

**CODE OF CONDUCT**

**ASSESSMENT FOR**

**SANGHAMITHRA RURAL**

**FINANCIAL SERVICES**

Date of Report -17<sup>th</sup> July, 2012

## EXECUTIVE SUMMARY

The Code of Conduct report for Sanghamithra Rural Financial Services (Sanghamithra) evaluates the company's adherence towards different code of conduct parameters. The study examines and comments upon the common minimum indicators such as:

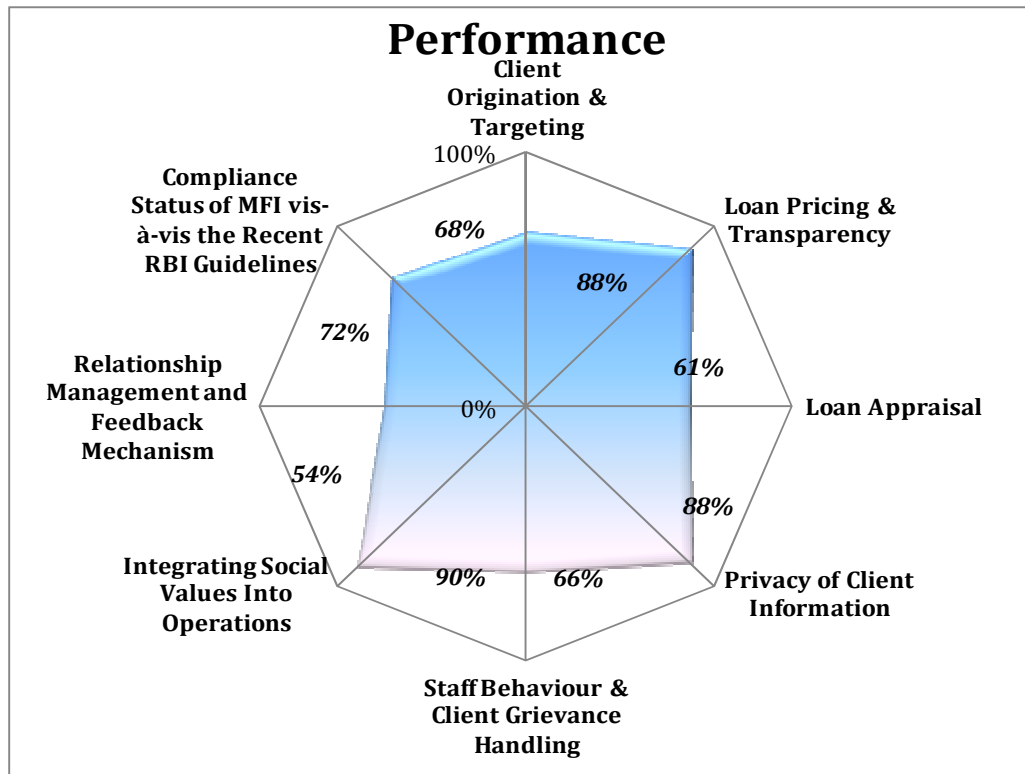
- Client Origination & Targeting
- Loan Pricing & Transparency
- Loan Appraisal
- Privacy of Client Information
- Staff Behaviour and Client Grievance Handling
- Integrating Social Values Into Operations
- Relationship Management and Feedback Mechanism
- Compliance Status of MFI vis-à-vis the Recent RBI Guidelines

SMERA believes that Sanghamithra exhibits an average level of adherence to all parameters and consequently complies well with the code of conduct laid out. This document details SMERA's approach and methodology for this study and gives observations of its assessment team while conducting the evaluation. The Approval; Documentation; Dissemination and Observance (ADDO) framework has been used for assessment and measuring Sanghamithra's adherence towards ethical operational practices.

## RATING

Code of Conduct Assessment Score : 69%, COCA Rating - 4 (Average Level of Adherence)

## MATRIX



## SCORES ON PARAMETERS

Code of Conduct Parameters	Obtained	Maximum Score	% Performance
Client Origination & Targeting	15	22	68%
Loan Pricing & Transparency	14	16	88%
Loan Appraisal	11	18	61%
Privacy of Client Information	7	8	88%
Staff Behaviour and Client Grievance Handling	23	35	66%
Integrating Social Values Into Operations	9	10	90%
Relationship Management and Feedback Mechanism	15	28	54%
Compliance Status of MFI vis-à-vis the Recent RBI Guidelines	23	32	72%

## SNAPSHOT

<b>MFI Name</b>	SANGHAMITHRA RURAL FINANCIAL SERVICES
<b>Tradestyle</b>	SANGHAMITHRA
<b>Registered &amp; Corporate Office Address</b>	#612, 1 'C' Main Road, Domlur Layout, Bengaluru - 560 071 Karnataka India
<b>Telephone</b>	(91) (80) (25350301)
<b>Telefax</b>	(91) (80) (25354708)
<b>Email</b>	<a href="mailto:sanghamithra_bg@yahoo.in">sanghamithra_bg@yahoo.in</a>
<b>Webpage</b>	<a href="http://www.sanghamithra.org">www.sanghamithra.org</a>
<b>Line of Business</b>	Microfinance services using Self Help Group (SHG) Model
<b>Chief Executive</b>	Mr. R.D. Gadiyappanavar, Chief Executive Officer
<b>Legal Form</b>	Section 25 company registered under Indian Companies Act, 1956
<b>Registration Number</b>	U85110KA1995NPL017199
<b>Incorporation Date</b>	15/Feb/1995
<b>Commencement of Microfinance Operations</b>	February, 2000
<b>Operation Area</b>	03 States (Karnataka, Andhra Pradesh and Tamil Nadu)
<b>No. of Branches</b>	70
<b>Total Staff</b>	141
<b>Visit of the Assessment Team</b>	April, 2012

## **BACKGROUND AND LENDING METHODOLOGY**

Mysore Resettlement and Development Agency (MYRADA) was founded in the year 1968 to assist the government in resettling Tibetan refugees. The programme ended in 1982.

MYRADA along with NABARD (National Bank for Agriculture and Rural Development) worked together to formalize Self Help Groups (SHGs) and started linking programme with the banking system, particularly with Regional Rural Banks (RRBs). This organizations conducted several studies relating to transaction costs of various models of credit delivery in the rural context.

