Responsible Microfinance Practices by Microfinance Institutions in India

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MicroSave
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Abbreviations

AMCCS	Annapurna Mahila Co-operative Credit Society
BOD	Board of Directors
CB	Credit Bureaus
CGAP	Consultative Group to Assist the Poor
COC	Code of Conduct
COCA	Code of Conduct Assessment
CPP	Client Protection Principles
FPC	Fair Practice Code
GLP	Gross Loan Portfolio
IMFP	India Microfinance Platform
KOGMA	Key Objectives, Goals, Measures, and Activities
KYC	Know Your Customer
MFIN	Microfinance Institutions Network
MFIs	Microfinance Institutions
NBFCs	Non-Banking Finance Companies
RBI	Reserve Bank of India
RF	Responsible Finance
SIDBI	Small Industries Development Bank of India
SKS	*Swayam Krishi Sangham*
SPM	Social Performance Management
SPTF	Social Performance Task Force
SVCL	SV Credit Line Private Ltd
USSPM	Universal Standards of Social Performance Management

Executive Summary

Responsible Finance (RF) has gained importance in recent years due to the series of crises that hit the microfinance industry in India as well as several countries globally. Across the world, a number of efforts and campaigns are underway that promote adoption of responsible finance practices within MFIs and the sector at large. In light of these initiatives and other similar developments in the Indian MF sector, SIDBI wanted to assess the "As-is" status of the sector in terms of impact of RF initiatives on different stakeholders. Key policy recommendations that can enhance RF practices were expected as an outcome of this study.

Study Objective

1. *Scanning responsible finance practices in the Indian microfinance sector;*
2. *Evaluating the impact of RF-related regulations and practices on (a) the clients and (b) the institutions;*
3. *Forming implementation strategy to address broad areas of concern.*

Key Findings of the Study are:

The findings of the study are divided into two parts: the first part describes findings around the implementation of RF practices by MFIs, and the second part talks about the impact of implementing these initiatives on clients, staff, institutions, and the sector as a whole.

A. Findings on the implementation of responsible finance practices by MFIs

Implementation of RF practices was assessed in adherence to the code of conduct established by Industry associations, Boards' roles in implementing RF practice in MFIs, MFIs' practices as responsible employers, MFIs' efforts to balance social and financial performance including offering credit plus services, and tracking responsible finance practices for both internal and external reporting.

MFIs tended to focus heavily on the implementation of code of conduct and client protection. The increased focus on these aspects was because of the focus on compliance with regulations.

Under non-financial services, client education seems to be the preferred intervention for MFIs. MFIs have made several innovations, including adoption of audio-visual media, to deliver financial education programmes. Some MFIs have implemented initiatives around health, community development initiatives and education. To fund these efforts, MFIs use a combination of external grants, individual sponsors and internal profits.

In terms of HR practices, MFIs largely have well defined HR policies, which outline a gamut of HR functions, policies, and benefits for the staff. Few MFIs have a staff grievance redressal mechanism, although its use by employees is low. Communication about the availability of a grievance redressal mechanism and employees' rights are yet to be strongly conveyed among the MFIs' staff. MFIs have included industry code of conduct in induction and refresher training for their staff.

Human resource management practices still need to attain strategic importance in MFIs. HR departments need to look beyond HR administration and focus on HR development and addressing staff concerns more sensitively. Increased competition among MFIs and industries that look for similar manpower, as well as margin caps, are posing challenges to MFIs retaining

their staff. Capacity building of the staff members is another area in which MFIs are lagging behind.
MFIs mentioned that the additional expenditure incurred for improving responsible finance practices was not high. However, smaller MFIs raise the issue of added costs. Increased cost is due to the additional costs incurred in client verification and rejections due to credit-bureau referencing, measures to train staff and also in obtaining certifications from chartered accountants.

The average yield on loan portfolio of 36 studied MFIs has come down. It is significant, 23.11% in 2009 to 21.74% in 2012, in NBFC MFIs. MFIs are promising lower return to investor compared to pre-2010 years.

Of the 36 researched MFIs, 31 report complete financial and operational data to MIX Market, while three MFIs report only operational data and two MFIs do not report any data. When it comes to reporting on social performance data to MIX Market, very few MFIs submit this data.

