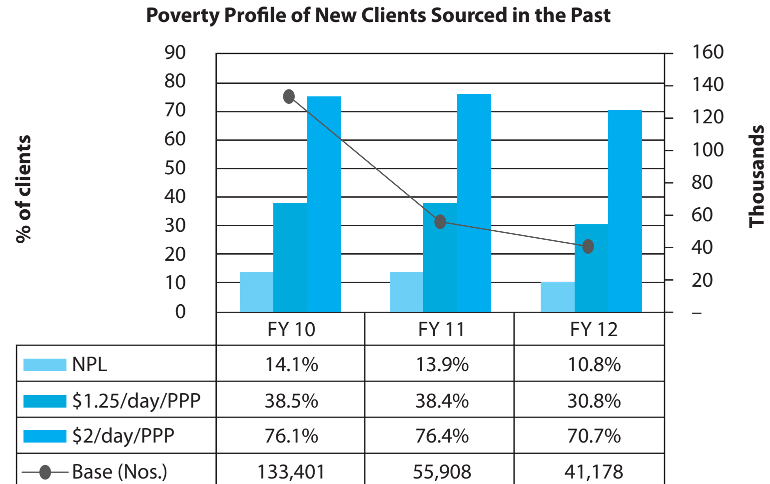
c. 'Rural' and 'Urban' Clients:

Active clients	Base (Nos)	Below NPL	Below \$1.25/day/PPP	Below \$2/day/PPP
Rural Clients	150,799	12.8%	36.3%	75.3%
Urban Clients	125,929	10.0%	28.2%	67.2%

d. 'New Clients' sourced in FY 12:

Portfolio	Base (Nos)	Below NPL	Below \$1.25/day/PPP	Below \$2/day/PPP
New Clients	41,178	10.8%	30.8%	70.7%
All other active clients sourced before FY 12	235,550	11.7%	32.9%	71.8%

New Clients sourced in the past:

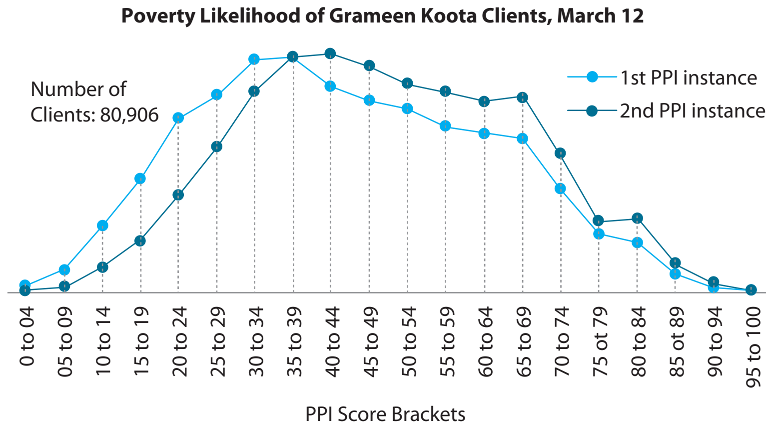


	FY 10	FY 11	FY 12
NPL	14.1%	13.9%	10.8%
\$1.25/day/PPP	38.5%	38.4%	30.8%
\$2/day/PPP	76.1%	76.4%	70.7%
Base (Nos.)	133,401	55,908	41,178

4. 'Poverty Movement Trend'

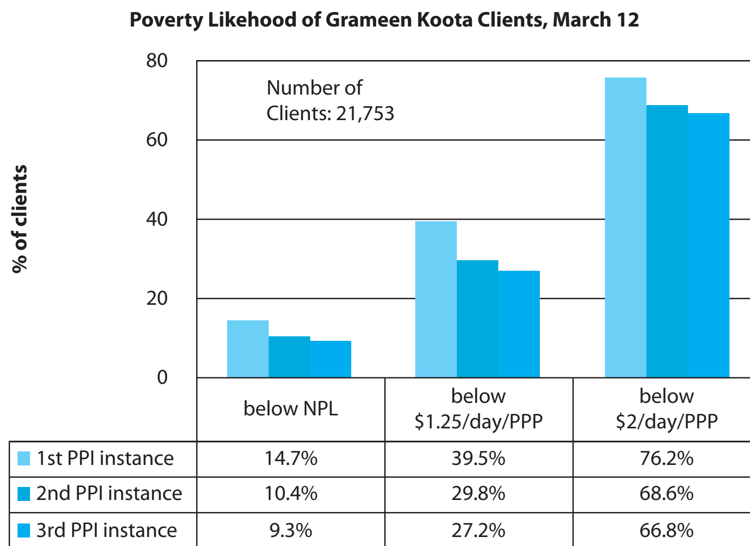
   a. Clients with 'two PPI Instances':

Portfolio	Below NPL	Below $1.25/day/PPP	Below $2/day/PPP
1st PPI Instance	14.0%	38.1%	75.1%
2nd PPI Instance	10.5%	30.5%	70.1%



- The average period of these clients since joining Grameen Koota till the latest PPI available is 29 months.
- The average period between 1st PPI Instance and 2nd PPI instance is 17 months.

b. Clients with 'three PPI Instances':



	below NPL	below $1.25/day/PPP	below $2/day/PPP
1st PPI instance	14.7%	39.5%	76.2%
2nd PPI instance	10.4%	29.8%	68.6%
3rd PPI instance	9.3%	27.2%	66.8%

- The average period of these clients since joining Grameen Koota till the latest PPI available is 42 months.
- The average period between 1st PPI Instance and 3rd PPI instance is 26 months.

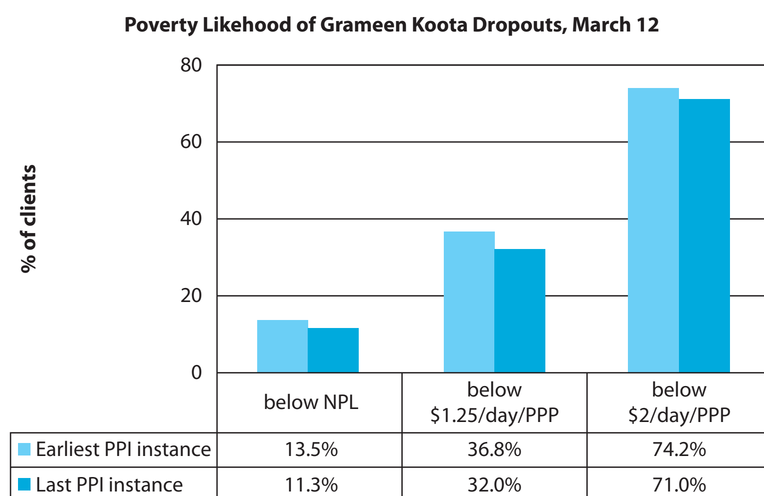
5. 'Analysis of Dropouts'

a. Dropouts as of March 2012 (last PPI instance available of each client):

Portfolio	Number of clients	Below NPL	Below $1.25/day/PPP	Below $2/day/PPP
Dropouts	155,387	13.7%	37.2%	74.7%
Active Clients	276,728	11.5%	32.6%	71.6%

It is evident from the above figures that the poverty likelihood of dropouts is worse off than the current set of active clients. However, it would be interesting to know what poverty levels they stood at during their 1st PPI instance. There are 50,567 such dropouts whose scores can be analyzed; comparing the poverty levels of dropouts during 1st PPI instance and the last PPI instance, significant proportion of people move out of absolute poverty line ($1.25 a day)

b. Poverty Profile of Dropouts at different instances:



- The average period of these clients since joining Grameen Koota till the latest PPI available is 25 months.
- The average period between 1st PPI Instance and last PPI instance is 16 months.

Analysis of active clients

i. Customer Cycle:

	No. of clients	Below NPL	Below $1.25/day/PPP	Below $2/day/PPP
Cycle 1&2	219,887	12.4%	34.7%	73.5%
Cycle 3	22,157	9.0%	26.1%	65.8%
Cycle 4 and higher	34,684	7.9%	23.4%	63.2%
	No. of clients	**Below NPL**	**Below $1.25/day/PPP**	**Below $2/day/PPP**
Central Karnataka	110,544	12.8%	35.5%	73.5%
South Karnataka	83,081	10.3%	30.0%	69.5%
North Karnataka	34,664	14.4%	38.9%	75.8%
Maharastra-Aurangabad	22,042	10.3%	31.5%	73.7%
Maharastra-Pune	26,397	7.1%	21.2%	63.3%

	No. of clients	Below NPL	Below $1.25/day/PPP	Below $2/day/PPP
Arrears	6,612	11.4%	34.4%	76.4%
No Arrears	270,116	11.5%	32.6%	71.5%
	No. of clients	**Below NPL**	**Below $1.25/day/PPP**	**Below $2/day/PPP**
General	264,141	11.5%	32.4%	71.4%
WatSan	6,377	11.0%	32.3%	72.4%
CookStove	6,210	14.1%	40.7%	79.5%

Source: Source: Report prepared by Grameen Koota on PPI data.

NOTES AND REFERENCES

1. 'Aspects of Outreach: A Framework for the Discussion of the Social Benefits of Microfinance, Mark Schreiner, June 2002', *Journal of International Development*, 14 (2002), USA.
2. Mark Schreiner, 'Aspects of Outreach: A Framework for the Discussion of the Social Benefits of Microfinance', Journal of International Development, 14 (2002), USA.
3. Graham A.N. Wright and Aleke Dondo, 'Are you Poor Enough? Client Selection by Microfinance Institutions', MicroSave Briefing Note # 7. Lucknow, India: MicroSave, March 2001).
4. Mark Schreiner, 'Aspects of Outreach: A Framework for the Discussion of the Social Benefits of Microfinance', *Journal of International Development*, 14 (2002), USA.
5. Sunit Bhatt and A. Veena Yamini, *Poverty Measurement: Challenges and Benefits*, MicroSave India, Focus Note 96 (Lucknow, India: MicroSave, July 2012).
6. This includes list of 100 backward districts and list of 41 additional LWE affected and backward districts.
7. Sunit Bhatt and A. Veena Yamini, *Poverty Measurement: Challenges and Benefits*, MicroSave India, Focus Note 96 (Lucknow, India: MicroSave, July 2012).
8. Michael W. Krell, 'Poverty Measurement and the PPI: Some Preliminary Findings from India', August 2012. Unpublished, prepared for the MIX Market for purpose of this report.
9. Furthermore, Anjali's commitment to knowing each and every client has led it to take a strong stance against sampling: as the needs of every client are unique, Anjali feels that it is not acceptable to allow one client's situation to represent another's.
10. MIX Market, http://www.mixmarket.org/node/34932/report (accessed 13 August 2012). Anjali has just completed its third year of microfinance operations.
11. The data used in this aggregation is not statistically significant because it has been drawn from clients of MFIs following different lending methodologies, differences in sampling procedure used by MFIs and difference in time period over which the data was collected by MFIs.

Community-owned institutions and member-centric services

8
Chapter

There are three different categories into which we can classify the MFIs—for-profits, non-profits and mutual benefit. All the mutual benefits are community-owned while some of the for-profit and non-profit companies are also community-owned. The excesses which were witnessed whether in growth rates, efficiency, lending practices and mission drift were more or less associated with the for-profit companies with external investor shareholdings. While some of the not-for-profits also aped these practices in order to compete, community-owned institutions were largely not part of this phenomenon.

> *The growth is also accompanied by apprehension that the poor and disadvantaged are not being served to the best extent feasible. The products and processes which were to be aligned with the requirements of the customers no longer show the intent that customers matter. In quite a few cases, the costs, loan terms, recovery practices and governance militate against customer-responsive financial intermediation. There has been a sense that MFIs have been adding to their profits and enterprise value at the expense of the customers. Microfinance in many respects has become a commercial activity, losing its soul on the way to becoming big, strong and profitable.*[1]

However, community ownership is not an unadulterated success. This model could have significant problems unless it is carefully designed and run. There are a number of failed community institutions, especially in the financial sector which serve as examples of how not to create such institutions. A strong possibility exists of these democratic institutions having their governance captured by political elements or the elite to the detriment of the poor. Even financially successful ones were not always inclusive and some of them became political. Some financial federations of SHGs who were once considered as star performers are not functioning any more.

When these institutions are of the appropriate size (to render effective peer monitoring and review feasible), they function effectively; when they grow beyond the optimal size, the governance and control systems become weak. The more opportunistic members would tend to take advantage of the laxity in the control systems. Elite capture, borrower members influencing the board decisions, management capture of the institution, weak internal controls are some of the weaknesses that dog these institutions.

There are a number of institutions in the community space that have done well. Since they are member-owned institutions and governed by member board, they are expected to be client-centric. One does not usually hear of the 'excesses' in their lending practices. Are these institutions performing better in balancing their social and financial performance?

This chapter draws its findings from five[2] community-owned financial institutions, who have been well managed and proven to be sustainable. Details of the COMFIs are given in Annex 8.1.

MISSION AND POVERTY FOCUS

COMFIs like other MFIs have varied missions—ranging from promoting affordable financial services, building institutions for women empowerment to improving the quality of life of the member households. Some of them are poverty-focused and others are not. COMFIs have been largely formed by NGOs that were keen to include the vulnerable and poor into the institutions but do not have exclusive poverty focus.

Indur Intideepam MACs federation was formed by Grama Abhyudaya Mandali (GRAM) who targeted

marginalized sections such as scheduled castes and tribes who are the members of SHGs. Bagnan Mahila Bikash Cooperative Credit Society (BMBCS) was formed with the women producer groups under Integrated Rural Development Program (IRDP) and Development of Women and Children in Rural Areas (DWCRA). Cooperative Development Foundation (CDF) does not exclusively target poor but all rural households are encouraged to join the village thrift cooperative. There are exclusive women and men cooperatives. Grameen Mahila Swayamsiddha Sangha (GMSS) is focused on providing financial and non-financial services aimed at empowering the rural poor women. GMSS follows an inclusive approach, without barriers to screen out non-rural or non-poor.