MYRADA formed Sanghamithra Rural Financial Services (hereafter referred as Sanghamithra) in 1995 as a Section 25 Company registered under Indian Companies Act, 1956. However Sanghamithra started its microfinance operations in February, 2000, when it gave a first loan of ₹ 10,000 to a SHG in Chitradurga, Karnataka.

Sanghamithra provides collateral-free loans to women groups residing in rural and semi-urban areas. The loans are given to groups; in turn the group members take the internal decision for distributing the loan amount within the group. The loans are given for carrying various income generating activities, house construction, consumption purpose, etc. Clients are organized in a group of 10-20 members; where the group mobilize their savings & lend out its own resources, attend weekly/monthly group meeting for collection of loan installments from the members. Sanghamithra has presence in three southern states i.e. Karnataka, Andhra Pradesh and Tamil Nadu.

### **OBJECTIVE OF THE STUDY**

The objective is to evaluate Sanghamithra's adherence to the code of conduct laid down by Sa-dhan, MFIN, best practice guide by multilateral agencies and Reserve Bank of India.

The broad parameters for assessing the Code of Conduct are as follows:

- Client Origination & Targeting
- Loan Pricing & Transparency
- Loan Appraisal
- Privacy of Client Information
- Staff Behaviour and Client Grievance Handling
- Integrating Social Values into Operations
- Relationship Management and Feedback Mechanism
- Compliance Status of MFI vis-à-vis the Recent RBI Guidelines

## **FRAMEWORK AND SCOPE**

The current perception surrounding Indian microfinance paints all entities across the sector in the same shade. However the fact that microfinance organizations display significant variations is important and needs to be adequately brought out. SMERA has always comprehensively and holistically assessed the risks involved in MFI operations and the resultant social impact of MFI operations.

Besides evaluating creditworthiness of MFIs, SMERA also assess trustworthiness, operational excellence, quality of loans of MFIs, socio-economic impact and MFIs emphasis towards ethical behavior and responsible lending.

SMERA has used the following framework for assessment of MFIs - The Approval; Documentation; Dissemination and Observance (ADDO) framework for measuring adherence of MFIs towards ethical operational practices.

As a part of the assessment, SMERA visited 10 branches of Sanghamithra in various districts of Karnataka. The assessment was conducted as per a specific methodology and questionnaire. Details of branches visited and methodology used for evaluation are provided in Annexure I and II.

## LIST OF BOARD MEMBERS

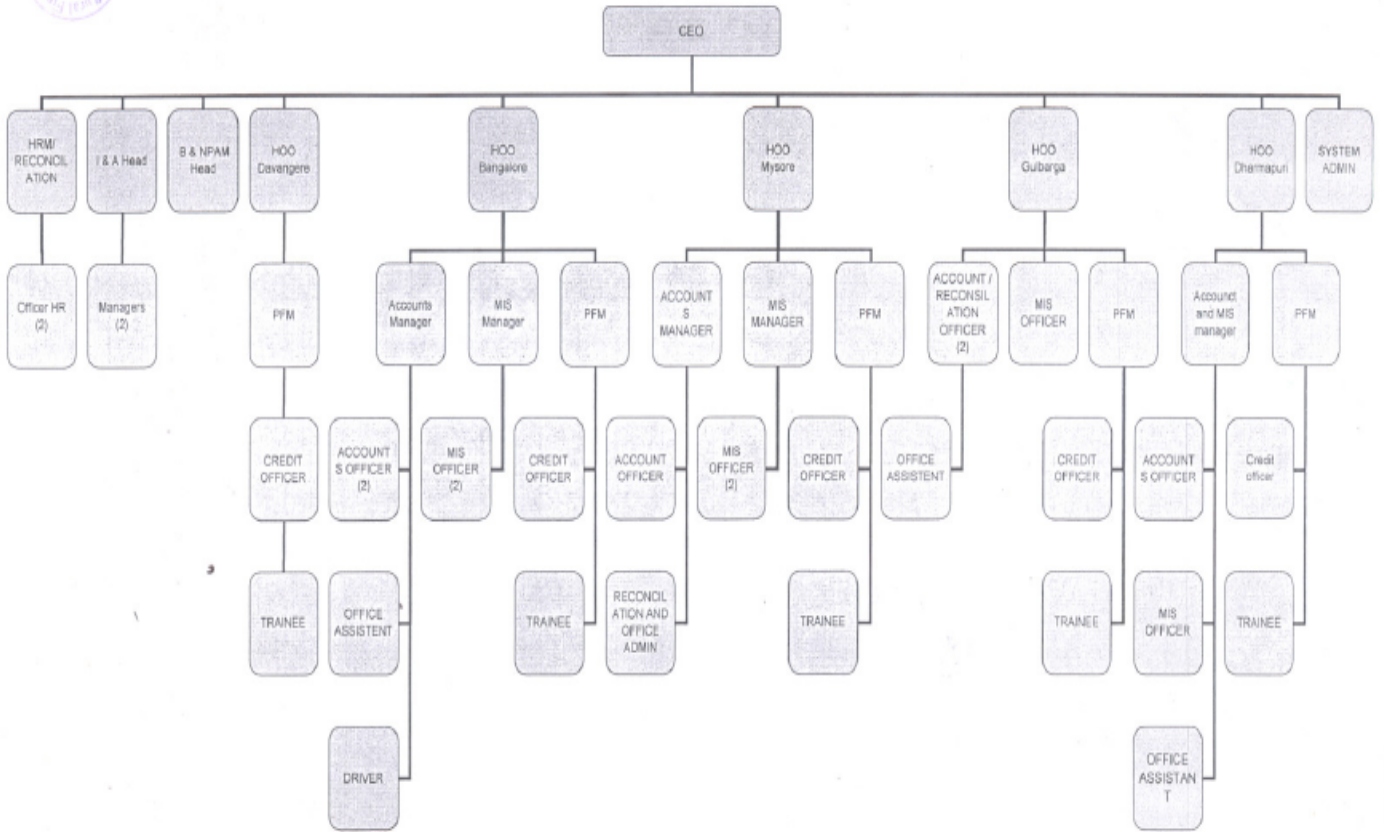
<b>List of Board of Directors</b>	
Padmashree Aloysius P. Fernandez	Founder Chairman
Mr. Ramesh Ramanathan	Vice-Chairman
Mr. William D'Souza	Vice-Chairman
Mr. Arvind G. Risbud	Director
Ms. Rohini Nilekani	Director
Ms. Yasmin Master	Director
Ms. Vidya Ramachandran	Director
Prof. M.S. Sriram	Director
Mr. Doraiswami Ashok	Director
Mr. Anal K. Jain	Director
Mr. R.D. Gadiyappanavar	CEO