The boards of directors across the MFIs focus mostly on compliance with the code of conduct because it comprises RBI's fair-practice code. Social investors on the MFIs' boards are pushing for the implementation of responsible finance practices, but it is still not data driven. About 25% of the MFIs have set up SPM systems and some report SPM progress to the board with regular frequency.

Fifty three per cent of the MFIs have more than one-third of directors who are independent and 74% of the MFIs have at least one female director on their board. Although MFI boards are ensuring compliance with regulatory norms, their competence and role in making MFIs operations and processes client-centric need improvement.

B. Findings on the impact of implementation of RF practices on clients, staff, institution, and the sector as a whole

1. Impact of RF on the Clients:

Clients across various MFIs do not perceive any change due to RF practices. When asked about the impact of the RF guidelines, clients think that not much has changed, except the guidelines around the number of MFIs that they can borrow from, credit bureaux, and the cap on loan size. Although interest rates have on average come down in the sector, clients do not see any direct impact or feel any benefits as such.

An increased awareness of the clients is one of the major impacts of RF practices observed in the field. Clients show more eagerness to understand loan terms and conditions, and to know about credit bureau functions and the number of loans they can take from MFIs.There was a general feeling among clients that the cap on the number of MFIs they can borrow from is good for them, as it avoids temptation and saves them from the hassle of attending group meetings, which affects their work.
Clients did not like condition of loan tenure being two years for loans above Rs.15,000. They clearly wanted more flexibility in choosing the loan tenure irrespective of the loan size. While clients accept the cap on the number of MFIs that they can borrow from, they expect higher loans from the MFIs to

meet their increasing financial needs. Clients did not raise any concerns on the cost of credit but they benefited from the cap on interest rates and processing fees. In the opinion of the clients, staff behaviour has remained good throughout, thus they do not see any change on this front.

2. Impact on the Staff:

In the MFIs interviewed, almost all those in senior management cadres mentioned that the employee engagement levels or buy-in for RF practices has increased. Staff indicated that the guidelines on code of conduct and responsible finance have brought stability to the sector. They feel that MFIs are not only doing well but are also perceived to be doing well.

In some of the MFIs, staff caseload has been capped to ensure efficiency and productivity while balancing customer service. The high level of awareness among staff on code of conduct indicates that training in this aspect has been effective and COC has been institutionalised in MFIs.

The staff members feel that they are more professional now and are considered to be so by both clients and management. The strict guidelines around behaviour, as well as the training provided to staff members, has brought about this change.

3. Impact of RF on the Institutions:

The average operating costs among NBFC MFIs has come down from 23.4% in 2009 to 11.35% in 2011 and reduced further in 2013. MFIs perform better in implementing customer protection principles and code of conduct. MFIs studied as part of this report have scored an average rating of 78% on COC. Based on assessment of 18 MFIs, the SMART Campaign finds that the MFIs' average performance on customer protection is adequate. Clients are showing better performance on loan repayment, plus staff and client satisfaction levels are good. Almost all the MFIs now have the customer grievance redressal system in place, which has increased their credibility in the sector. However, there are areas that need further attention and improvement.

4. Impact of RF on the Sector:

Overall, the impact of responsible finance practices has been positive on the sector. Some of the trends observed are improved credibility of the sector among lenders and investors; higher adoption of client protection and code of conduct among MFIs; improved perception on the interest rates and regulations; increased and improved roles for industry associations like MFIN and Sa-Dhan, and increased awareness of clients on credit bureau and other guidelines.

Key Challenges

Most MFIs and stakeholders mentioned that there have not been significant challenges in implementation of responsible finance practices. One of the reasons cited was the realization of the fact that responsible finance is not an option, but a necessity, to be sustainable and profitable in this business. However, there are some aspects that require improvement:

Some MFIs follow the guidelines only in letter, but not in spirit.