Thus, the missions and poverty focus of the COMFIs are no different from other MFIs. What however sets them apart is that mission drift is unusual in these institutions. Excessive interest rates and profiteering, opaque pricing and coercive recovery practices causing member distress is unheard of among well-managed COMFIs. Community-based institutions are able to focus on their mission over long periods of time. Growth and profits are incidental and hence the operations concentrate on providing effective services to customers.

Box 8.1 CEO, IIMF, Nizamabad, AP

We are very much mission focused; separate drive for social performance management and CPPs are all for institutions with external stakeholders. These are not largely applicable for community owned institutions.

Source: CEO, IIMF.

ENABLING INSTITUTIONAL STRUCTURES

COMFIs have engaged in group mobilization, created institutions in the grass roots and meso-levels, decentralized functions and empowered the lower tier institutions to provide mechanisms and space for several user members to get involved in the operations and growth of the institutions.

Many of them follow group methodology; in the primary groups, members have the opportunity to not only carry out financial transactions or receive financial services but also where discussions on non-financial services and issues of common concern are facilitated.

The SHG methodology is more common among COMFIs. The SHGs are termed to be more socially oriented; discussions in meetings are neither time bound nor centred on only loans.

COMFIs usually have two- or three-tiered structure with grass root leaders getting elected into each of the higher structure. The multiple tiers facilitate greater participation of people in the governance of the institution and develop leadership competencies necessary for continued improvement. An important aspect of such structure is the opportunity the members get to voice their needs to the office bearers directly. However, the tiers need to be appropriately designed to ensure reach of members, adequate controls on operations as well as the financial sustainability of the COMFIs. For example, in the CDF model for each village, a thrift cooperative is formed with the potential of up to 1,000 members. When numbers increase, more thrift cooperatives are formed. Thus, 10–15 cooperatives within 10–12 km radius form an association. This makes the structure member-focused and ensures adequate support to thrift cooperatives.

In the COMFIs, on account of the participative processes and the involvement of members in governance through their representatives, member needs are better handled. The different tiers at grass roots keep the participation of members high, build member confidence in governance, provide valuable leadership experience and lead to member-responsive intermediation processes. The building of multiple tiers also ensures that risks and problems are contained at the point of occurrence without contaminating the other parts of a larger system.

OWNERS AND FUNDERS

The structure of such institutions have ensured continued holding of equity by members. By not providing space for others to enter, these institutions have safeguarded the future form and ownership. IIMF by setting up itself as a federation of MACS has ensured that the board remains under the influence of members. Thrift cooperatives of CDF and Bagnan have not borrowed from external sources. They totally manage their operations through member shares and savings and thus there are no external pressures that guide their operations. In community-owned institutions, setting up barriers to prevent entry of unsuitable external persons is as important as getting the ownership form and structure right.

Absence of external owners is in a way a boon to these institutions. The institutional efforts are focused on mobilizing member shares/savings which

has twin benefits—building members' stake in the institution and building member's assets. For example, initially the promoters of Bagnan requested the Government of West Bengal for equity investments in the cooperative but the proposal was rejected which prompted them to develop several savings products to build the corpus of the cooperative.

Mission drift is least likely to occur in community-governed institutions. In privately owned institutions where a stake sale brings in new owners, the organizational ethos could change. In user-member-owned institutions, such a change in business model is not likely.

The availability of grant funds for such forms of organization tends to impair discipline and erode governance principles that arise from a strong sense of ownership. External funds unless infused with discretion, distort institutional priorities and weaken ownership.

GOVERNANCE

Such institutions ensure the involvement of members in the organizational and governance processes. The board of directors are from the community who meet on a monthly basis and operational and financial review is conducted in each of the meeting. The frequent meetings enable the board to be more in the know of the operations and the extent to which member needs are fulfilled. The meetings focus on financial and social aspects of operations.[3]

The boards' perception and understanding of member needs and ground-level operations is exemplary. However, these boards, especially in the women-owned institutions, depended on the staff to provide them adequate technical information on financial performance. Bankers see this lack of technical expertise of grass roots leaders as a major weakness. Some of the promoters have strengthened the Boards through different mechanisms—appointing representatives of promoters to the Boards, appointing advisory committee of experts and engaging professionals to provide policy oversight and control.

In the federations formed by IDF, independent director of repute have been inducted as board members though the majority of the leaders are from the SHGs. IIMF is guided by the promoter in developing strategies for growth, though he is not an official member of the board. In BMASS and Sanginee, federations of SHGs in Orissa external professionals provide policy oversight. GMSS had an advisory board of five members with microfinance experience (three from Chaitanya the supporting NGO, two independent professionals) to assist the Executive Committee. However, at present, policies are framed by the federation with the support of Chaitanya. Cooperative Development Foundation is playing the role of facilitator for policy setting for all the cooperatives in its network.

ELITE CAPTURE OF THE BOARD

Since board members are drawn from different socio-economic segments, there are possibilities that some members who are more resourceful may exert more influence and power over others. This can lead to inequitable decisions and member discomfort. Well-designed feedback mechanism and enabling organizational processes can help in addressing this issue. Very often the intervention of the promoter will also be needed to address this issue.

GMSS has included more tribals into SHGs in the last few years. In order to ensure that tribal board members were given adequate space and consulted in an equal manner in decision-making, older members were assigned the responsibility for training and mentoring new members.

Long-serving board members have a strong sense of ownership and it is difficult for them to step down. Institutional mechanisms for upward movement of these leaders for tasks such as forming new federations, working as community resource persons need to be in place to tap their experience and energy. Thus, the relationships with them need to be managed to promote institutional growth and facilitate rotation of leadership in governance.

Some borrowers default in spite of occupying board positions. Since this sets bad example and precedents, rules are often made that defaulters cannot occupy board positions. Peer pressure from federation and cluster leaders often solve the issues.

BALANCED GROWTH, BALANCED PROFITS

COMFIs have balanced growth plans and grow at the pace the members set. While they make plans to meet member needs, they do not have over ambitious growth targets.

Every effort is made to conserve resources and cut costs. Many COMFIs mobilize compulsory savings in order to bolster their low-cost resources. The management and operations staff is paid adequately. The CEO to field staff salary is very reasonable with a multiple of 4–6. No compensation is usually paid to the board members; all of them do the COMFI-related work on a voluntary basis.

Interest rates on loans are set by the ability of the members to repay and are not based on what the market can bear. Some boards such as GMSS have reduced the overall cost to their borrowers once efficiencies are achieved. As per CEO of GMSS, 'If we reduce interest rate to SHGs, they may or may not reduce the interest to the individual member. Hence we reduced service charge by 1% which will directly benefit the member'. The CDF convenes the meeting of all presidents and accountants of cooperative associations who decide the terms of loans, savings and other financial products. Any decision taken has to be accepted and approved by members of the thrift cooperatives. Similar is the case of IIMF.

Many COMFIs also set aside a part of their earnings/profits for member benefit. Bagnan cooperative transfers 4 per cent of the interest income and 10 per cent of the profits to the Bagnan society to conduct vocational trainings, awareness programmes and other activities for the member households. All these trainings are planned in the start of the year and the progress monitored by the cooperative board every quarter. Similarly, GMSS allocates 5 per cent of the profits for social activities but GMSS is yet to develop a strategy—prioritization of activities, estimated costs—for using this amount. So far the funds have been utilized for rewards to well-performing staff and meeting the expenses of cluster meetings.

RETURNS TO MEMBERS ON EQUITY

Many COMFIs mobilize share capital but often the members are not aware of the returns that they can expect on the shares. In BMBCS, dividends are credited annually in the savings accounts of the members. IIMF and member MACs have not declared dividends so far but members expect dividend to the extent of at least fixed deposit interest paid by banks. The CDF promoted cooperatives mobilize compulsory thrift and pays bonus based on the profits. Since many of the older cooperatives have idle funds, the return to members has been low.

Box.8.2 Whose MFI is it?

CEO, IIMF, Nizamabad, AP
The members never think this institution is an MFI; it is an institution of their own. Even in the midst of media propaganda, local political cadres inciting women not to repay loans, women have repaid since they consider IIMF is their own institution.

Source: CEO, IIMF.

As the loans are priced at reasonable rates and the profits are allocated for non-financial services for members, the surplus available for declaring dividend is comparatively low. Members of COMFIs expect a return/dividend of about 10–12 per cent on face value of the equity.

MEMBER FEEDBACK MECHANISMS

The COMFIs have developed suitable structures and processes for capturing member needs and addressing them. In IIMF, the Representative General Body is the vital mechanism in ensuring that the voices of members are heard and addressed. These village representatives who are elected for a term of one year attend the meetings of different SHGs in their village to ascertain their problems and expectations from the MACS and IIMF. When they attend the RGB meetings of the concerned MACS, they represent the members' issues. Upon their return from the RGB, they brief the SHG leaders about the outcomes and developments so that the members are suitably informed. In the CDF, each village thrift cooperative has about 1,000 members and 12 directors on the board; each BOD is expected to be closely in touch with 100 members.

Apart from these structures, the annual general body meetings of the institutions is another forum for not only getting approval of the financials and activities of the COMFI but also to obtain feedback of members.

An important aspect of such institutions is the opportunity the members get to voice their grievances to the office bearers directly, in case that their problems are not solved by the staff. The CDF has institutionalized this process of written complaint duly acknowledged in writing by the cooperative. In GMSS, since the members regularly visit the office, they can complain to the manager and chairman directly. The lack of a grievance-handling system in most MFIs had been a source of customer discomfort, which is being addressed by MFIs with the recent regulatory guidelines of RBI. The larger the institution, the more remote is the solution to a problem in the ground and the more difficult it is for the customers to get the grievance across. In the COMFIs, on account of the participative processes and the involvement of members in governance through their representatives, grievances are also better handled.

None of the institutions have very strong client information on their demographic and socio-economic profiles. Tracking their progress over time to ensure

mission fulfilment is another aspect, which COMFIs do not normally focus much on. A CEO says,

> When external ratings are carried out they point out to lack of data on clients, systems to track their progress and lack of data on member exit. These are expensive exercises which we do not have much use for. We do not have to prove to external world about targeting and mission fulfilment.

GMSS has initiated a unique process of participatory impact assessment that it wants to use internally for improving processes, products and non-financial services.

APPROPRIATE PRODUCTS AND SERVICES

COMFIs are able to retain the loyalty and patronage of members only if they provide quality services. Many of the COMFIs are localized institutions that enable them to work more closely with the members they serve. The range of products that they offer and also the terms of the products are client focused. In GMSS, appropriate products have been designed based on member feedback/research. Mutual health insurance is a unique product of GMSS (Table 8.1).

Table 8.1 Product variety in COMFIs

Product	IIMF and MACs	GMSS	CDF	BMCS	IDF financial services
Savings					
Number of products	3	2	5	5 apart from share capital and guarantee fund	1
Compulsory	Yes (more than 97% of the savings at MACs)	Yes (group savings and monthly deposit)	Yes (forms more than 96%)	yes	Groups savings are mobilized at federation and deployed in bank, market instruments and shares of IDF
Voluntary	Nil	Nil	Yes	Yes	NA
Recurring deposit	Yes	Nil	Yes	Yes	NA
Fixed deposit	Yes	Yes	Yes	Yes	NA
Loans					
Number of products	9	3	1	5	4
Purposes	Crop, dairy, agriculture, allied, non-farm, housing, land purchase, general purpose	Short-term, long-term and emergency (not in vogue)	A member can borrow against his savings deposits in certain proportions	Short-term, medium-term and long-term loan, loan for poor and loan for distressed. ST and MT loan for poor form 75% of portfolio	1st cycle to 3rd cycle and emergency loan
Loan term	11–24 months (bullet to monthly depending on purpose and cash flows)	12 months and 24 months		1–5 years	12 months to 24 months
ROI	21%	21%		12 to 18 (long term loan is 18)	22 to 24%
Loan amount	10,000 to 50,000	20,000 and 50,000		10,000 to 100,000 (long term loan)	10,000 to 25,000
Insurance					
Credit life	Yes	Nil		Nil	
Life			Mutual life insurance	Nil	3
Non-life	Mutual death insurance	Mutual health, accident insurance with company		Nil	

Source: Data provided by the institutions.

Some COMFIs like GMSS due to their organizational form as a society are not able to mobilize savings legally, though they mobilize compulsory savings which poses a regulatory risk. Even in COMFIs with the cooperative format, the compulsory savings forms more than 95 per cent of the savings portfolio. Compulsory savings ensure enough stakes in the institution for members to continue their relationship.

Fixed deposits are offered for enabling lower tiers to managing excess liquidity. The product innovations in terms of voluntary withdrawable savings, recurring and fixed deposits are minimal primarily due to complexities involved in liquidity and asset liability management. Some COMFIs like GMSS are exploring the possibility for tie-up with banks as banking correspondents for enabling voluntary member savings that will also yield income to GMSS.

The interest on savings that COMFIs offer is lower as compared to what banks offer. The MACS in IIMF offer an interest rate of 6 per cent on compulsory savings received from the members, and for fixed deposits and recurring deposits from members, the interest rate offered is 7 per cent. Though the interest offered may not be competitive, the service offered is hassle free.

What sets them apart is the range of loan products suiting a variety of client needs. The loan terms were based on cash flows and were generally medium term except for crop loans. The rate of interest is very competitive. Many MFIs had to adhere to RBI regulation norms and hence made adjustments to offer longer term loans. It is commendable that COMFIs were always offering client-focused products including long-term loans.

The key features in products that differ from typical MFIs are:

- Different types of loans for different purposes.
- Longer loan repayment periods, taking into account the purpose and cash flows.
- Flexibility in fixing periodicity of instalments based on customer cash flows.
- Savings schemes designed to capture income when they occur.
- Insurance products of a kind not available in the market.
- Lower interest rates charged in a transparent manner.