## HIGHLIGHTS OF MICROFINANCE OPERATIONS

<b>Particulars</b>	<b>31-Mar-2010</b>	<b>31-Mar-2011</b>	<b>31-Mar-2012</b>
Number of Offices	60	66	70
Number of Staff Members	124	132	141
Numbers of SHGs	15,128	12,144	15,792
Number of Active Borrowers	118,807	126,750	120,994
Number of Loan Outstanding	7,361	7,289	7,754
Gross Loan Portfolio (₹ in thousands)	692,491	795,442	922,394
Borrowers per staff member (No. of SHGs)	122	92	112



# ORGANOGRAM



Client origination is an essential element to conduct ethical microfinance operations. The code of conduct requires MFIs to practice fair client origination process while enhancing access to financial services. Also, an MFI's commitment to targeting low income clients demonstrates its social mission. The way an MFI identifies and grows its client base must be approved by the board. The board should also ensure that MFI's product and services reach suitable clientele.

Sanghamithra is dependent on external agencies to originate clients; as they are not directly involved in forming the SHGs. The SHGs are promoted and nurtured for about six months to one year by agencies like Community Managed Resource Centres (CMRCs) promoted by MYRADA, Non-Governmental Organisations (NGOs), groups formed under government sponsored programmes like Swarna Jayanthi Shahari Rozgar Yojana (SJSRY) and Anganwadis. The villages where MYRADA carry its livelihood programmes, Sanghamithra has its presence to provide financial services.

These agencies form SHGs, provide services such as training group members, nurturing the group (facilitating regular meetings, savings, credit activities and linkages with banks), educating group members to maintain books of accounts, conduct regular audit/review of SHG functioning, etc.

Sanghamithra performs due-diligence for the NGOs before empanelment and extending credit to SHGs formed by respective NGOs. The due-diligence report of NGO is prepared by collecting preliminary information like NGO profile, registration copy, Balance Sheet and Profit & Loss A/c for last three years. The preliminary information is collected by credit officer or portfolio manager of Sanghamithra and due-diligence is carried out by the operational heads of the respective areas. Later the report is submitted to CEO for the final approval and once it is approved, the partnership agreement is signed between the two parties.

*Earlier the due-diligence of these NGOs was not carried by Sanghamithra, which has resulted problems in originating and targeting right clients to provide services. Now the management feels that due to the measures of due diligence of NGOs it has been able to overcome the problems related to selection of proper SHGs and clients.*

The client origination process begins on receipt of an introduction letter from the agencies formed the SHGs. Further on receiving the written request from SHGs to avail the loan, credit officer of Sanghamithra visits the SHG for a meeting in the village. Credit officer introduces Sanghamithra's scope of work, product & services, lending methodology, etc and ask SHG to fill the registration form to get the group registered with Sanghamithra by taking ₹ 100 as a registration fee which is valid for three years

(registration fee is collected only at the time of first linkage and it is deducted from the sanctioned amount). The credit officer also goes through the books of accounts maintained by the SHGs.

*However, there is no scoring or quantitative framework prescribed by Sanghamithra to select the groups below an income threshold. The client selection thus remains subjective to the decision of SHG members, as groups are promoted by NGOs and other agencies.*

Once the SHG associates with Sanghamithra for getting the credit, organization pay ₹ 350/- to the NGOs as an incentive per group and 1% of the loan amount to CMRCs for every linkage.

Sanghamithra collects two KYC (Know Your Customer) documents from the group members such as photograph and proof of identity and residence i.e. Voter ID Card/Ration Card.

*One of the weaknesses of the client origination process of Sanghamithra is that groups are formed by other agencies, therefore it lacks on quality of the group. Sanghamithra collects KYC documents of only two group representatives, as representatives are responsible for running the SHG and maintaining the books of accounts. This increases the possibility of enrolment of false/undeserving clients (As per example no.1). The documentary evidence to ensure the correct identity and address of the clients was not available in few groups visited by the assessment team. However, from September 2011, Sanghamithra has started obtaining KYC documents from all the members.*

Sanghamithra has adopted Sa-Dhan's code of conduct where it has committed to ensure that services will be provided to the low-income clients and total exposure of a single client will not be more than ₹ 50,000. *However the assessment team has observed that few members in the group were having well constructed houses (two storey houses) and income level was very high. It has been observed that there was no equal distribution of loan amount within the group members; as internal decision has been taken by group members for distributing the loan amount which has resulted allotment of high loan amounts i.e. ₹50,000 to ₹100,000 to few members.*

As a social initiative, Sanghamithra also provide microfinance services to Soukhya Groups (sex worker groups), where the interest rates are very low as compared to other group loans and limit it to 9% p.a. (monthly rest) upto the loan amount of ₹ 100,000 per group. Sanghamithra has taken this initiative to bring the attitudinal changes in the soukhya groups, so they can carry alternative livelihood activities.

**Example No.1** - In Channapatna Branch, the credit officer has created fake groups along with two women's and loans have been sanctioned without taking proper KYC documents. In Inspection register maintained by Sanghamithra, it was noted that only one member has taken the entire loan amount and other members are not traceable. The details are as follows:

Financial Assistance No.	Name of the group	Loan Amount Taken	Remarks mentioned in inspection register
18432	Sri Chethana	₹300,000	Ms. Girija has taken the entire loan amount
18431	Sri Vinayaka	₹250,000	Ms. Girija has taken the entire loan amount
17954	Varamahalakshmi	₹200,000	Ms. Girija has taken the entire loan amount
17360	Sampige	₹200,000	Ms. Girija has taken the entire loan amount
7359	Parvathi	₹200,000	Ms. Girija has taken the entire loan amount
19665	Chamundeshwari	₹150,000	Ms. Girija has taken the entire loan amount
19767	Sumangali	₹250,000	Ms. Girija has taken the entire loan amount
18754	Vimala	₹300,000	Ms. Girija has taken the entire loan amount
18559	Durga Devi	₹250,000	Ms. Sugana has taken the entire loan amount
18554	Durga Devi Thayee	₹250,000	Ms. Sugana has taken the entire loan amount
18555	Durga Shakthi	₹200,000	Ms. Sugana has taken the entire loan amount
18553	Nesara	₹200,000	Ms. Sugana has taken the entire loan amount
	<b>Total</b>	<b>₹2,750,000</b>	

While conversation with the branch staff, it came to know that Ms. Girija and Ms. Sugana, both are sisters and they have created the fake groups along with ex-credit officer.