- A few of the regulations and guidelines, such as purpose of loans, loan tenure etc., have to be changed since client needs are different, and some of them, such as income level of clients, are difficult to implement.
- Limited funding support to smaller MFIs to implement RF practices; these MFIs require support to invest in technology, improvement in MIS to report to credit bureaux, and improvement in staff training.
- Excessive reporting requirements due to demand for similar sets of data in various formats by various stakeholders, especially lenders and investors.
- Competitive and overlapping initiatives by several agencies to certify or rate the MFIs. This becomes a challenge for the MFIs given the time, effort, and costs required for assessments and/or certifications.
- The role of industry associations in creating awareness of the financial education is not yet adequate.
- Boards need to strengthen their efforts in guiding and monitoring responsible finance initiatives.
- The role of banks in (a) taking responsible finance practices into consideration while sanctioning loans and (b) in following the practices themselves.

Key Recommendations

Various recommendations have emerged during the course of discussions with MFIs, stakeholder interviews, and deliberations in the workshop conducted with MFIs and other stakeholders. The following is a summary of key recommendations:

- To strengthen MFI governance by inducting independent and women directors with relevant experience.
- To enhance board capacity through training.
- Data sharing to credit bureaux by MFIs, irrespective of legal form, and banks in retail microfinance.
- MFIs must look to enhancing their product portfolios; one way could be to leverage the BC model.
- RBI may re-look at some of the policies that cause bottlenecks for MFIs when working on products.
- To enable client to think beyond credit, MFIs need to work on client financial education.
- MFIN may consider making some short data analytics available in the public domain that can show district, block, or pin-code wise credit concentration.

Introduction

1. Introduction

Responsible Finance (RF) has gained importance in recent years due to the series of crises[1] that hit the microfinance industry in India as well as several countries globally. The industry has become conscious of the importance of RF due to the moderate practices adopted by the industry in general and MFIs in particular:

- The race for growth and profits has undermined the due focus on customer service and product innovation[2];
- Microfinance institutions (MFIs) were alleged to be profiteering from the clients;
- There is increasing concern over the MFIs' insensitivity towards client protection principles, particularly over-indebtedness and coercive collection practices;
- The market, particularly in India, is entirely credit-led and lacks aspiration to address the diverse need of the clients.

"To be client centric is the key word in responsible finance; product diversification, responsible behaviour, efficient process, reasonable growth, and price are ways to become client-centric."

In India, the allegations mentioned above gained media and government attention, leading to the microfinance crisis in Andhra Pradesh, which later had an adverse impact across the country. This was the biggest crisis ever faced by the Indian microfinance sector. Post the Andhra crisis, prudent norms and strict regulatory guidelines have been set up by the Reserve Bank of India (RBI) to govern the Indian microfinance sector with an increased focus on client protection. These developments have turned the focus of the microfinance industry, in India and globally, towards 'Responsible Finance' (RF) practices.

'Responsible Finance' refers to the provision of financial services in an accountable, transparent, and ethical manner. Responsible finance as defined by CGAP[3] is "a way of doing business – a never-ending process of adapting your products, processes, and policies to keep your clients at the centre". Thus, the focus of responsible finance is to create a favourable environment to encourage retail service providers to think about products and processes that can benefit the clients by keeping growth and profit reasonable. Responsible finance also focuses on clients to improve their capacities to understand and use high-quality financial services.

Responsible finance, therefore, is clearly essential for the long-term success of any financial service business that is serving the poor.

Study Background, Scope, and Approach

[1]Including repayment crises that hit Morocco (2008), the "Movimiento No Pago" (Movement for Non-Payment) in Nicaragua (2008), and Pakistan (late 2008), as well as over-indebtedness in the microfinance sector in Bosnia and Herzegovina (2009) and the crisis in the state of Andhra Pradesh, which changed the face of microfinance forever in India (2010).

[2] MicroBanking Bulletin's Defining responsible financial performance: how to think about growth and Defining responsible financial performance: the role of profits

[3] Source: http://www.cgap.org/topics/responsible-finance

Globally, a number of efforts and campaigns are underway to promote adoption of responsible finance practices within MFIs and the sector at large. In India, the RBI has promulgated NBFC-MFI guidelines and the Government of India has introduced the MFI Development and Regulation Bill. The objective of these two initiatives is to strengthen operations, improve transparency levels, and fortify responsible lending practices among Indian MFIs. Similarly, the Small Industries Development Bank of India (SIDBI) has initiated various responsible finance initiatives to improve MFI practices and raise the bar for client protection. These initiatives include Code of Conduct Assessments (COCA), endorsing Client Protection Principles of the SMART Campaign, encouraging transparency through setting up global web-based microfinance information platforms especially for Indian MFIs, and creation of a lenders' forum to coordinate the efforts of wholesale debt providers to the sector.