Member-owned institutions are better placed to offer a range of products services—while this is on account of the pressure of member demands. The substitution of profit-targeting with customer comfort is what enables the operation of product lines that might not initially be profitable. Products are well thought through in design and finalized based on discussions with the members.

Box 8.3 Mutual health insurance

Leveraging the expertise of Uplift, a Pune-based organization with extensive work in micro-insurance, Deepthi Arogya Nidhi (DAN) was launched by GMSS as a joint effort with Uplift. The purpose of DAN is to help women to change their own behaviours to health by going to the doctor as soon as symptoms manifest themselves since a discount is available. The product details are given in Annex 8.2. The DAN is offered to groups rather than individuals, for better economies of scale. The product is becoming increasingly popular; a larger pool will increase viability of the product. Claims have been preferred by been less than 1 per cent of persons covered, but payouts have been almost 17 per cent of premiums collected, which may have implications for long-term viability if covariant health problems surface in the area.

Source: CEO, GMSS.

CLIENT PROTECTION AND RESPONSIBLE FINANCING

Three major issues that have dogged the MFI sector have been related to lending practice—the high interest rates charged, disregard for over-indebtedness of clients and coercive recovery practices. The MFIs were also charged of losing focus of their mission. COMFIs have not faced these issues largely.

Interest rates

The foregoing section on products and services illustrated the client centricity of the products development and implementation. Compared to other MFIs, COMFIs have been charging lesser interest rates on declining loan balance and offering longer term loans. Growth and profits are incidental and hence the operations concentrate on providing cost effective services to members. These institutions target sustainability and not high profits as eventually profits also accrue to the same set of member customers and this thinking enables them to set appropriate interest rates.

Over-indebtedness

Many COMFIs are functioning in areas where other MFIs are functioning and thus it is difficult to avoid over-indebtedness. Many COMFIs adopt SHG methodology and SHG is a credible source of information to estimate the loans outstanding of the member from three sources of credit—internal loans in the group, bank loan and from COMFI. But it is difficult to estimate the loans taken from other MFIs. IIMF finds that SHG members enquire about the indebtedness levels and repayment capacity but this does not always work and subscribing to credit bureaus is the only solution. COMFIs need to be institutionally ready with appropriate systems for providing and using data of credit bureaus.

GMSS has refused to lend to groups borrowing from elsewhere; there has been a reduction in portfolio, due to more conservative lending because of entry of competitors. GMSS has been rationing loans, with a ceiling of ₹35,000 per member due to the increased competition in their area**.**

More over COMFIs are also carrying out financial literacy primarily aimed at educating members on the interest rate calculation, so that they are able to compare the rates of different institutions and take appropriate decisions. In the trainings, they are also providing information on the products and services of COMFIs.

Ethical staff behaviour and collection policies

Staff recruitment processes, their training and orientation and their incentives promote ethical behaviour. COMFIs recruit staff from local areas who are known to the members or from member families. This deepens the relationship between the institutions and the staff. There is a strong sense of ownership among staff of GMSS since most staff are SHG members.

Staff are provided in-depth training in class rooms as well as on the job. The CDF provides training to all the staff of the cooperatives it has promoted. Curriculum covers apart from skills related to the job, training on cooperative principles, values and behaviour towards members. GMSS staff are provided 15 days' training by Chaitanya. IIMF has uniform HR policy for all the MACs and staff are provided on the job training.

In GMSS, staff were formerly incentivized on the parameters of new group formation and portfolio size, but this resulted in a sudden spike in loan sizes and new groups so GMSS stopped all target based incentives. Monetary prizes and gifts are awarded and apart from financial indicators such as portfolio size and quality, aspects such as group quality, health insurance enrolment, strength of clusters and good behaviour are the parameters for assessing the staff for rewards. In Bagnan, the staff incentives are based on the repayments and savings collected, activities (trainings and programmes) conducted.

Staff tend to become aggressive in their behaviour towards defaulting clients when their performance is assessed on the basis of on-time repayments. COMFIs avoid such situations by client-centric policies for non-wilful defaults. COMFIs as members of Sa-dhan adopt the unified code of conduct for MFIs. Staff have been instructed not to indulge in inappropriate behaviour with members.

Since group lending is involved, in some cases groups repay one or two instalments on behalf of a member in difficulty in order to retain their credit worthiness. Grameen Mahila Swayamsiddha Sangha increases repayment period where needed. The BMBCS considers the situation (death of primary earner, natural calamity, disability, etc.) and interest is waived off and the loan is classified a 'medium term loan—distress'. The member can repay the principal amount whenever and whatever she can, within the tenure.

IIMF is functioning in the crisis-hit state of AP. The portfolio quality of the JLG loan products (JLG loans were given to non-members of SHGs in a village) was adversely affected. The JLG borrowers considered these loans as any other MFI loan and stopped repaying to the MACS, citing the new government regulations. However, the SHG members in the villages have been successful in persuading some of these delinquent women to repay the JLG loans. Since the ownership of the MACS was in the hands of the women villagers, the MACS affiliated to Indur Federation have been successful in tiding over this tumultuous phase in AP's microfinance sector.[4] The members enable the MFI to overcome the effect of influences that are not socially responsible such as calls for loan waiver or mass defaults.

WHAT MFIs CAN LEARN FROM COMFIs

An important learning is that these institutions can compete with others in the market. Bagnan has all the leading national MFIs within its market and is still growing. IIMF has to compete with highly subsidized credit programmes of the state government. Self-employed Women's Association (SEWA) Bank is operating in a saturated urban market, competing effectively for savings. Their ability to compete does not come from financial strength. The extra

effort that had gone into developing and customizing products to suit the client's needs is what perhaps ensured customer loyalty. Every institution studied had developed a portfolio of products after studying the requirements of the customers and their livelihoods. There is also an ongoing effort to refine the products and introduce new ones.

From a review of the performance of well-run COMFIs, one could conclude that the dismissive attitude towards small, community-owned institutions is ill-held. The COMFIs have showed greater resilience in difficult times on account of their customer centricity and managing customer protection and socially responsible behaviour without having to make special efforts for the same. The continued subordinate treatment of COMFIs in ratings, appraisals and loan approvals should be reconsidered on the basis of their better social performance and customer-centric products and processes. The learnings from successful COMFIs could be used to educate the others on how to build responsible finance practices in to institutions instead of making these as options to be exercised in times of need.

ANNEX 8. 1

Self-reported data of the COMFIs (as of 31 march 2012)

Particulars	IIMF and MACS	GMSS	CDF**	BMCS	IDF financial services
Year of start-up	2002		1978	1997	2006
Form	MACS		MACS	Cooperative	NBFC
Area of operation	Two districts in Andhra Pradesh			One district	
Methodology	SHG	SHG	JLG		SHG
Number of tiers	3	3	3	2	3
Number of members	46,817	7,770	183,658	23,042	149,810
% of women	100	100	62	100	100
Community ownership	100%	100%	100%	100%	68% and rest with promoters
Number of active borrowers	13,903	1,547	106,613	9,364	143,470
Loan outstanding	157,676,222	48,105,030	924,900,000	83,517,082	543,809,751
Savings outstanding	At MACS (not available)	11,899,510	896,300,000	90,501,391	NA
Financial performance					
OSS	112	96	NA	129	106
Return on assets	3	0.41	NA	2.6	0.77
Return on equity	12	3.19	NA	8.77	3.22

Note: ** as of 31 December 2011.

ANNEX 8.2

GMSS—Chaitanya

Deepti Arogya Nidhi

Started in	June 2010
Premium	₹200/person up to two people per family. ₹150/person for three or more per family. No age limit for participants.
Fees	₹30 remain with GMSS for administration expenses. ₹20 to Uplift technical support, plus ₹3,000 per month for Uplift staff's visits, which GMSS has refused to pay in 2011–12. Rest remains in claim fund.
Coverage	1) ₹15,000 per person per year for inpatient treatment, subject to caps for specific diseases and procedures. If govt. hospital is used, then travelling fee up to ₹500 can also be given for up to two hospitalizations. 2) Medical assistance given by network doctors and network labs, medical stores identified by Uplift—includes rebate on outpatient treatment and medication. 3) If services are received from a government hospital, 100% expenses or ₹15,000—whichever is less is covered; if a network hospital, then 60% expenses or ₹15,000—whichever is less is covered.
Exclusions	Existing diseases not covered up to three years. Exclusion list gives details of diseases completely excluded, or having coverage ceilings under the scheme.
Check-up	No medical check—depends on self-declaration and evaluation of pre-existing conditions during claim processing.
Other features	1) Voluntary—but entire group has to sign up. 2) Member must submit discharge card, all bills, etc., to get the claim. Documents sent to Uplift, who recommends claim processing. GMSS also has a doctor who visits field in certain areas to check complexcases. A DAN committee formed from Executive Committee members considers Uplift's decision—sometimes overrides. 3) Uplift has a 24-hour helpline where members can call to identify nearest network hospital. 4) No claim for non emergency usage of non-network partners. Emergency use of non-network partners can be considered. 5) Deliberately not referred to as 'insurance' due to regulatory issues.6) GMSS has used own funds for salaries of programme staff.

NOTES AND REFERENCES

1. Girija Srinivasan and N. Srinivasan, *Community-owned Microfinance Institutions Enables Double Bottom Line Impact* (New Delhi: Access Development Services and Rabo Bank, 2009).
2. Sudipto Saha, ACCESS-ASSIST, visited Bagnan and prepared the findings for the study.
3. As studied in the minutes of the three institutions visited—Bagnan, IIMF and GMSS.
4. Ananya Finance for Inclusive Growth, unpublished document, Case study on IIMF, Ananya Finance for Inclusive Growth, 2012, prepared for Common Wealth Secretariat.

Outcomes and impacts of microfinance

Chapter 9

There has been lot of hope and hype around microfinance's ability to achieve poverty reduction and millennium development goals. Some iconic sector leaders have claimed that microfinance has the ability to push poverty into museum in due course of time.[1] However, these very claims have pushed the microfinance industry into public glare and scrutiny. Researchers, media and civil society sought hard evidence of the impacts that microfinance claims to be creating. The practices of some of the MFIs leading to the microfinance crisis and the negative publicity that followed created an impression that MFIs are nothing but glorified moneylenders. If the earlier hype swung the pendulum to an overly hopeful extreme, the crisis and negative publicity have managed to drive the pendulum to the other extreme of despair. The MFIs claims as to their positive impact on poor people's lives were received unquestioningly in past; but today these are painted as institutions whose developmental impact will at best be marginal and more likely be negative. The MFIs are a bewildered lot today; they are asked to prove that they are not only providing client-centric financial services but also creating developmental impact.

Many of them had set to achieve realistic outcomes and impacts in their clients' lives. A few of them had always been poverty focused and had been measuring the changes in their client households. Others were providing inclusive financial services and had set minimal outcomes to be achieved. Almost all of them agree that microfinance, especially credit alone, cannot lead to poverty alleviation. While many had played along when the euphoria lasted and tall claims were being made, today they find that the need is to have realistic expectations about what microfinance can achieve and should.

Many microfinance service providers have genuinely believed that they were making a difference in the lives of their clients. Some of them carry out small sample studies to understand these changes and improve their practices. However, there are other stakeholders, especially academics and donors, who needed proof that MFIs were creating positive impacts through third-party assessments. There was a trade-off between the methodology and rigour of impact assessments and costs.

However, even the findings of the methodologically rigorous large sample studies involving high costs have been disputed.[2] The present debate is around the design of the impact assessments, the measurements and attribution of findings of impacts to microfinance. Serious researchers emphasize on

Box 9.1 Ambiguity in impact measurement

Roodman[3] summarizes his observations on the ambiguity about average impact arises from an opaque mixture of four factors: *(a)* different people use microfinance in different ways; *(b)* credit in particular must make some borrowers' lives worse and leave others little changed, and those effects weigh into averages; *(c)* families, villages and neighbourhoods are complex webs of causal relationships, which are hard to disentangle from each other, except with RCTs; *(d)* average effects depend as much on the ability of microfinance institutions to select those most likely to use finance well as it does on the spectrum of potential effects on different kinds of borrowers.

Source: David S. Gibbons, 'Debate of Outreach and Impact, What Do We Know and How Do We Know', paper commissioned by Global Microcredit Summit, 2011. Available online at http://www.globalmicrocreditsummit2011.org/userfiles/file/Workshop/David Gibbons pdf (accessed 10 June 2012).

randomized control trials for the purity of findings and that the impact should be attributable to the initiatives of the MFIs and not contaminated by any other influence.

While Randomised Control Trilas (RCTs) and other such rigorous methods measure the true, isolated impact of microfinance interventions, it must be recognized that MFIs do not have the luxury of working with customers that are isolated from their environment and influences. The RCTs require the control group not to have access to microfinance for as long as the experimental group that is being studied. Impacts in microfinance clients are typically larger after five loans cycles and finding such control group that has not had access to microfinance loans for five years, would be difficult in countries where microfinance outreach is rapidly growing. MFIs work in real time, in different field level situations where they cannot wish away the other influences on their clients' lives. MFIs cannot also afford rigorous measurements year to year covering large samples. For them whether the change is visible to the end customers and whether clients' expectations are met are better tests of the outcome and the relevance of their business.

This chapter is an attempt to put together outcomes and impacts 'as perceived and measured by the MFIs'. The desk-based study results form the Section 1 of the report. A special study was commissioned to listen to the voices of clients, which forms the Section 2 of the chapter.

SECTION 1: DO MFIs TRACK THEIR BUSINESS OUTCOMES AND IMPACT ON CUSTOMERS?