Approval	Documentation	Dissemination	Observance
<ul style="list-style-type: none"> <li>Sanghamithra have approved policies for involvement of registered agencies / NGOs empanelled with Sanghamithra in the client origination &amp; targeting process.</li> </ul>	<ul style="list-style-type: none"> <li>Due-diligence report for external agencies is documented.</li> <li>Client origination process has been documented clearly in the operational manual.</li> </ul>	<ul style="list-style-type: none"> <li>Sanghamithra provides training to its field staff which includes processes and procedures to be followed for originating clients.</li> <li>On receipt of an introduction letter from agencies for extending the credit to SHGs.</li> </ul>	<ul style="list-style-type: none"> <li>Some policy deviations were observed in the client origination and targeting, as lot of clients were having high standard of living and taken high loan amounts.</li> <li>Sanghamithra has not collected the KYC documents for majority of its clients.</li> </ul>

<b>Client Origination &amp; Targeting</b>	<b>15</b>	<b>22</b>
Approval	3	4
Documentation	2	3
Dissemination	3	5
Observance	7	10

## **LOAN PRICING & TRANSPARENCY**

**Score - 88%**

The transparency observed by the MFI in terms of pricing of loans is examined in detail. The pricing of loans covers interest rate, loan processing charges, additional charges taken if any, security deposits or advance installments, etc. Considering these costs while pricing the loans may change the effective interest rate charged to the clients. The scientific determination of loan price (interest rates) reflects well on the MFI's management and it also shows how effective the MFI is in providing loans to the clients at the least possible cost.

SMERA covers transparency by assessing honesty, communication, and accountability of the practices of MFI through sub parameters such as frequency of training given to clients, disclosure of terms and conditions of MFI, measuring awareness of the terms and conditions through client visit, language used in the disclosure and surprise visit conducted by the MFI staff.

Sanghamithra maintains high level of transparency in interest rates and other charges on the loans. Interest is charged on a declining basis, there are no upfront fees, no security deposits and no prepayment penalty or late payment charges collected from the groups. The organisation discloses its terms & conditions in the sanction letter along with interest rate, tenure of loan, stamp paper charges, repayment schedule, and installment amount to be paid every month, cheque amount along with cheque number. Sanghamithra gives loan passbook to the group rather than individual members, where the credit officer updates the loan passbook on the loan collection date.

### **Registration and Stamp Paper Charges**

Sanghamithra takes registration fee of ₹ 100/- per group which is valid for three years (at the time of first linkage) and stamp paper charges of ₹ 60/- from the group.

### **Upfront Administration Charges**

From November 2011, Sanghamithra has stopped taking 1% of the loan amount as upfront administration charges from the SHGs. Earlier, this upfront administration charges were deducted from the loan value and balance amount was disbursed through cheque.

### Interest Rate

Sanghamithra has revised its interest rate structure on its loan products after the directions issued by RBI to cap the interest rate. On the general loans the organisation charges interest @ 21% p.a. (monthly rest) and on housing/sanitation loans @ 20% p.a. with no other processing charges. Earlier Sanghamithra used to charge interest @ 18% p.a. (monthly rest) for general loans and 17% for housing/sanitation loans.

Sanghamithra also provides microfinance services to soukhya groups, where the organization subsidizes the interest rate and limit it to 9% p.a. (monthly rest) upto the loan amount of ₹ 100,000 per group. If the loan amount exceeds the ceiling limit, then it is categorized normal as general loan.

### Late Payment Penalties & Prepayment Charges

From November 2011, Sanghamithra has stopped collecting late payment penalties & prepayment charges from SHGs.

Interest Rate	Effective Rate of Return	Annual Percentage Rate
21%	21%	21%

Sanghamithra has recently entered into providing life insurance services to SHGs through Life Insurance Corporation of India (LIC) named as “Janashree Bima Yojana”. However Sanghamithra has not made it compulsory for the groups to avail the insurance cover. *During the visit, assessment team has not found any group who availed the insurance scheme.*

Approval	Documentation	Dissemination	Observance
<ul style="list-style-type: none"> <li>Sanghamithra’s board has approved principles of pricing loans and transparency in a responsible manner.</li> </ul>	<ul style="list-style-type: none"> <li>The loan pricing criteria and method of charging have been clearly documented in policy circulars issued time-to-time.</li> </ul>	<ul style="list-style-type: none"> <li>The sanction letter given to the SHGs clearly specifies the interest rate and tenure of the loan in regional language.</li> <li>Groups are also given the loan repayment schedule which clearly shows the installment amount and loan outstanding balance.</li> <li>Credit officers were not able to impart the knowledge to the group members about the loan pricing.</li> </ul>	<ul style="list-style-type: none"> <li>Most of the clients were aware of the installment amount to be paid, tenure of the loan and outstanding installments to be repaid.</li> <li>There were instances found that clients were not aware of interest rate been charged by the MFI.</li> </ul>

<b>Loan Pricing &amp; Transparency</b>	<b>14</b>	<b>16</b>
Approval	3	3
Documentation	1	1
Dissemination	1	2
Observance	9	10



## LOAN APPRAISAL

Score - 61%

The selection of the right kind of client and proper assessment is critical for the success of the MFI. The appraisal process followed by the MFI, the checks and balances, know your customer (KYC) documents collected by the MFI to verify the genuineness of the borrowers, the process adopted by the MFI to avoid multiple lending / over-indebtedness and requirement of the loan are assessed in detail. The loan appraisal should take into account the repayment capacity of the clients given the loan sizes and the duration of the loan.

The loan appraisal or sanction process begins with the written request received by the SHG to avail the loan. On the receipt of a letter from the SHG, credit officer visits the SHG in village for first meeting, where credit officer checks various books of accounts maintained by the groups. The credit officer asks SHG to fill the registration form and gets the group registered with Sanghamithra by paying a nominal fee of ₹ 100/- per group.

After the registration, credit officer visits group member's house for assessing their repayment capacity. Further credit officer assesses the members by collecting preliminary information in a questionnaire, where the scoring system is followed. The questionnaire covers various parameters which are as follows:

Category	Parameters
Groups Activity Information	Date of formation, group's activity, saving habits, regularity of savings, internal lending, repayment of loans and control over funds
Internal Non-Financial Information	Continuity in membership, regularity of meetings, attendance in meetings, governing structure, literacy level and financial transaction in the group
Groups Appraisal Information	Distribution and purpose of loans, interest rate, overdues in internal lending, maintenance of books of accounts and quality of maintenance
External Non-Financial Information	Economic and income level, credit worthiness of the SHG according to NGO
External Financial Information	Bank linkage and funding, repayment rate on bank loans, overdue of SHG and awareness about banking procedures among members

The above five categories are summarized in 500 marks and based on this parameters scoring is done by the credit officer. If the group scores:

- 350-500 marks - it will be considered for lending
- 250-350 marks - it will be considered for lending but capacity building is required
- Less than 250 marks - group is not considered for lending and intensive capacity building is required

Only if the group scores minimum marks required and credit officer satisfies himself for the credit worthiness of the SHG, credit officer precedes the application-cum-appraisal form along with pre-sanction documents and forwards it to portfolio manager.

*Earlier in Sanghamithra, the loan appraisal and sanctioning was primarily the responsibility of the credit officer which has resulted into formation of fake groups and faulty assessment. This is clearly evident from Example No. 1&2.*

Now the portfolio manager verifies the entire loan file in his end and forwards it to the head office for sanctioning. The chief manager at head office goes through the proposal and puts it across to the loan sanction committee which consists of CEO, head operations and portfolio manager, where the final decision is taken. Sanghamithra does not have any policy in terms of loan utilization check, where credit officer can ensure that group members have utilized the loan amount in productive or non-productive purpose.

**Example No.2** – *The loan appraisal process for Financial Assistance No. 23459 which belongs to “Gulabi Group” was not adhered strictly as per policy established by Sanghamithra. The group has been sanctioned a loan of ₹ 300,000 which was disbursed on 29/May/2009, At the time of discussion the assessment team came across that actually the group does not exist and only one person has taken the entire loan amount and it has been categorised as Non-Performing Asset (NPA). Kindly refer to example no.1, this is another group formed by Ms. Girija to take the loan; where already she has defaulted on previous loans.*

*After doing the detailed verification, it was found that the Head Office has sanctioned and approved the loan to the particular client to repay the earlier loan taken from Sanghamithra.*

Approval	Documentation	Dissemination	Observance
<ul style="list-style-type: none"> <li>Sanghamithra's policy requires that adequate loan appraisal to be performed before disbursing a loan.</li> </ul>	<ul style="list-style-type: none"> <li>The guidelines for appraising a loan application are clearly documented in the policy manuals. Information pertaining to income, purpose of loan and the indebtedness of borrowers' households is obtained at the time of loan application.</li> </ul>	<ul style="list-style-type: none"> <li>The branch staff was found to be well aware of how to conduct the loan appraisal as per the guidelines.</li> </ul>	<ul style="list-style-type: none"> <li>There were instances that credit officers have not conducted pre and post disbursement visits.</li> <li>There was no equal distribution of loan amount within the group. The variation of loan amount within group is found to be wide and asymmetrical as SHG members takes the decision.</li> </ul>

Loan Appraisal	11	18
Approval	3	5
Documentation	3	4
Dissemination	2	3
Observance	3	6

**PRIVACY OF CLIENT INFORMATION**

**Score - 88%**

Client confidentiality is an important concern of any organization. An MFI collects personal information about its clients that is either required or necessary to provide with financial products or services. The MFI should not disclose or misuse personal information to affiliates or non-affiliated third parties, except as permitted by law or client privacy policy disclosure. For this, SMERA assessed whether MFI maintains physical, electronic and procedural safeguards for the client information.

Sanghamithra has an adequate system of storage and retrieval of documents and information collected from the clients. The files containing sanction letter, documents and members profile are kept at the respective branches. The relevant data is entered into the software “Core Banking” web based solutions developed by Apparent Infotech Private Limited at the head office from where registration and financial assistance number is generated. This increases the ability to retrieve client data in a timely fashion. It was found that only authorized people had access to this sensitive data.

Approval	Documentation	Dissemination	Observance
<ul style="list-style-type: none"> <li>Sanghamithra’s policy requires that adequate safety to ensure privacy of client data. The software has well-defined security features and user rights.</li> </ul>	<ul style="list-style-type: none"> <li>Process manuals provide adequate guidelines on how the client documents and information has to be recorded and files have to be stored.</li> </ul>	<ul style="list-style-type: none"> <li>Branch staff was aware of how client data had to be stored.</li> </ul>	<ul style="list-style-type: none"> <li>Branch staff has an access to entire data of the client and all loan files are kept in the branches. However documents were missing for few groups in the branches.</li> </ul>

Client data security	7	8
Approval	1	1
Documentation	2	2
Dissemination	2	2
Observance	2	3

This section evaluates the process of the MFI with respect to staff's code of conduct and behavior with the clients.

**Staff Behaviour -**

Sanghamithra provides adequate emphasis on the conduct of its staff members towards the clients. The following are the important aspects of the expected behaviour of staff towards the clients.

1. Staff should not discriminate the clients on the basis of caste or religion in extending credit.
2. Staff must behave politely with the clients at all the times and in all situations.
3. Staff should not use abusive language and threats for recovery of dues.
4. Staff should not ask for any physical collateral from the groups.
5. Staff should use peer pressure or social collateral for loan recovery.
6. Staff should not visit client's residence at odd hours for recovery.
7. Staff should not forcibly enter the client's house and threaten or force seizure of assets for recovery.
8. Staff should not collect any extra money from the client which is not permitted by the company.

One of the important aspects of staff's induction training is conduct towards clients. Detailed guidelines (Do's and Dont's for the field staff) have been provided to staff in the policy documents as well as operational manual regarding the way they should interact and behave with the clients.

Sanghamithra does not have any incentive-based salary structure for their field staff on the performance based on loan disbursement and collection. However Sanghamithra pays 2.5% as an incentive on recovery of NPA accounts (outstanding for 2-3 years) and 5% on write-off accounts (outstanding for >3 years).

**Loan collection and recovery process**

MFI's should develop collection practices that require all clients to be treated with dignity and respect, even when they fail to meet their contractual commitments. Clients should also be aware of the debt recovery practices of the MFI. They should be aware of what to expect in case there is a delayed payment or a default.