For the specific purpose of the report, a desk-based study was made to analyze outcomes and impacts 'as perceived and measured by the MFIs'. As a first step, a thorough review of the national and relevant international studies on impact assessments was carried out. The literature survey covered the Indian impact assessment studies commissioned/carried out by NABARD, SIDBI, NCAER, EDA rural systems, etc., and international studies especially in South Asia (see Annex 9.1 for the list of studies). There after the most common set of indicators that have been used in various impact assessments were identified (Table 9.1).

A questionnaire was circulated among the MFIs on the above indicators and their response was sought on the following:

Table 9.1 Outcome/impact indicators

Economic Indicators	Change in overall savings
	Change in borrowing of households from high cost informal sources
	Increase in employment of households
	Change in family income
	Change in number/value of assets acquired by the households
	Change in poverty levels
	Any other indicator that the MFI is measuring
Social Indicators	Changes in pattern of food consumption
	Change in education levels/expenditure on education of children
	Change in pattern of decision making of women in economic activities of the household
	Change in pattern of decision-making of women with respect to financial resources
	Change in the pattern of domestic violence
	Change in confidence level of clientele
	Any other indicator measured by the MFI

Source: Literature survey.

- Does the MFI aim for this outcome indicator/impact on the client household? Apart from these indicators, do they measure any others and why?
- How do they measure the outcome/impact of each of the indicator? (For example, through specific tools, MIS, specific studies, etc.)
- How often do they measure this outcome and impact?
- Major findings of the measurement exercises of each of the indicator.
- Have they made any changes in the microfinance programme based on the findings?

This has been a desk study based on the disclosure and sharing of information by the MFIs. The results were collated and cross-verified with the MFIs where needed and are presented in the following section.

PROFILE OF RESPONDING MFIs

Responses were received from 45 MFIs to the questionnaire that was circulated. These MFIs are headquartered in 11 states of India and operating among other districts, in 67 backward districts. Please see Table 9.2 for the profile of MFIs.

More than 93 per cent of the MFIs offer credit only and the rest offer both savings and credit. However, many of these MFIs enable savings through SHGs

Table 9.2 Profile of MFIs

Total number of responding MFIs	45	100%
Legal form		
NBFC	28	62%
Section 25 company	5	11%
Society and trust	10	22%
Cooperative	1	2%
Lending methodology		
JLG	22	49%
SHG	5	11%
Mixed	16	36%
Individual	2	4%
Tier		
1 (more than 250,000 clients)	12	27%
2 (50,000 to 250,000 clients)	15	33%
3 (less than 50,000)	18	40%

Source: Survey undertaken for the report.

(about 45 per cent); a few of the Section 25 companies are acting as BC of banks in order to provide savings facilities to clients. Most of them offer credit life insurance, which is beneficial in protecting the portfolio of the MFIs in case of untimely death of the client. Very few of them offer need-based insurance and pension services.

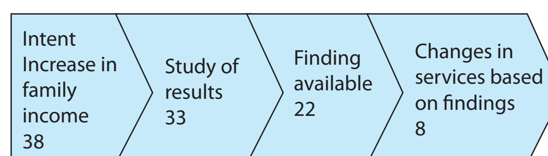
Table 9.3 MFIs reporting tracking the indicator

	% of MFIs
Economic indicators	
Change in family income	84
Change in poverty levels	80
Change in borrowing of households from informal sources/reduction in interest rates of informal lenders	80
Change in assets of the households	74
Increase in employment of households	64
Change in overall savings	64
Social indicators	
Change in pattern of decision-making of women	69
Change in education levels/expenditure on education of children	57
Changes in pattern of food consumption	47

Source: Survey undertaken for the report.

ECONOMIC OUTCOMES AND IMPACTS

Change in family income



Eighty-four per cent of the sample, i.e., 38 MFIs aimed at increasing the family income through microfinance services. Out of 38 MFIs who aim at increasing the household income, 33 MFIs assess the same. Eighteen MFIs endeavour to assess the impact while processing the loan applications and cash flow analysis; largely these data are self-reported by clients. Samhita and GMSS compare status of household income of clients with the baseline survey at every loan cycle. The PPI as a tool is being used for measuring this change by ESAF and IDF.

Twenty-two MFIs which aim at increasing the family income have provided the findings out of which only some have provided specific findings.

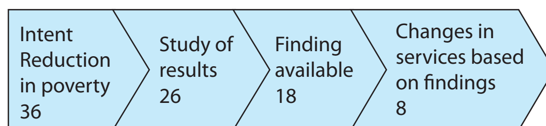
Following are some of the findings:

- Society for Model Gram Bikash Kendra observed positive changes in family income of the household with each cycle of loan. However, the information collated and analysed for all clients is not available.
- Margadarshak observed positive change in cash flow when client graduates to the next cycle but the change is small ranging between 5 and 10 per cent.
- Bandhan finds that number of income sources increased; '33.6% clients have one income source, 58% have two income sources and 9.6% have more than 3 income sources. The stability in the enterprises is leading to increase in income'.
- Janalakshmi finds an average of 10 per cent increase in the average income in a year for the client base.
- Trident observed 20–25 per cent increase in income of clients.
- ESAF finds seasonal variation in the income of the clients which was overall positive.
- Bandhan finds that there is major shift from labour-based income to entrepreneurial income among the households. Their studies also find that stable income sources have been established in household level.

Eight MFIs in the sample have brought about changes in the programme based on the findings from various assessment studies. ESAF developed new Business Development Services for clients involved in poultry and dairy to further support them in increasing family income. RGVN has developed a proposal for skill upgradation of members/the family members for increasing the income sources and family income.

Janalakshmi initiated a livelihood programme based on the quarterly customer feedback surveys where customers wanted Janalakshmi to help in increasing their income further and generating further surpluses apart from educating them to be good users of credit and to save their surpluses. Market analysis and segmentation of the households and assessment of their needs were carried out. Since Janalakshmi does not have core competence in promoting individual livelihoods and enterprises, the role they identified for themselves was that of an aggregator and linking client households to the supply chains/markets/companies. Women were largely employed in household enterprises which were not amenable for aggregation. Youth skill upgradation for employment/self-employment was identified as an area that had potential to diversify household livelihood sources and income. However, the initial efforts have yielded marginal results since urban youth have different aspirations and opportunities.

Change in poverty levels



Eighty per cent of the sample, i.e., 36 MFIs aim at reducing poverty levels of clients. Twenty-six of them measure the results through various means. Nine use PPI tool either in each loan cycle of the client or measure the progress on a sample of clients every year. Internal audit team of CASHPOR conducts annual impact survey using PPI. Specific internal studies are conducted by Research and Development Team of Bandhan along with external studies. BASIX carries out biannual impact assessment. Others measure through data collected in loan applications and some through sporadic studies.

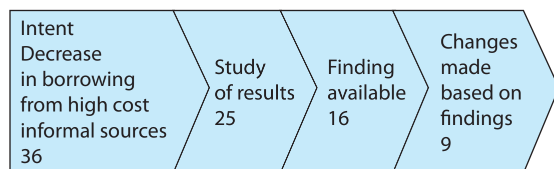
Though 18 MFIs have provided overall findings which portray reduction in poverty levels, five MFIs have provided very specific findings:

- According to Grameen Koota, poverty levels of clients with data from second PPI data sets and third PPI data sets have improved consistently across all poverty brackets for the duration of the loan. Twenty-three per cent of the clients who were below the $1.25/day line and 9 per cent of the clients who were below the $2/day line during the first PPI data set have moved above their respective poverty lines. When PPIs were collected across loan cycles, it was found that poverty rates decreased with the increasing number of loan cycles and that a similar reduction in poverty rate occurred during each loan cycle.
- CASHPOR, uses PPI scores to measure poverty levels of clients (US$1.5 international poverty line), over medium (4–6 loans) and long term (seven or more loans) and measures US$1.5 international poverty line which translates to PPI score of lesser than 25. Those who score more than 25 are considered as no longer poor as per the above poverty line. Credit and Saving for the Hard Core Poor finds that the proportion of clients scoring more than 25 increases from less than half (48.4 per cent) to 60.1 per cent as the category of number of CASHPOR loans increases from one to three to four to six; and it further increases to 68 per cent for the clients who have taken seven or more loans from CASHPOR.
- Jana Lakshmi, urban-focused MFI, finds the PPI tool is not well constructed for urban clients. Most customers when measured by the tool have income of US$ 3–4 per day since at present metrics of measurement for urban and rural are the same whereas urban poverty has different dimensions. However, they find that with each loan cycle, the PPI scores of the clients improve marginally.
- RGVN based on an external assessment of 1980 randomly selected clients and finds that the poverty levels of clients are decreasing with continued access to credit over a number of loan cycles. In loan cycle one, the proportion of poor was 59.2 per cent and in loan cycle four, it declined to 48.2 per cent. The PPI tool was used to measure the poverty levels.
- For VFSPL clients, incidence of poverty is lower among clients who have been with the VFSPL for more than three years compared to recently joined clients. In first loan cycle, proportion of poor clients was 49.6 per cent, which declined to 36.8 per cent in loan cycle five.
- According to Trident, after three years of availing credit facilities from MFI, the household incomes have increased from below US$2 to US$3 per day.
- The IDF and ESAF microfinance limited have commenced analysis of poverty-level changes in

customers using the PPI tool and the results will be available later in the year.

It is encouraging to see the decreasing trend of poverty level of MFI clients with repeat loans, though how far the trend can be attributed to MFI loans alone can still be a matter of debate. The key element is for the clients to have continued access to credit. In CASHPOR's experience, only about 25 per cent of clients borrow continuously for at least five years.[4] The PPI tool is found to be effective in measuring poverty and also tracking the change in poverty levels over loan cycles but does not attribute causation for the results, i.e., the PPI scores do not indicate what caused the change. This is one area where MFIs could probe more to understand the trends.

Change in borrowing of households from high-cost informal sources



Eighty per cent of the sample, i.e., 36 MFIs aim to move households away from informal sources of high cost borrowings. Among them, 81 per cent, i.e., 25 MFIs actually assess the outcome—11 take up quarterly/annual assessments through specific internal/external studies/surveys; eight MFIs collect this information before sanctioning loan and through loan utilisation checks. BASIX carries out biannual impact assessment. Others follow less rigorous methods such as case stories, field officers' perceptions, etc.

Sixteen MFIs have stated that the clients borrow less from informal sources, while a few claim that their clients do not take any loans from moneylenders any more. Only five MFIs have shared specific findings.

- Credit and Saving for the Hard Core Poor carried out an annual client survey in 2012 with a random sample of 1,505 clients.[5] Eighty per cent of the clients surveyed said that they no longer borrow from other moneylenders.
- Chaitanya, NBFC, mentions that based on their loan utilization check, about 10 per cent of its clients use MFI loans to clear off loans taken from moneylenders/informal sources of credit.
- Trident, NBFC, finds that the households have reduced their dependence on informal sources to the extent of about 50–60 per cent.
- BASIX, in its impact assessment studies found that 9.9 per cent households are dependent on moneylenders for meeting household credit needs with average credit of ₹31,917 per household and credit outstanding at ₹19,142 per household.
- Janalakshmi, which is an urban-based MFI, finds that it is able to make a small change after 2–3 years. Overall 10 per cent of the base show an increase in surplus/disposable income largely on account of reduced loan repayments. 'We are a significant partner to our clients in providing financial services but not the sole ones.'

Nine MFIs brought about programmatic changes based on findings from assessments. Chaitanya, which was not offering loans for repaying informal loans, designed a product for this purpose. Sajja has reduced its interest rate substantially to suit the requirements of borrowers and to encourage them to opt their services in preference to informal loans. RGVN is taking measures to enhance fund inflow to improve the coverage of clients and reduce their dependence on moneylenders. Janalakshmi focuses on education/training of clients to decrease their high cost loans and multiple borrowings. Grameen Mahila Swayamsiddha Sangha, a federation, has introduced short-term loans after finding that members turn to moneylenders for their short term needs.

Change in number/value of assets of households

Thirty-six MFIs, i.e., 77 per cent of the sample aim at increasing the number/value of household assets. Out of those, 28 MFIs assess the achievement of the indicator through various tools and techniques. Ten MFIs collect the information along with loan application or prior to disbursement. The PPI tool has been used by five MFIs and the rest through periodical studies.

Equitas aims for the improvement in quality of life of customers. Household asset (HHA) details are captured as part of the form completed prior to every primary loan cycle. The change in HHA across cycles is taken as a proxy for the improvement in quality of life of the customers.

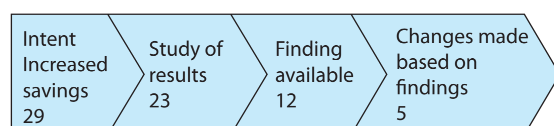
Thirteen MFIs find improvement in asset base of the clients and three MFIs have shared very specific findings.

- According to Trident, items like TV, cooking gas, etc., are found to be added to the client households after taking loans from them.
- Bandhan's clients have increased their assets—with every successive loan cycle, increasing number of clients invest in more number of assets. These clients are investing in jewellery, household commodities, livestock and land by the fifth loan cycle.
- According to Equitas, 57 per cent of its 248,606 customers have seen their household assets increase by more than 50 per cent.

The MFIs using PPI as a measurement tool are largely monitoring the overall score and do not seem to disaggregate and compare the scores for assets separately.

Change in overall savings

Sixty-four per cent of the sample, i.e., 29 MFIs, aim for achieving change in savings of the client households as one of the outcomes of the microfinance programme.



Except 3 per cent of these MFIs registered as cooperatives, the remaining 97 per cent of MFIs who aim at achieving increased savings as an outcome cannot legally offer own account savings as a service to their clients because of their legal form and regulatory norms.

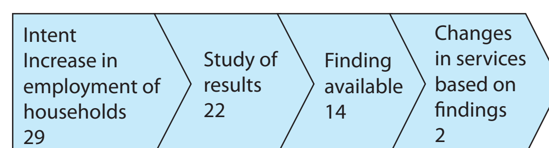
Many of these MFIs form SHGs through which they encourage savings. Credit and Saving for the Hard Core Poor, a Section 25 company, offers savings through BC model. Jana Lakshmi Financial Services has been promoted by Janalakshmi Social Services, Section 25 company, which offers several savings products through BC arrangement. Samhita Community Development Services, an NBFC, is in the process of becoming a BC.

Out of the 29 MFIs that have customer savings as the intent, 23 report measuring the progress. The means and rigour of measurement vary. Janalakshmi tracks the debit and credit data of clients' bank accounts every month and analyzes the trends. Eleven MFIs carry out annual assessments for measuring this outcome mostly on a sample basis. Six MFIs capture this data in every loan cycle, though four of them mention that data is not analyzed. BASIX carries out rigorous assessments every 2–3 years.

Twelve MFIs have been able to make available the findings. Seven MFIs report significant increase of more than 20 per cent in savings on a year to year basis and also diversification of the savings portfolio. Janalakshmi Social Services which acts as BC offers withdrawable savings apart from other savings through the Axis Bank. They find increase in average monthly balances of 10 per cent from August 2010 to July 2012. They also found that only about 30 per cent of the Janalakshmi clients are saving through the BCs. Bandhan finds on the basis of yearly sample-based study that only 68 per cent of the clients in first loan cycle save and by the fifth cycle nearly 90 per cent of the clients save. The MFIs also report to have initiated programmatic changes based on findings of assessments.

- ESAF Micro finance limited, an NBFC, facilitated formation of Swasraya Cooperative Society to enable members to withdraw their savings like in any bank.
- Society for Model Gram Bikash Kendra, an NBFC, is planning to support its members in opening accounts with banks in order to improve their savings base.
- RGVN is emphasizing on productive utilization of credit in order to improve the savings of households.
- Janalakshmi has commenced a campaign for increasing savings among its clients. Jana one has been recently initiated where one to one counselling is done for the customers where targets for savings are also set and monitored.
- Bandhan, Samhita, ESAF, Janalakshmi became aggregators for National Pension Scheme and have enrolled 1.4 lakh, 0.12 lakh, 0.60 and 0.0 lakh members, respectively, thereby providing an opportunity to save for their old age.

Increase in employment of households



Sixty-four per cent of the MFIs, i.e., 29 MFIs aim at improving the employment levels through self-employment as well as by engaging household members and others as businesses/enterprises to expand.

Twenty-two MFIs measured the impact through various tools/studies. Margadarshak takes up assessment of businesses of the clients before lending and one of the aspects studied is employment generated. Suryoday has tied up with Future Group retail chains for providing them manpower and is providing orientation training to the clients/household members of household.

According to impact assessment studies conducted for the clients of BASIX, each microenterprise on an average creates employment of 2.3 persons with 46 per cent of those employed in trade, 12.7 per cent in agriculture and 13 per cent in agriculture allied activities the clients are under taking.

Fourteen MFIs mention overall positive impact of microfinance on the employment generated at client households. The MFIs largely finance income generation activity or enterprise thus resulting in creation of employment for the client and her family members. Margdarshak observed improvement in employment of family members with increase in business opportunities, while Bandhan observed employment of domestic labour in household enterprise leading to increase in employment other than self-employment. Bandhan finds that 13.5 per cent clients in first loan cycle hire labour, which increases to 20 per cent by fifth loan cycle. While the MFIs have affirmed the positive effects and livelihoods have stabilized but precise numbers have not been reported.

Based on the findings of evaluations, two MFIs have made programmatic changes to suit the requirements of borrowers. Sonata is one among these MFIs and has launched 'utility finance' a top-up loan to suit the needs of its business customers.

Box 9.2 Employment creation by MFIs possible

Hand-in-hand and Belstar's contribution to job creation[6]

Hand-in-hand has been working in Tamilnadu since 2002, with interventions in SHG formation, bank linkage and financing, creation of enterprises, elimination of child labour, health and environment. Belstar is an NBFC promoted by HiH and is taking over the loan portfolio of HiH in phases. Hand-in-hand along with Belstar has set itself a goal of creating 1.3 million jobs by 2012.

Hand-in-hand group commissioned a study to estimate the number of borrowers who have taken loan from HiH group or under SHG Bank Linkage Programme (SBLP) for starting or strengthening different types of business activities/enterprises and the number of jobs created by these enterprises (inclusive of the borrower-entrepreneur). The study was carried out by M-CRIL.

Key hypothesis of the study is:

> The credit facility provided to SHG members through HIH/Belstar and under SBLP has been used by majority of the members for promoting existing or new income generation activities. These activities have resulted in creation of employment opportunities for both household members as well as outsiders.

For the purpose of the study, the following key definitions were used:

- An enterprise was defined as any income generating activity which did not involve employment by another person/agency.
- Enterprises were categorized as Family Business Enterprise (FBE) up to ₹50,000 and microenterprise (above ₹50,000), as per HiH's norms.
- Jobs were segregated as full time, part time and seasonal on the basis of a certain number of hours spent on an activity on a regular basis (minimum 180 days in a year). A job created was assumed as 'full time' if it provided work for an average of four hours and above per day on a regular basis. 'Part time' job provided work for an average of less than four hours per day on a regular basis. There are activities that are 'seasonal' in nature (such as agriculture) and job created through such activities were categorized as 'seasonal'.

Sampling

Stratified random sampling was used to arrive at a sample of 400 borrowers per district in six selected districts of Tamilnadu. The sample was stratified at three levels: *(a)* region—three operational locations each of HiH and Belstar; *(b)* geographical location (rural/urban) with each selected region; and *(c)* age of SHGs (0.5–2 years, 2–4 years and more than four years). The respondents selected from the SHG members were those who had received at least one loan from either HiH

group/SBLP. Overall 2,558 respondents from 330 SHGs were interviewed, representing 52 per cent of the overall membership of those SHGs. FGDs were used to collect group level information and discuss characteristics of group enterprises.

Key observations

About 79.8 per cent of enterprises supported are FBEs and 20.2 per cent are MEs.

Around 85.1 per cent have one IGA, 9.8 per cent have multiple IGAs and 5.1 per cent have not used the loans for any income generating activity.

Around 97.4 per cent of the activities in which the sample respondents were engaged are operational and only 2.6 per cent have become inactive.

Almost 48.8 per cent respondents had availed credit solely from HiH/Belstar and 3.8 per cent solely from bank linkage, while 47.4 per cent had availed credit from both sources.

Analysis of the consumptive use of ₹8.57 million out of ₹62.66 million loan provided to the sample respondents by HiH group and under SHG Bank Linkage Programme indicates that nearly two-third of the amount was used for general household expenses (like utility bills, grocery, etc.) and nearly one-fourth was spent on children's education. Some respondents also used it for clearing debt from other sources.

Among the respondents who had borrowed from both HiH and bank (also indicating multiple loan), just 3.4 per cent had to borrow from external sources. However, among respondents borrowing solely from HiH, around 15 per cent borrowed from other sources. The study team was of the view that the credit provided directly by HiH group and under SBLP had made a significant contribution in supporting the IGAs of the respondent households (in relation to total current investments and also in the context of credit source from other sources).

Conclusions

Out of 2,558 respondents, 2,428 had fully or partially utilized credit to establish 2,659 enterprises, from which 4,949 jobs were created. Of these, 1,639 represented jobs for males and 3,309 for females (mainly because women receive the credit and are therefore counted as the key entrepreneur). About 74.6 per cent jobs were for household members including borrowers, though females outside the family obtained a high proportion of 15.5 per cent of overall jobs as opposed to 9.9 per cent males outside the family, indicating rising empowerment levels.

FBEs have contributed in creation of 1.67 jobs; jobs created per MEs are more at 2.61, given the larger scale of these businesses (53.3 per cent for females of which 38.1 per cent within the household and 46.7 per cent for males of which 28.1 per cent within the household). This shows a higher skew towards male employment, probably based on skill requirement.

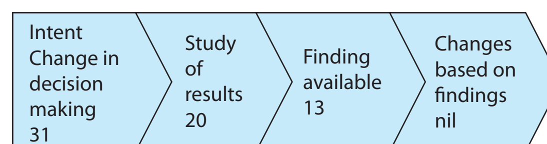
Overall, 1,356 seasonal jobs were also created by 2,659 enterprises covered by the study. Around 0.467 seasonal jobs were created per FBE and 0.678 per ME. Three-fourth of the seasonal jobs were created for outsiders.

The study based on a systematic step by step estimation has concluded that as on 30 November 2011, the total jobs created by HiH was around 0.77 million through 0.42 million enterprises. Additional jobs created were 0.21 million that were seasonal in nature. The total jobs that were still sustained was around 0.75 million through 0.40 million enterprises. Additional jobs created that were still sustained were 0.21 million.

Source: Opportunity International, SROI Pilot EMFIL, first draft, April 2012.

SOCIAL IMPACTS

Change in pattern of decision-making of women with respect to financial resources



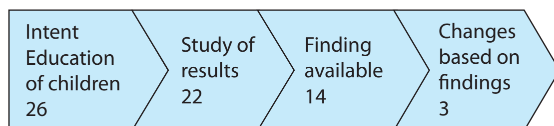
Thirty-one MFIs, i.e., 69 per cent of the sample aim at improving the role of women in decision-making regarding management of financial resources and economic activities of the household. Twenty MFIs measure the indicator largely through loan utilization checks, specific studies and during training programmes on financial literacy. Thirteen MFIs shared the broad findings.

- BASIX in their impact assessment study found that 38 per cent of sample report higher participation in financial decision-making, 51 per cent same as before and 10.5 per cent lesser than what they did before.
- Janalakshmi has developed films on financial literacy and one of topics is on improving women's

control over money because of which women are more aware of the need to have control over finances and their decisions have to be such that they do not lose control.

- Initially the decision to take a loan from Bandhan largely rested on the client's spouse. But as clients graduate to higher cycle, the decision was taken more and more jointly. Bandhan finds that more financial resources are being allocated for education of children especially girls and marriage of girls.
- Sarala, functioning in West Bengal, has intensive pre-disbursement meetings with the clients and finds that over the last two years, the members understand the cost of different financial sources and able to decide well on loans that are cheap and convenient to them.
- Samhita Community Development Services, an NBFC, provides financial literacy training on topics of savings, insurance, pension apart from loans. Members are the primary decision-makers for enrolling into these services. In individual insurance, they decide to take insurance coverage for their husband or children.
- ESAF has completed base line study on decision-making and proposes to develop leadership and decision-making programme for the members.

Change in education levels/expenditure on education of children



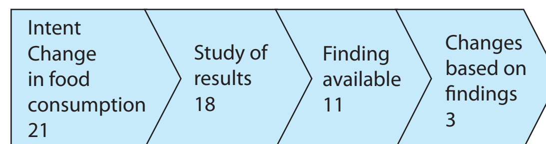
Twenty-six MFIs, i.e., 57 per cent of the sample aim at improvement in education levels/expenditure on education of children either directly or indirectly through their microfinance programme. Several of them have education loan as a product.

Twenty-two MFIs assess the impact through various means usually through cash flow analysis at the time of loan sanction and specific studies. Fourteen MFIs have shared their findings, which indicate that the children are getting more qualitative education, more expenditure is incurred by the members in educating the children *(a)* through additional tuitions, *(b)* shift to private English-medium schools and *(c)* supporting children through their graduation. Trident found that the clients on an average were spending 30 per cent more in the last two years for sending their wards to private schools. Bandhan also finds that gender discrimination in education is reducing.

Based on the findings, three MFIs have made changes in the programme for ensuring more children receive quality education.

Society for Model Gram Bikash Kendra has introduced a new loan product—'Education Loan'—with very low rate of interest. Samhitha has introduced an education loan product for members, to meet the admission expenses of their children, which is disbursed during school admissions period.

Change in pattern of food consumption



Fourty-seven per cent of the sample MFIs, i.e., 21 aim to achieve impact on food consumption of their clients. Eighteen of them assess/measure the same; eight of them collect the data on cash flow of household including expenditure on food along with loan application. Four MFIs collect data as and when required whereas others carry out specific studies. ESAF is taking up specific studies to assess this indicator. Except a few MFIs, others have not shared measurable data for the impact.

- According to NEED, cultivation of organic vegetables and backyard kitchen gardening along with increased Income levels through microcredit has improved food habits and consumption of clients.
- Bandhan found that quality and quantity of food consumption has improved and observed shift towards a balanced diet.

Box 9.3 Dealing with ultra-poor—Bandhan model

Bandhan has designed and implemented a specific programme for hard core poor who are food hungry. Through specially designed package delivered over an 18-month period, the hard core poor are graduated to become regular clients of the MFI. As part of the package, consumption stipend is provided to these households and minimum food security is ensured for the beneficiaries until and unless they can arrange staple food on their own.

The pilot in West Bengal was studied by the Abdul Latif Jameel Poverty Action Lab (JPAL), MIT. The researchers report highly impressive findings—per capita food consumption increased 15 per cent; per capita income increased 20 per cent; the programme resulted in greater income from non-agricultural enterprises operated by the households. Overall, they compute a rate of return on 27 per cent on the programme investments.[7] These are impressive results from an intervention that seems to truly target and reach the poorest of the poor.

Source: Unitus and Equitas, *The Impact of Equitas Microfinance on Differently-abled Clients* (Chennai: Unitus and Equitas, December 2009).

SOME UNIQUE INITIATIVES

Assessing the economic and social change and returns

As part of an SPM strategy, Dia Vikas (Opportunity International) is looking at innovative ways of addressing impact evaluation and communicate findings to a broader base of stakeholders. The SROI is a relatively new methodology being used within the community development sector in western countries. The SROI uses a principle-based approach, and sound judgement is required throughout an SROI analysis, as there are no right or wrong answers or standardized ways to measure outcomes. Integrity of the results is sought to be achieved by following the principles throughout the analysis and constantly referring back to them.