SHG members conduct weekly/monthly meetings as per their convenience in a designated place of their choice, where group members meet, handover their savings amount and loan installments to the group's representative. The group's representative keeps the cash and later she handovers it to the credit officer on the due date. Credit officers of Sanghamithra meet the group's representative on predetermined date to collect the loan installments. The credit officer collects the cash, updates the group's loan passbook and issues the cash receipts to the group with the help of hand held billing machine given to them by Sanghamithra.

In case one or more members of the group are unable to pay the installment, other members of the group are asked to contribute on their behalf, reminding them of the group responsibility. In case the amount does not come till the end of the meeting, credit officer proceeds to the next meeting. He informs the group's representative to collect the pending installment from the defaulted member. If required the credit officer also visit the house of the delinquent client for recovery along with the group's representative.

An important aspect of the recovery procedure is that although there is high degree of emphasis on timely recovery and application of peer pressure, this does not always mean that all the scheduled installments should come on the same day. In case, one or more clients of the group are not able to repay during the scheduled meeting, the credit officer visits in the evening or next day for the unpaid installment.

Approval	Documentation	Dissemination	Observance
<ul style="list-style-type: none"> <li>• Various policies of the organization provide adequate directions for staff to treat client with respect and dignity.</li> </ul>	<ul style="list-style-type: none"> <li>• The organization has circulated do's and don't's for staff members while dealing with the clients.</li> </ul>	<ul style="list-style-type: none"> <li>• The staff members interviewed displayed an average level of awareness on staff behaviour. However unethical behaviour of credit officer shown in the past reduces the comfort level.</li> </ul>	<ul style="list-style-type: none"> <li>• All staff members were found to be aware of the rules of staff conduct.</li> <li>• Behaviour of staff towards clients was found to be professional in all situations encountered.</li> <li>• Proper client grievance handling system not in place. However as informed by management, client grievances are addressed during SHG meets and financial literacy programs.</li> </ul>

<b>Staff Behaviour and Client Grievance Handling</b>	<b>23</b>	<b>35</b>
Approval	6	7
Documentation	5	6
Dissemination	6	10
Observance	6	12

## **INTEGRATING SOCIAL VALUES INTO OPERATIONS**

**Score - 90%**

Sustainability is an increasingly relevant issue for MFIs; accordingly sustainability management strategies and practices are significant. For example, appropriate environmental and social performance objectives, targets and indicators need to be integrated with quality, cost and other more conventional performance measures. SMERA assess governance, board composition, and area of expertise of the board, how social values are assessed by the management or board and the transparency in financial accounting.

Sanghamithra Mission: *“Our mission is to service low-income clients-women and men-and their families, providing them short term and/or long term access to financial services, that are client focused, designed to enhance their well-being, and delivered in a manner that is ethical, dignified, transparent, equitable and cost effective”.*

Sanghamithra maintains a high standard of governance and integrity by inducting persons with good and sound reputation in the industry and understanding of microfinance as members of board of directors or governing body. Sanghamithra has qualified and professional board having diversified functional expertise. The board members are actively involved in policy making and approvals, fund mobilization, responsible for all strategic decisions, approving business plans & new products, reviewing the performance and other important decisions pertaining to Sanghamithra.

Currently, Sanghamithra focuses on providing microfinance services to SHGs normally for income generation, housing and consumption purpose. Sanghamithra also provide funds to NGOs and SHG Federations for carrying institutional capacity building and livelihood programme for SHGs.

Sanghamithra believes in inclusive growth and trying to reach the unreached marginalized/vulnerable section of the society. The company is intensively financing soukhya groups in Kolar, Chitradurga, Bellary and Gulbarga districts, promoted by MYRADA as well as vulnerable groups formed by CMRCs/MYRADA in Chitradurga. In Dharmapuri region, Sanghamithra has extended credit to SHG members for sanitation program in the district of Ooty for construction of individual toilets. Sanghamithra has financed 870 toilets with a loan amount of ₹ 159.80 lakhs. Sanghamithra has also propose to encourage ‘organic farming’ in collaboration with Krishi Vigyana Kendra, Gobi and MYRADA Kaveri Pradeshika Samsthe (MYKAPS). Further the company has also entered into partnership with LIC to provide life insurance cover to its group members; however it is yet to be implemented in all the branches.



Sanghamithra have also taken up socially desirable activities in collaboration with Water.org, lending for sanitation, water connectivity, roof water harvesting and water filter, with a view to improve the health of the members and improve the quality of life. Sanghamithra have also joined hands with SELCO Lights Private Limited, for providing lighting to the individual households.

The field staffs perform their duties as per operational guidelines and their conduct and attitude towards clients adequately reflects the social objectives of the company. Sanghamithra's social mission and objectives are reflected well in its ground-level operations.

Approval	Documentation	Dissemination	Observance
<ul style="list-style-type: none"> <li>Sanghamithra has approved principles of social values into operations.</li> </ul>	<ul style="list-style-type: none"> <li>Sanghamithra maintains integrity by inducting policies or process notes to attain the vision of the organisation to improve the quality of life of the poor by providing access to financial and support service.</li> </ul>	<ul style="list-style-type: none"> <li>Sanghamithra provide funds to NGOs and SHG Federations for carrying institutional capacity building and livelihood programme for SHGs to improve the living conditions of the target clients.</li> </ul>	<ul style="list-style-type: none"> <li>Sanghamithra maintains a high standard of governance and integrity into operations.</li> <li>Some of the loan was given to members having higher income level and better quality of housings.</li> </ul>

Integrating social values into operations	9	10
Approval	2	2
Documentation	2	2
Dissemination	2	2
Observance	3	4

MFIs need to build sustainable and long term relationship with their clients. Sound relationship management enhances the quality of the clients' experience with the MFI. This allows the MFI to better understand clients' needs and grievances. MFIs need to have formal mechanisms to get feedback and complaints from the clients. Customer complaints should be taken seriously, investigated and resolved in a timely manner. Responsibilities relating to receiving client grievance, feedback and action plans need to be clearly identified and allocated. SMERA evaluates these practices in detail.

As per present policy and processes, Sanghamithra does not have any complaint drop boxes or registers at the branches for any suggestions or complaints for client or employees. At present, Sanghamithra does not have any separate customer care department for registering complaints or understanding client's difficulty. However the organization provides few informal feedback channels to the clients, although none of these channels have been implemented with processes, responsibilities, records, timeliness and monitoring mechanisms. A few of the feedback channels available to the client's are-

- a) Regional office contact numbers printed in the sanction letter.
- b) Availability of mobile numbers of the credit officers with the group members.