The SROI of ESAF MFIL's Income Generating Loan (IGL) product was carried out in 2011–12.[8] It examined the potential outcomes and impact that will be generated by a capital investment in EMFIL to finance its IGL loan portfolio. The analysis assesses the social value created to existing clients, in order to be able to project similar outcomes for future.

The SROI analysis identified a list of stakeholders, covering clients and their family, SHG Federation, loan officers and management, from which client perspective was analyzed in 'Client Journey', through different loan cycles. As part of the study, a total of 120 clients were interviewed through visiting three EMFIL branches. The SHG federation trustees and staff of EMFIL were also interviewed to estimate the outcomes. Thus in consultation with all the stakeholders, the major analysis was conducted on the impact of income generating loan products on the lives of the clients.

Applying the theory of change method, through consultations with clients and other stakeholders, the changes in the lives of the clients with each loan cycle has been captured (please see Annex 9.2 to this chapter for details). The theory of change was then applied to equity investments. Although a forecast, the analysis was based on the outcomes experienced and reported by stakeholders.

An impact map demonstrating the impact value chain for two key stakeholders—clients and equity investors—was constructed. It links stakeholders' objectives to inputs (e.g., what has been invested), to outputs (e.g., number of microfinance clients), through to the outcomes (e.g., increase in income through microenterprise development). It then identified indicators of achievement of outcomes which are capable of being quantified by applying financial proxies.

Assumptions were used throughout the analysis for the duration of outcomes, attribution to other services and understanding what would have happened anyway without EMFIL loan and thus the outcomes as attributable to microfinance were arrived at.

The outcomes were then monetized and included in the SROI analysis. Some examples are given in Table 9.4.

The time period of the analysis included the activities and value to be created by a projected equity investment of ₹1,000 million over the next four

Table 9.4 Indicators and financial proxies per outcome (per client)

Outcomes	Indicator	Financial proxy	Financial value*
CLIENTS			
Improved access to credit	Number of women that had never accessed personal credit before	Interest Rate paid on EMFIL's loan (27%)	₹2,700
	Change in number of women accessing loans through informal sources (moneylenders)	Difference in interest rates (moneylenders–EMFIL)	₹2,000

(Continued)

(Continued)

Outcomes	Indicator	Financial proxy	Financial value*
Increased self-confidence	Number of women that report feeling good/positive about themselves	Average expenditure on social activities, i.e., visiting family and relatives	₹1,968
	Number of women attending Sangam meetings (Attendance Rate %)	Membership Fee paid to be member of federation	₹100
Reduced financial stress	Reduced levels of debt with informal sources of credit	Reduced amount of debt with informal sources of credit	₹2,500
Increased contribution to their household	Number of women that report increased participation in HH decision-making	Average money invested into consumer durables (furniture & appliances)	₹7,768
Increased social bonds	Number of women visiting their Sangam members outside the Sangam meeting	Average expenditure on social activities, i.e., visiting family and relatives (excluding transportation costs)	₹2,496
	Number of women reporting feeling strong about their Sangam	Cost of setting up a Sangam	₹2,000

Source: SROI report of EMFIL.

years. Projections were made on the debt leveraged by such equity, the number of clients that can be reached and loans they would avail of. An analysis of investor social returns showed that an investment of ₹4,900 million, including equity investment and interest paid by clients, could potentially create ₹15,610.3 million of present value, resulting in an indicative SROI ratio of 3.19:1. That is, for the equivalent of every ₹1 invested in ESAF Microfinance, ₹3.19 is returned in social value.

While the SROI is a forecast tool, it is useful in identifying whether social pay-offs are likely and the extent thereof. The tool will be useful for investors and funders that would like to invest in MFIs for social outcomes apart from the financial ones. The SROI methodology has to be tested over a number of institutions to understand whether it can be utilized on wider scale.

Disability programme of equitas

Based on the suggestions of the board, Equitas started the differently abled initiative. Equitas branch managers encouraged the group leaders to invite differently abled people to be a part of the group. Although, loans had been given to differently abled population since December 2007, it was not until December of 2008 the programme gained momentum. Equitas commissioned a study in November 2009[9] to determine the impact of microfinance on the differently abled clients when such client base had touched nearly 2000. The main priorities of the study were the assessment of impact on income levels, self-esteem, attitudes of society and family/friends. Around 186 respondents among the clients, based in Chennai and Coimbatore, and 30 among the differently abled non-client population were sampled.

SECTION 2: THE VOICE OF MATURE CLIENTS

The objective of the study carried out by Center for Micro Finance, Institute of Financial Management and Research (IFMR)[10] for the purpose of this report was to assess how the lives of the clients have changed overtime as they get sustained access to credit and related services from the MFIs. The study broadly covers the socio-economic outcomes during the period of their engagement with MFIs. It also aimed at understanding the change in clients' self-esteem, their involvement in household decision-making and vulnerability to shocks.

Since the objective of the study is to assess the effects of sustained access to loans from MFIs, data on a range of socio-economic parameters and client perceptions of the impact of MFI loans were collected. Clients who received few doses of credit from at least one MFI were the focus of the study. In-depth interviews were conducted with 231 clients belonging to five different MFIs, from seven districts across four states. Since the primary objective was to understand the effect of MFI loans on mature clients, 129 clients were randomly selected with loans at least in the 4th cycle and with

Table 9.5 Key results of Equitas' programme for the disabled

		Indicators (Mean) All figures are per month	Before (₹)	After (₹)
Business changes	The client has seen improvement in business	Expenditure	3,638	4,622
		Savings	423	780
		Income	1,885	3,847
Self-esteem	The client has similar levels of self-esteem as that of a comparable population			
Society acceptance	1. Differently abled client population is more involved with society after the loan than before the loan 2. Differently abled client population is more involved with society than differently abled non-client population			
Family acceptance	1. Differently abled client population perceives similar or worse treatment from family/friends after the loan than before 2. Differently abled client population perceives better treatment fromfamily/friends than the differently abled non-client population 3. Differently abled client population is more involved with family/friends than the differently abled non-client population.			
Perception of differently abledmember by the other group members	1. Differently abled clients are very prompt in payment of loan instalments 2. Differently abled clients are not considered a burden 3. Groups are willing to add more differently abled as members			
Perception ofdifferently abledmember by the staff	1. Staff are very happy to be involved with the initiative and feel satisfied 2. Staff are very enthusiastic of adding new differently abled clients 3. Disbursement processes can be tweaked to ensure 'home delivery' of loans			

Note: Characteristics of the 4th cycle clients could possibly be different from the characteristics of the 2nd cycle clients as 4th cycle clients might have chosen to continue borrowing from the MFIs as they would have foreseen more benefits from MFIs. Thus, the control group (2nd cycle clients) of this study might not be truly identical to the treatment group (4th cycle).

102 clients with loans in the 2nd cycle, selected for the comparison group.[11] Retrospective data on these parameters before taking the first MFI loan was collected from the clients and contrasted with status on the same parameters during latest loan from the MFI.

Using the data, the following before and after analyses were conducted:

- Comparison of socio-economic parameters to identify changes between the first and the most recent loan for all the clients (including 4th cycle and 2nd cycle clients).
- Comparison of the difference in socio-economic parameters at the most recent loan cycles between the 4th cycle and 2nd cycle clients which will identify the marginal difference in achievements.[12]

The sampled clients are predominantly females—around 98 per cent with median age of 38 years. A large majority of the sample are labourers—working in the agricultural and non-agricultural firms, followed by clients with primary activity in business, agriculture and animal husbandry. The distribution of primary engagements as reported in Table 9.2A2 in the Annex 9.2 shows no major shift in occupation profile overtime, possibly indicating that longer association with MFIs does not necessarily result in shift in occupation profile of the clients. However, comparison of engagement with income generating activities recorded significant improvement over time. Around 79 per cent of the clients were found engaged in some income generating activities when the survey was conducted (July 2012) against 65 per cent clients with such activities before taking the first loan from the MFI.

KEY FINDINGS

To find the effect of extended access to credit from MFI on the clients' lives, the changes in outcome variables that could be distinctly measured and assessed were identified and analyzed. In addition, qualitative aspects were measured through capturing the perceptions of clients.

KEY OUTCOMES

The following Table 9.6 provides the summary of the key outcome variables:

Table 9.6 Key outcome variables

	Loan cycle	Full sample	2nd cycle	4th cycle	Comment
Monthly average number of days engaged in income generating activity	Before 1st Loan	15	14	16	Before and after
	Latest Loan	18	16	20	
Average monthly income for the household (median)	Before 1st Loan	₹3,500	₹3,100	₹4,000	Significant increase even in 2nd cycle
	Latest Loan	₹6,750	₹8,500	₹10,000	
Average monthly income for the client (median)	Before 1st Loan	₹1,500	₹1,350	₹1,500	Significant increase in 4th cycle Significant increase
	Latest Loan	₹2,000	₹1,500	₹2,000	
Savings of the clients (% with positive savings)	Before 1st Loan	46%	48%	45%	significant increase even in 2nd cycle
	Latest Loan	66%	68%	65%	
Savings of the clients (median savings)	Before 1st Loan	₹1,100	₹2,000	₹1,000	Significant increase even in 2nd cycle
	Latest Loan	₹3,000	₹3,000	₹3,000	
Percentage of households with Pucca residence	Before 1st Loan	60%	58%	61%	Significant increase
	Latest Loan	70%	70%	72%	

Source: Study findings of 'The Voice of Clients: A Study of Mature MFI', commissioned for the book.

Analysis indicates that there has been a statistically significant increase in monthly average number of days of engagement in the income generating activity (IGA) for the entire sample and also across the clients of both loan cycles. There is a greater increase in the engagement in IGA of the 4th cycle clients as compared to the 2nd cycle clients.

There is about 33 per cent increase in median income of the clients in the overall sample. Cycle-wise break-up of the data indicates that more mature client households (4th cycle clients) have reported larger increase in their median income as compared to the 2nd cycle clients.

Savings of the clients with continuous access to credit from the MFI significantly increases over the period of engagement with the MFIs as depicted by the proportion of households with positive savings and also, by the median value of savings. The cycle-wise data indicates greater increase in savings for the clients with 4th loan cycle (three-fold increase in current savings as compared to the time before the first loan), though the 2nd loan cycle clients seem to have started off well than the 4th cycle clients.

In addition, a larger proportion of households live in Pucca houses now, as compared to the period before they took their first loan from the MFI.

CLIENT INDEBTEDNESS

There is a significant increase in the percentage of clients with loan outstanding as can be expected. The median outstanding loan increases from ₹5,500 to ₹14,000 for the entire sample and from ₹7,000 to ₹15,000 in case of 4th cycle clients.

Table 9.7 Comparison of loan portfolio of clients

	% with positive loan outstanding		Median amount (₹)	
	Before	Now	Before	Now
Full Sample	22	80	5,500	14,000
2nd Cycle	23	78	5,000	11,120
4th Cycle	21	81	7,000	15,000

Source: Study findings of 'The Voice of Clients: A Study of Mature MFI', commissioned for the book.

Comparing the indebtedness to MFIs vis-à-vis other sources (Table 9.2A3 in the Annex 9.2), it seems that borrowings from MFIs reduce the propensity to borrow from other informal sources. While there was a significant increase in percentage of clients with outstanding MFI loans (from 7 per cent to 68 per cent), there is a small increase in percentage of clients with outstanding loans from informal sources (11 per cent to 13 per cent).

The share of total outstanding of the clients across sources of credit indicates that loans from MFIs have become predominant over time, marginalizing the importance of informal sources from 45 per cent before the first loan to 8 per cent currently. Thus, even as the median loan size from informal sources grew over time with the increase in loans from MFIs, the share of informal loans in the households' total loan portfolio significantly shrunk overtime (Figure 9.1).

Thus, 'before and after' comparison of observable outcome variables show considerable improvement in some key economic variables.

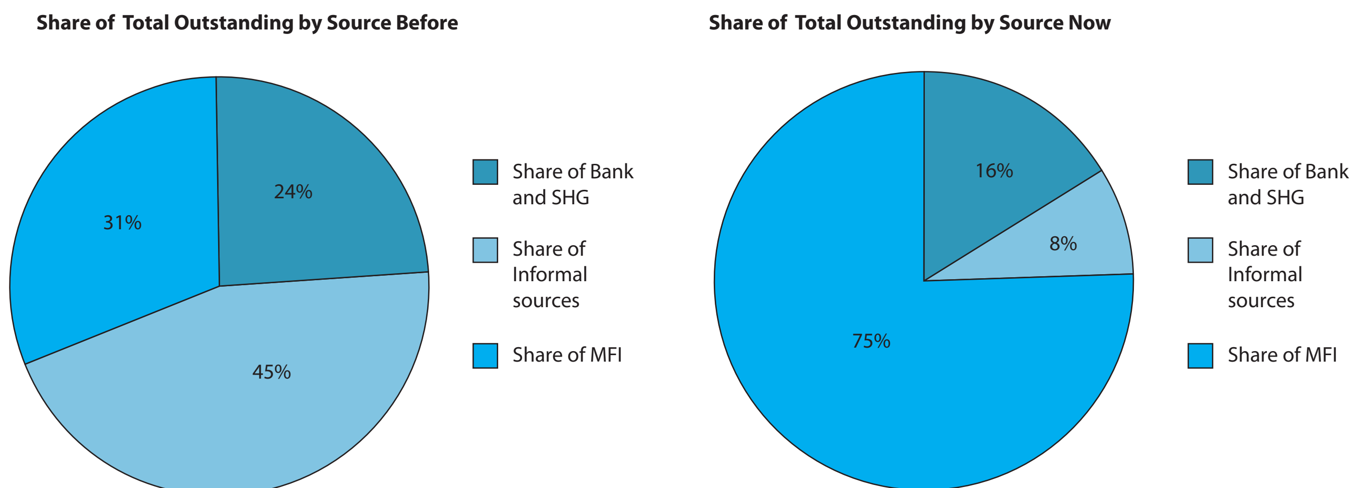


Figure 9.1 Share of clients' total indebtedness by sources

CLIENT'S PERCEPTIONS

While the outcome variables analyzed in the previous section were based on data captured on clients' status pre and post MFI loans, more qualitative aspects of change in clients' lives depend on perceptions of clients.

Comparison of data on clients' perception relating to access to credit for major purposes (business, education, home improvement, household consumption and health and other emergency) shows that client had improved access to credit for each purpose over time (Table 9.2A4 in Annex 9.2).

Table 9.8 provides the summary of variables measuring client's perceptions about MFI loans.

It has been often argued that the clients frequently use MFI loans for 'unproductive purposes' that do not directly contribute towards income generating capacity and often leads them to a vicious debt cycle. Usage information shows that around 77 per cent of all loans taken by clients were deployed for income generating purposes.[13] Around 80 per cent of all the clients experienced increase in their earning capacity during this period and more than half of those clients attributed the increase to sustained and easy access to MFI loans, 21 per cent to availability

Table 9.8 Variables measuring client's perceptions about MFI loans

	Full sample	2nd cycle	4th cycle	Comment
Percentage of loans used for income generation after taking the first MFI loan	77%	78%	76%	A predominant proportion of loans taken after taking first MFI loan was used for income generation
Percentage of clients experienced increase in earning capacity after taking the first MFI loan	80%	75%	84%	Income earning capacity significantly increased after taking first MFI loan
Client perception on availability of substitute of 1st MFI loan	61%	65%	67%	Percentage perceived that there would have substitute sources to first MFI Loan
Sources that would have been substitutes for MFI loan				
Loan from friends, relatives and neighbours	46%	53%	38%	Friend & relatives and moneylenders are predominant substitute of MFI loans
Loans from moneylender	40%	35%	45%	
Selling asset	3%	2%	5%	
Loan from bank/SHG/CHIT	11%	10%	12%	

Source: Study findings of 'The Voice of Clients: A Study of Mature MFI', commissioned for the book.

of cheaper loans from MFI and another 21 per cent felt that skill enhancement and livelihood training provided by the MFIs were one of the three most important factors in contributing to the increased earning capacity (see Table 9.2A5 in the Annex 9.2). Thus, it seems that a large proportion of clients feel that MFIs play a catalyzing role in increasing their income generating capacity.

When asked about the substitute source of their first loan from the MFI, 61 per cent of the all the clients surveyed expressed that they would have been able to find a substitute source of their credit needs catered by the first MFI loan, indicating that the remaining 39 per cent might not have access to credit in the absence of MFIs. Clients perceive that the alternative sources are much more expensive than the MFIs—with more than three times of the interest rate charged by the MFIs on similar loans. This indicates that availing MFI loans has helped clients reduce their interest burden quite significantly.

Ability to cope with financial shocks is a very important aspect of improvement in quality of life. Fourty-five per cent of the clients expressed that they are now better prepared to cope with the shocks. The difference in clients in 2nd and 4th cycles (Table 9.9) indicates that longer association of MFIs can enhance preparedness to cope with shocks. The data on comparison of coping strategies to be adopted by clients presented in Table 9.2A6 in the Annex 9.2 shows that borrowing from friends, relatives and neighbours was seen as one of the most prominent strategies adopted by 45 per cent of the clients to overcome the financial shock before they took their first MFI loan. Comparing the before and after data it appears that a significantly larger proportion of the clients (39 per cent) would have utilized accumulated savings to weather shock and 32 per cent would have borrowed from moneylenders if the shock were to happen now—a picture that shows better preparedness to weather the shock. It is evident from the data that more mature clients (4th cycle) are better prepared to use savings also less dependent on the moneylender to cope with wealth shock. These findings indicate that longer association with MFIs can result in better preparedness to cope with shocks and less dependence on more expensive coping mechanisms.

With respect to changes in financial decision-making capacity, around 55 per cent of the total sample indicated that it has become easier now as compared to the period before taking the first MFI loan (see Table 9.9).

Table 9.9 Perception about household financial management

	Full sample	2nd cycle	4th cycle	Comment
Percentage expressed that they are better prepared to 'cope with wealth shocks'	45%	33%	55%	statistically significant change
Percentage expressed that financial decision-making has become easier now as compared to time before first MFI loan	55%	47%	63%	statistically significant change

Source: Study findings of 'The Voice of Clients: A Study of Mature MFI', commissioned for the book.

QUALITATIVE ASPECTS

Availability of sustained credit from MFIs seems to influence various economic parameters of clients' lives. There are more nuanced qualitative aspects of life that may be affected by the changes in opportunities that are created by the availability of MFI loans over a period of time. These qualitative aspects are not easy to measure as an observable outcome and the study attempted to measure these aspects through a set of subjective questions.

Perception of clients about their involvement in major decision-making of the household is shown in Table 9.2A7 in the Annex 9.2. As compared to the period before taking the first loan, clients now have greater say in decisions about savings, household expenditures and, more interestingly, about starting new business. A significantly larger proportion of the clients are now participating in decisions regarding loans of the household—a direct outcome of managing loans of the MFIs. These changes as perceived by the clients indicate that longer association with the MFIs is likely to improve the clients' self-confidence about their own capabilities and also bring greater say in the household decision-making, which are steps towards the empowerment of the clients who mostly are married women.

Using a set of two subjective questions, clients' level of optimism was assessed. Combining the two sets of responses (Table 9.2A8 in the Annex 9.2), and comparing across loan cycles, the results shows that mature clients (4th cycle) are more optimistic and confident about their own abilities than the less mature clients.

Finally, to portray whether and how their aspirations change while their relationship with the MFI matures, the clients were asked to list out their three most important aspirations before they took their first MFI loan and list their current aspirations. Data presented in Table 9.2A9 in the Annex 9.2 shows

that as the clients receive more loans, primary aspiration shifts from their own business development to their children's welfare—an aspiration that is not a priority for the clients in the initial stages of their relationship. This shift possibly indicates that after the basic requirements are met using MFI loans, the clients' aspirations move to fulfilling higher order requirements, indicating improvement in overall household well-being.

Summing up[14]

Findings of this study show that clients' savings and income increased significantly during the period of their engagement with MFIs. The data also indicates significant improvement in clients' involvement in various household decisions-making processes. The comparison also indicated better preparedness of clients to cope with financial shocks and less dependence on costlier coping mechanisms. The mature clients are more optimistic and confident about their own abilities to resolve their problems. Finally, there is an indication of qualitative improvement of clients' well-being as portrayed by a clear shift in aspirations of the mature clients. Overall, the analysis indicates that certain economic factors and qualitative aspects of life improve after the clients receive sustained access to credit from the MFIs.

CONCLUSIONS

In recent times there have not been many outcome/impact assessment studies either carried out internally or through external institutions that are available in the public domain. It is clear that MFIs aim at both economic and social impacts; however, more MFIs aim at impacts that are economic than social. Improvement in family income, reduction of poverty level and reduction of borrowing from high cost informal sources are emerging as three important outcomes that MFIs want to cause in their client lives.

Though several MFIs share their intent on achieving certain outcomes/impact, not all have systems in place through internal or external studies to measure this. In most MFIs, dedicated teams within the organization carry out specific studies and inform the management about needed programmatic changes. Very few commission external impact assessments. Many MFIs report that they collect data in loan applications, cash flow analysis, etc., but these are largely self-reported data which should to be thoroughly verified. Most MFIs have not systematically collated the collected data and converted it to useful information. Many tend to share impressions rather than concrete results.

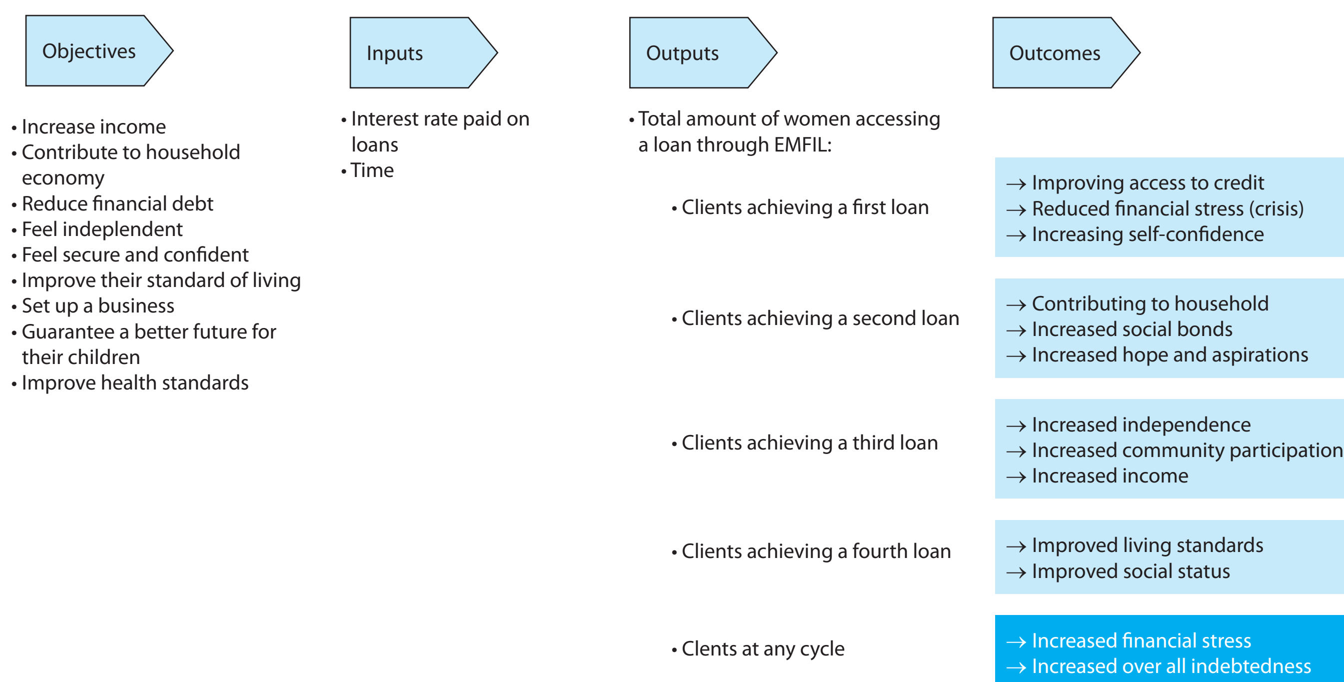
Anecdotal evidence shows that smaller institutions, especially those set up by NGOs, are more focused on clients, offer more need-based services and thus may be creating better impact on the clients. This is yet to be systematically studied and proven. Many of the smaller institutions do not have the wherewithal for robust studies, though they may be already creating larger impacts. This is an area for study, especially by the social investors who are keen to measure client impacts and social returns.

However, one wonders why the MFIs have to prove to others that they cause positive impacts in customers' lives. In the normal course of business an institution would not have been expected to prove it is also creating social impacts. But in microfinance on account of the mission that MFIs have set for themselves and also the focus on double bottom line, it has become necessary to establish that there is an impact on the clients. In well-governed institutions, one would expect that measuring outcomes/impact, reviewing the same and initiating necessary changes in the products/services is part of the institution's ongoing governance and operational mechanisms. To the extent MFIs do not do this internally as part of their normal governance and management functions, the pressure from external stake holders will be felt. When the sector is in a downward cycle and faces criticism of mission drift, the demand from external stakeholders becomes strident and, at times, out of proportion to the actual benefits to customers. The realization that measuring results and impacts is a governance function should become deeper across all stakeholders. The MFIs must invest in understanding the outcomes and impact of their business and other activities. Some of the MFIs in the sample covered by the study show that it can be done and is being done.

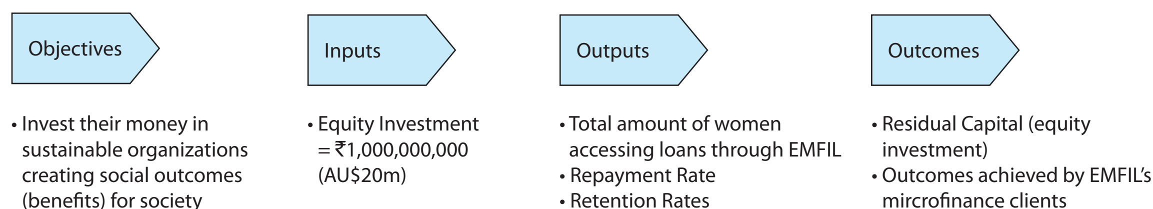
While the state of practice can be improved upon, the role of external players is to support governance and operations in making necessary improvements within MFIs so that they deliver a wholesome package of services to their customers. The recent trend is to make MFIs prove time and again to different sets of external institutions that they create positive outcomes and impact. It is for the sector to note that there are costs associated with measurement of outcomes/impact on a recurring basis, which in the current context is not affordable for most of the MFIs. Investors, donors and others who have an interest in improving field practices for better outcomes and impacts should provide necessary resources to MFIs rather than taking it upon themselves to carry out such studies. Emphasis should be on creating a mindset of curiosity on impacts within MFIs and investments in internal capacities and systems to carry this forward.

ANNEX 9.1

EMFIL: Social return on investments—theory of change for the clients



Theory of change for equity investors



ANNEX 9.2

Changes in the lives of the clients with each loan cycle

Table 9.2A1 Sample selection

Name of the MFI	Districts	Number of clients selected
KGFS	Thanjavur, Tamilnadu	50
Hand-in-hand	Trichy, Tamilnadu	50
VFS	Hooghly and North 24 Parganas, West Bengal	61
Swadhaar	Mumbai, Maharashtra	30
Grameen Koota	Bangalore and Tumkur, Karnataka	40

Table 9.2A2 Occupation profile of the sampled clients

	Before taking the first loan from MFI	Now
Percentage having income generating activities	65%	79%*
Primary Engagement	% Engaged Before taking the First loan from MFI	% Engaged Now
Agriculture and Animal Husbandry	16	14
Salaried in the Private/Public Sector, Self-employed Professionals	12	16
Firm and non-firm Labourer	37	35
Hawker/Petty Trader	9	7
Own business/Trade/Manufacturing	13	16
Others	13	11

Note: *Represents difference is statistically significant.