*The assessment team feels that with existing feedback channels, the customer grievance mechanism needs improvement. There is a big risk of the suggestions/feedbacks/complaint of clients not reaching appropriate levels in the organization and getting resolved inappropriately. Further, the interactions of the group members are largely limited to credit officers and portfolio managers. The mobile numbers of the higher designated personnel are not made available to the clients and this can be an area of compromise with a responsible client relationship management. Further it is very difficult to assess the promptness of field staff resolving the customer's complaints as there is no formal customer redressal system in place.*

Some cases of frauds, however, have come to limelight in last few years apparently on account of inadequate internal controls and audits (See Example No. 3). The organization has taken several steps to improve controls (like introduction of hand held billing machine, strengthening of loan appraisal and sanctioning process, internal audit, etc) to eliminate frauds. Instances of frauds reduce the confidence of the clients in the organization and impacts client relationship.

**Example No.3** – This pertains to Financial Assistance No. 22378, 19899, 22109, 20950, 20951 and 20422 from Chitradurga Branch, where Sanghamithra has disbursed loans of ₹ 100,000, ₹ 120,000, ₹ 100,000, ₹ 120,000, ₹120,000 and ₹100,000 respectively through cheque. The group representative has withdrawn the entire cash from the bank and inturn lend the money as a loan to Mr. Shivakumar, Credit Officer of Sanghamithra, by executing a letter of intent in ₹50/- stamp paper. In Sanghamithra’s books of accounts, these accounts are categorised as a Non-Performing Asset (NPA).

After discussing the case with the staff members, the assessment team has understood that the credit officer has borrowed the money from the group for one month and not repaid it later. However Sanghamithra filed the case against the credit officer, but the case did not materialise in favour of Sanghamithra, as the letter of intent was signed between the group and the credit officer. As per legal opinion obtained by the company, Sanghamithra cannot take any legal action against the credit officer as the two parties have agreed to do the mutual understanding. Nevertheless the credit officer has been removed from Sanghamithra.

Approval	Documentation	Dissemination	Observance
<ul style="list-style-type: none"> <li>The board has provided formal and informal channels for feedbacks and suggestions to handle complaints of the clients.</li> <li>There is no separate customer care department for registering complaints or understanding client’s difficulty.</li> </ul>	<ul style="list-style-type: none"> <li>Sanghamithra does not document or maintain any complaint registers at the branches for clients to register complaints or suggestions.</li> </ul>	<ul style="list-style-type: none"> <li>The sanction letter given to the groups contains Sanghamithra’s regional office phone numbers and not the complaint registration phone numbers.</li> </ul>	<ul style="list-style-type: none"> <li>There is no formal grievance redressal and feedback system and records in place.</li> <li>Most of the clients were aware only of credit officer phone numbers.</li> <li>Clients were more comfortable in discussing their problems and issues to the credit officer. Further, clients confirmed that they feel easy to share their concerns with the credit officer and have never faced any significant issues regarding the complaints. This can be an area of compromise with a responsible client relationship management.</li> </ul>

<b>Relationship Management and Feedback Mechanism</b>	<b>15</b>	<b>28</b>
Approval	0	2
Documentation	4	7
Dissemination	4	6
Observance	7	13

**COMPLIANCE STATUS OF MFI VIS-À-VIS THE RECENT RBI GUIDELINES**

**Score - 72%**

SMERA examines the adherence level of the MFIs with respect to the guidelines issued by RBI. Thus the Code of Conduct exercise involves a comprehensive review of MFIs policies and systems and whether these translate into ethical microfinance practices. However Sanghamithra does not fall under the purview of RBI, though they have complied with the most of the terms and conditions of guidelines issued by RBI. Such as -

Conditions as per RBI Guidelines	Sanghamithra's Policy	Compliance
Household annual income levels for eligible borrowers in Rural Areas not exceeding : ₹ 60,000 Non-Rural Areas not exceeding: ₹ 120,000	The monthly income of the clients should be below ₹ 5,000 in rural areas and below ₹ 10,000 in non-rural areas	The company obtains the declaration from the borrowers on the SHG application form. However during the interaction with the clients, the assessment team observed that income levels of few borrowers were very high compared to the declaration given at the time of availing the loan.
Loan size should not exceed 1 <sup>st</sup> cycle loan : ₹ 35,000 2 <sup>nd</sup> cycle loan : ₹ 50,000 Tenure of the loan should be 24 months for amounts in excess of ₹ 15,000	The maximum loan size is ₹ 600,000 per group and repayment tenure ranges from 12 to 36 months.	The SHG takes the decision to distribute the loans among the members. The assessment team has observed that loans are not equally distributed among the borrowers and few members have taken major portion of the loans.
Total Indebtedness of the borrowers should not exceed to ₹ 50,000	The company takes a declaration from the client for the amount of indebtedness in the application form.	The SHG takes the decision to distribute the loans among the members. The assessment team has observed that members have borrowed more than ₹ 50,000 within the group.
Minimum 75% of the MFIs portfolio should be given for income generation activities	Loans will be given for productive, housing and consumption purpose.	The company does not conduct loan utilization check.
Repayment frequency should be weekly, fortnightly or monthly at the choice of the borrower	Repayment of the loan installments is monthly. However options have not been made available to client.	The company meets the criteria prescribed by RBI partially.
Interest rate should not exceed 26% p.a. on a reducing balance basis	The company charges interest @ 21% p.a. (monthly rest) on a reducing balance basis	The company meets the interest rate criteria
Collateral free loans	The company does not accept any collateral for extending the credit.	No collateral or security deposits have been accepted from the clients.
No late payment or prepayment penalties and no security deposits	The company use to take late payment and prepayment	The company has changed its product features and policy to

	penalties from the clients; however after the RBI directions they have stopped taking it.	be compliant with the RBI guidelines.
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Approval	Documentation	Dissemination	Observance
<ul style="list-style-type: none"> <li>Board has changed the product features and policies as per the guidelines issued by RBI.</li> <li>Board has approved to become a member of High Mark.</li> </ul>	<ul style="list-style-type: none"> <li>Circulars have been issued to follow the RBI guidelines.</li> </ul>	<ul style="list-style-type: none"> <li>All staff members showed a high degree of awareness on the recent changes in the business as per the RBI guidelines. Further, management updates the staff on regularly intervals on all the changes in the policy.</li> </ul>	<ul style="list-style-type: none"> <li>Sanghamithra has no control over the groups in terms of loan disbursements within the members which has resulted unequal distribution of loan amount. The SHG members decide the loan amount to be given to each member.</li> <li>Presently, Sanghamithra does not share its database with credit bureau to understand the indebtedness of the client.</li> </ul>

Compliance status of MFI vis-à-vis the recent RBI guidelines	23	32
Approval	5	6
Documentation	4	5
Dissemination	6	9
Observance	8	12

## WEIGHTS

The following matrix presents the weights given to the various parameters in the assessment tool.