Table 9.2A3 Clients borrowing by major source

	Percentage with positive loan outstanding		Median	
	Before	Now	Before	Now
Bank/SHG/NBFC	5%	19%	10000	10000
Moneylenders, Friend Employer/Landlord/Others	11%	13%	5000	10000
MFI	7%	68%	4500	12250

Table 9.2A4 Client's perception about their access to loans

	Mean score before taking the 1st loan	Mean score now	Difference statistically significant
Perception regarding access to loan for			
Business	2.39	3.87	Yes
Home Improvement	2.13	2.95	Yes
Education	2.5	3.5	Yes
Household Consumption	2.82	4.4	Yes
Health Emergency	2.6	3.66	Yes
Other Emergency	2.3	3.34	Yes

Table 9.2A5 Most important reasons contributing to increase in present earning capacity as compared to the period before taking the first loan

	Full sample	2nd cycle	4th cycle
Increase in earning capacity contributed by sustained and easy access to MFI loan	55%	56%	54%
Increased demand for product/service	47%	46%	47%
Skill enhancement/livelihood trainings provided by the MFI	21%	17%	23%
Increase in earning capacity contributed by cheaper MFI loan	21%	27%	16%

Table 9.2A6 Most important means to cope up with shocks

	Full sample		2nd cycle		4th cycle	
Percentage quoted the instrument as one of the three most important means to cope up with shocks to asset	Before first loan+	Now+	Before first loan+	Now+	Before first loan+	Now+
Savings	31%	39%*	32%	33%	29%	43%*
Loan from Moneylenders	39%	32%*	46%	42%	34%	24%*
Loans from Friend, Relatives, Neighbours	45%	42%	48%	42%	43%	42%
Grant from Friend, Relatives, Neighbours	36%	34%	45%	40%	29%	29%
Loan from MFI	8%	50%*	8%	44%*	9%	55%*
Selling or Mortgaging any Property	15%	13%	13%	13%	17%	13%

Notes: + Row total could be more than 100 as the responses quoted the percentage of clients who would have adopted any source as one of the three most important sources.
* Indicates the difference between now and before is statistically significant.

Table 9.2A7 Clients' role in decision-making

	Percentage of clients equally or more involved in household decision-making	
	Before taking the first loan	Now
Savings	62	74
Loans	64	74
Household expenditure	69	81
Education	75	79
Buying/selling of assets	61	65
New business	57	68

Table 9.2A8 Perception towards problems and optimism: percentage disagreed to the statements

	Overall	2nd cycle	4th cycle
There is no real way I can solve the problems I have	74	71	76
There is little I can do to change many of the important things in my life	37	33	40

Table 9.2A9 Clients' aspirations

	Percentage of clients quoted a given aspiration	
	Before taking the first loan	Now
Agricultural Development	5	2
Improving Overall Financial Conditions*	16	16
Improving Children's Education and Marriage	12	26
Developing New Business	29	20
Improving Quality of Housing **	24	23
Buying New land	1	2
Buying New Assets ***	3	3
Others	3	7
No Aspirations	7	2

Notes: *Overall financial requirements define client's need for financial improvement by reducing interest rate, increasing loan amount, repaying moneylenders, etc.
** Household Development defines clients' aspirations for having better living standards, good housing quality, better living for all family members.
*** Buying new assets defines their interest in developing more durable assets like television, cars, motorcycles, etc.

ANNEX 9.3

Literature reviewed for arriving at the indicators for measuring outcomes and impact of microfinance

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1. I strongly believe that we can create a poverty-free world, if we want to.... In that kind of world, [the] only place you can see poverty is in the museum. When school children will be on a tour of the poverty museum, they will be horrified to see the misery and indignity of human beings. They will blame their forefathers for tolerating this inhuman condition to continue in a massive way.

   —Professor Mohammed Yunus. Available online at http://www.muhammadyunus.org/Quotes/ (accessed 2 August 2012)

2. Khandker (2005) analyzed data from a massive survey of households participating in microfinance programmes in Bangladesh and households in comparison villages. The survey work was conducted in 1991/1992 and repeated in 1998/1999 to provide panel data (longitudinal data, from two or more time periods) that allows what is very likely the most reliable, large-scale impact evaluation of microfinance to date. However, Morduch raised key doubts on the interpretation of their data and conclusions drawn. Shahidur R. Khandker, 'Microfinance and Poverty: Evidence using Panel Data from Bangladesh', *World Bank Economic Review*, 19 (2, 2005): 263–86. Morduch Jonathan, 'Does Microfinance Really Help the Poor? New Evidence from Flagship Programmes in Bangladesh'. Mimeo. Available online at http://www.cgdev.org/doc/RM/Morduch%201998,%20Does%20Microfinance%20Really%20Help%20the%20PoorNew%20Evidence%20from%20Flagship%20Programs%20in%20Bangladesh.pdf (accessed 10 June 2012).
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4. David S. Gibbons, *Debate of Outreach and Impact, What Do We Know and How Do We Know, Paper Commissioned by Global Microcredit Summit* (2011). Available online at http://www.globalmicrocreditsummit2011.org/userfiles/file/Workshop/David Gibbons pdf (accessed 10 June 2012).
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8. Opportunity International, 'SROI Pilot EMFIL', first draft, April 2012. Please see Annex 9.1 for the underlying assumptions.
9. Unitus and Equitas, *The Impact of Equitas Microfinance on Differently-abled Clients* (Chennai: Unitus and Equitas, December 2009).
10. Led by Dr Santadarshan Sadhu, with research assistance from Ujjawal A., Anushree and Mudita Tewari.
11. Table 9.2A1 in the Annex 9.2 provides details of sampling.
12. Characteristics of the 4th cycle clients could possibly be different from the characteristics of the 2nd cycle clients as 4th cycle clients might have chosen to continue borrowing from the MFIs as they would have foreseen more benefits from MFIs. Thus, the control group (2nd cycle clients) of this study might not be truly identical to the treatment group (4th cycle).
13. The data on most important usage of MFI loans show that around 62 per cent of the clients used their first MFI loan for business purposes (either for setting up of new business or for supporting existing business), with a similar usage in the most recent loan as well.
14. This study has certain limitations. The findings are all based on recall and perception data of the

customers surveyed and as such recall bias is a possibility. The results based on the comparison of data on current achievements of 2nd and 4th loan cycle clients might not be robust as the 4th cycle clients might 'self-select' to maintain a sustained relationship with the MFIs and thus could possibly be characteristically different from the 2nd cycle clients who may or may not continue to borrow from the MFI for sustained period. The study findings should be interpreted with these caveats in mind. The findings do indicate clearly, despite these caveats, that sustained access to microfinance has a positive effect on customers' livelihoods.

Future is about balance—everywhere

10

Chapter

The last two tough years have triggered different responses in different quarters in the microfinance sector. The MFIs threatened with near extinction undertook massive exercises individually and as a group to reflect on what they did wrong and, more importantly, how to remedy the same. Investors were shaken and made to reconsider their assumptions of perennial fair weather in the investment climate. Social investors were questioned on their social role and others were asked about their responsibility to ultimate customers. Investments became a trickle, but the advice and guidance from investors to MFIs became a deluge. Bankers were the hardest hit in terms of financial losses and they responded with stoppage of loans to the sector. They are being asked to take additional responsibility of enforcing customer protection related regulatory norms on the MFIs. Regulators have been prodded in to action to protect their turf from encroachment. A clear benefit emerging from the crisis is the regulation of microfinance sector with emphasis on customer protection. The government at the centre woke up to the need for policy-based regulation of the sector. Customers in states outside AP have the most to gain from the crisis and its aftermath in the form of less aggressive and more responsive MFIs. Customers in AP temporarily enjoyed the equivalent of a massive loan waiver of about ₹90 billion, but seem to be out of options for finding reasonable lenders in the absence of MFIs. If anything, the AP statute seems to fails the test of responsible regulation as it did not foresee the lack of viable options for people that were denied MFI services.

The sector lost more than reputation. It lost its innocence and the unquestioning faith it enjoyed from others. The ongoing calls for proof that MFIs are socially relevant will continue to be strident. The response to such challenges can no more be in words, but in deeds. Since last two years, the regulator and MFIs have taken several measures to improve responsible finance practices in the sector. In spite of narrowing margins and increasing financial stress, MFIs are investing in systems and training of staff and clients to ensure compliance with regulatory norms as well as code of conduct. The MFIs, despite compliance to regulatory norms and improved practices, cannot declare that they have turned a new leaf. The right of self-certification has been taken away from them, at least for the present. External actors have come to centre stage and decide on which MFIs meet standards of social performance and which do not. For a sector that dared to send poverty to museum, the presumed loss of social relevance is a severe setback that would take a few years to repair. The entry of well-meaning third parties between the customers and MFIs is a politically expedient but operationally inconvenient development, which the sector has to deal with.

The emerging future is not just about institutions strategizing their business but also about communicating politically correct messages to the stakeholders. Concerns of financial sustainability are less likely to occupy management time; establishing customer centricity and social responsibility will be preoccupations of the sector where the overriding concern is access to capital and bulk funds. While equity investors are likely to return to the market sooner, the banks are likely to take longer on account of the heightened risk perceptions and the stressed assets overhang. They might demand that MFIs achieve a higher standard of customer protection and responsible finance than what the customers think reasonable. The sector is entering a period when excessive demands for proof of social intent and welfare

impact of business will seem reasonable. The only sane counsel prevails in RBI and the Government of India. Their expectations from MFIs reflect that they had not been carried away by the hype of the past. The regulatory and policy establishments seem to have a better appreciation of the potential of the sector and what is needed to set it right.

What does the sector do from here onwards? Instead of going on a welfare overdrive, the sector has to proceed on a well-thought-out and calibrated response in developing customer-oriented products, processes and models of business. Financial sustainability should not be cast aside in the quest for becoming socially performing. There should be emphasis on internal improvements in customer protection issues and responsible practices rather than on external scrutiny and certifications.

While MFIs are taking several measures to improve the business practices, there are some aspects that the governance boards of MFIs still have to address. First of all, MFIs should have a very clear idea of what their mission is and revisit their mission if need be. There is a disconnect between the mission and the business performance in many MFIs. If MFIs define their mission as trying to provide cost-effective financial services to marginalized people, then they will be able to do their business very efficiently. A lofty mission bereft of practical strategies might to irresponsible business behaviour. Going down-market from the supply side has been found to have severe limitations. The business models should focus on the customer and then build it upwards into a business rather than first have a business idea in terms of a product or a process or a location and build it downwards. This would mean that there should be investments in product and process redesign after listening to the customer. The gap that developed between the customer and the MFIs during the phase of frenetic growth is a key reason why the institutions have failed to recognize customer concerns. The MFIs should invest in strengthening the relationship with the customers and understanding their needs and concerns.

At a policy level, the apex funders and regulator, while admitting that the MFI credit flows to priority sector, should find ways of increasing flow of domestic equity and loan funds. While market-based solutions for liquidity constraints would be found over time, in the near future, supply response from apex development banks will provide much-needed succour. Denial of access to financial services to poor by restricting flow of funds to deserving MFIs is also a socially irresponsible behaviour on the part of bulk funders.

Many MFIs have gone beyond financial services and provided need-based non-financial services in education, health, housing, sanitation, water supply and rehabilitation of the very poor. Those who do not engage in such non-financial interventions should take a cue from those who do. Not only will this build loyalty and a lasting relationship with their clients, it may also positively impact repayment rates and provide answers to political risks. Communicating the outcomes of such interventions has been tardy. The sector should find ways of disseminating information on the livelihood improvement-related interventions undertaken for the vulnerable customers. The MFIs have to showcase not only the improvements they have made in their responsible finance practices but also the changes they are bringing about in their clients' lives. The annual reports of the institutions should contain detailed reporting on responsible finance and social performance.

The role of regulation in future is critical not only for sustainability of MFIs but also for responsible finance practice. The regulatory definitions of what are acceptable as poverty level, debt level, loan purposes and interest rates may be seen as the ideals that an institution should attain. The fact that regulatory norms are the minimum standards to be attained and that MFIs should actively pursue bettering these benchmarks should be brought home. An incentive package is necessary to push the MFIs to go well beyond the minimum in customer protection and responsible practices. The notion that existing customers gaining protection and appropriate services is the best outcome by way of responsible finance has to be questioned. By policy, institution design and products, if the coverage of services is limited to certain geographies or to upper half of the poverty pyramid, then it is a collective failure on the part of the sector to drive a responsible agenda. Those who justify the contraction in outreach and business actually work against the interests of a large population that still remains excluded. It is time to revisit our assumptions on what is fair and appropriate and ensure that the sector looks ahead to expand with responsibility. Sustainable business expansion holds the key for the financially excluded people to hope for access to credit and other services. Let us work towards an inclusive microfinance sector.

> *It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.*
>
> Adam Smith

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The SMART Campaign is a global effort to unite microfinance leaders around a common goal of keeping clients as the driving force of the industry. The SMART Campaign was launched in October 2009 and has worked to successfully embed the core Client Protection Principles (CPPs) within the industry. It has achieved this through securing industry endorsements, conducting trainings and fostering a market of technical assistance and support for institutions who want to improve adherence to the CPPs. Over 3,000 microfinance institutions, microfinance support organizations, investors, donors and individual industry professionals have signed up with the SMART Campaign, representing over 130 countries.

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