Weight Matrix	Approval	Documentation	Dissemination	Observance	Total
Client Origination & Targeting	2%	2%	3%	6%	13%
Loan Pricing & Transparency	2%	1%	1%	6%	9%
Loan Appraisal	3%	2%	2%	4%	11%
Privacy of Client Information	1%	1%	1%	2%	5%
Staff Behaviour and Client Grievance Handling	4%	4%	6%	7%	21%
Integrating Social Values Into Operations	1%	1%	1%	2%	6%
Relationship Management and Feedback Mechanism	1%	4%	4%	8%	17%
Compliance Status of MFI vis-à-vis the Recent RBI Guidelines	4%	3%	5%	7%	19%
<b>Total</b>	<b>18%</b>	<b>18%</b>	<b>23%</b>	<b>41%</b>	<b>100%</b>

### LIST OF BRANCHES VISITED

SMERA has used the following framework for assessment of MFIs - The Approval; Documentation; Dissemination and Observance (ADDO) framework for measuring adherence of MFIs towards ethical operational practices. The assessment requires visits to the MFI's head-office as well as branch offices.

This assessment includes:

1. Discussions with key staff members and the senior management at the head office and branch office, particularly the senior operational management team as well as the human resources team. These discussions focus on key issues of the code of conduct identified above and systems and process of MFI.
2. Review of manuals and policy documents at the head office. These are reviewed in order to assess the policy as well as documentation regarding important aspects.
3. Sampling of branches at the head office. The assessment team selected ten branches as samples, as per the size of the MFI for review. The branches are chosen in across different districts of Karnataka which include old & new branches as well as branches that are distant from the regional office and branches with the higher overdue. The sampling of the branches is performed at the head office of the MFI.
4. Detailed discussions with the branch staff to assess their understanding of the key code of conduct principles and systems and processes.
5. Review of loan applications, loan ledgers and registers maintained in the branch office. This review focuses on loan appraisal performed before disbursing loans as well as the documents collected from the clients and the process of recovery if the loans are overdue.
6. Selection of groups from the sample branches. A judgmental sampling is performed on the MFI's clients by the assessment team to draw respondents from the interest group. Two/three groups from each sample branches were selected for interviews. Out of which few respondents are those that have been having repaying loans on time, those having been facing problems in repayment, and the groups whose loans have been categorised as NPA, etc.
7. Interview with the clients. Information from the clients is collected ideally during the group meetings as well as visits are made to the clients' locations for collecting information.



As part of the assessment, SMERA visited 10 branches of Sanghamithra in Karnataka. The details of the branches visited are provided below.

Sr. No.	Branch Name	District Name	Branch Opening date
1.	Nelamangal	Bengaluru	August, 2003
2.	Kolar	Kolar	July, 2003
3.	Channapatna	Ramanagram	January, 2005
4.	Kodambally	Ramanagram	July, 2007
5.	Srirangapatna	Mandya	April, 2006
6.	Mandya	Mandya	May, 2004
7.	Kollegal	Chamarajanagar	August, 2002
8.	Hunsur	Mysore	April, 2001
9.	Anekonda	Davangere	May, 2006
10.	Mariyammanahalli	Bellary	April, 2009

## METHODOLOGY

1. Collecting minimum documents from the MFI to understand in detail the scope of operations in terms of areas, products, borrower profile, etc.
2. Sample selection of branches as indicated by SIDBI (sample may be decided by taking into account the loan outstanding portfolio, recency customer grievances received, different products concentration, location, type of borrowers, PAR, etc.)
3. Visit to head office and understanding the code of conduct, vision and mission statement, policies, procedures and processes of MFI pertaining to loan appraisal, loan pricing, collection mechanism, documentation, re-scheduling & write off, etc.
4. Interacting with CEO and the core team and seeking relevant information.
5. Detailed review of the processes framed for selection of areas and villages, client orientation, group formation and pricing of loans.
6. Interaction with the groups to find out the extent of transparent disclosures, the MFI has made to them in terms of pricing, insurance, terms and conditions, overleveraging or multiple borrowings, frauds or corruption/commission kickbacks asked by the officers for sanctioning of loans if any. Unethical behavior of the staff, if any, would be specifically addressed.
7. Interaction with the credit officers on sample basis to assess compliance with policies and obtain their feedback / opinion on the policies and systems with specific focus on customer grievances and feedback mechanisms.
8. Prepare detailed report and submit to the management for review.
9. Prepare final report and submission to SIDBI.

**Questionnaire for the field visit**

1	Name of the Group/Member
2	How did members came to know about the MFI and who motivated to form the group
3	What kind of training provided before sanctioning of loan?
4	Does anyone visited the house pre and post disbursement
5	Loan amount taken
6	Amount applied for (If sanctioned is less - Reason)
7	Interest rate and any other charges
8	Any commission paid to anyone for availing loan
9	Purpose of loan
10	Mode of repayment
11	Installment amount
12	Aware of pending installments or balance outstanding
13	Any penalty charged
14	What are the KYC documents submitted?
15	Where the disbursement of loan happens and under who's presence?
16	Where collections of loan take place?
17	Any delays / default at present or in past, if yes, what is the reason?
18	Number of family members
19	Earning family member
20	Occupation of spouse
21	Monthly family income
22	Number of childers going school
23	Aware about any other MFIs operating in the area
24	Loan from any other MFIs / banks / moneylenders / others
25	If Yes,
26	Name of the MFIs / bank / moneylender / others
27	Amount taken and interest rate
28	Is the group formed by the persons living in nearby vicinity?
29	Know the house / name of each group member?
30	What are the responsibilities of the group?
31	Attendance of members
32	Saving habit among the group members?
33	Dominant nature of group leader?
34	Familiar with the credit officer / branch staff?
35	How are the interaction / behaviour of the MFI staff?
36	Process / awareness of feedback / complaints mechanism?
37	Have made any complaints in past?
38	Any request / demand
39	Others, if any

\*\*\*\*\*The End of Report\*\*\*\*\*