In the light of these initiatives and other similar developments in the Indian MF sector, SIDBI wanted to assess the "As-is" status of the sector on compliance to responsible lending practices and to lay out key policy recommendations to improve it further.

MicroSave was contracted to conduct the study of the current state of implementation of responsible finance practices within MFIs, identify best practices as well as current gaps, and propose a set of recommendations, as a way forward to strengthen the adoption of RF practices.

The study was conducted with the following broad objectives:

1. **Scanning responsible finance practices in the Indian microfinance sector**

   Under this objective, the present status of implementation of responsible lending practices in MFIs of different legal forms was analysed using a framework developed for this purpose. Analysis and documentation of responsible lending practices undertaken by Indian MFIs was taken up to determine the "As-is" status.

2. **Evaluating the impact of RF-related regulations and practices on (a) the clients and (b) the institutions**

   Under this objective, the impact of various sector-strengthening initiatives taken by SIDBI (Capacity assessment ratings, COCA, Lenders' Forum, IMFP etc.) and others were assessed. In addition to this, the impact of existing regulatory guidelines such as NBFC-MFI norms, RBI Fair Practice Code (FPC), impact of self-regulatory guidelines such as the MFIN and Sa-Dhan Code of Conduct were also analysed.

3. **Forming implementation strategy to address broad areas of concern**

   Under this objective, the broad areas of concern in current responsible lending practices being faced by Indian MFIs were identified. Relevant international best practices in responsible finance in the microfinance sector were reviewed to suggest their potential application in India's microfinance sector.

Based on the findings, an implementation plan has been proposed with recommendations to address highlighted broad concern areas.

To achieve the objectives of the study, *MicroSave* used both primary and secondary data collection approaches. The following activities were undertaken as part of the study:

Phase I: Designing Assessment and Analytical Framework

Activity#1: Selection of MFIs for the Study:

Of the broader list of 50 MFIs, we drew up a shortlist of 36 for secondary research. Subsequently, 10 out of the 36 MFIs were selected for primary research. Selection of the MFIs was carried out in consultation with SIDBI.

Activity#2: Development of Assessment and Analytical Framework:

We developed a comprehensive assessment and analytical framework consisting of both subjective and objective parameters to analyse secondary and primary data of selected MFIs. Parameters were decided based on the Industry Code of Conduct for MFIs; Corporate Governance (applicable to NBFCs) circular issued by RBI; USSPM advocated by SPTF; and the SMART Campaign CPP indicators. The framework also captured financial and operational data of the MFIs and assessments or certifications obtained by them. The information captured in the analytical framework was used to depict adoption trends for responsible finance practices in the microfinance sector and establish linkages between them. (***Refer to Annexure 1:*** *Assessment and Analytical Framework*)

Phase II: Secondary Research and Assessment

Activity#1: Secondary Research on Various Interventions in Responsible Finance Practices in India:

Detailed secondary research was conducted on the current regulatory framework for Indian MFIs in general and the prevailing responsible lending guidelines in particular. The study team also collected information on various initiatives taken up by SIDBI such as the COCA, activities of the Lenders' Forum, Loan Covenants, and the IMFP Transparency Guidelines. Based on the information collected, the team prepared comprehensive regulatory, self-regulatory, and best practices parameters/guidelines for steering the Indian MFI operations.

Activity#2: Secondary Research on International Best Practices in Responsible Finance:

The team gathered information on international best practices and successful examples in adoption and practice of responsible finance, from across the world.

Activity#3: Secondary Research on 36 Sample MFIs as per

Assessment Framework

The team collected secondary information about 36 MFIs as per the assessment framework from various internal and external sources. This included review of Code of Conduct Assessment (COCA) reports; Client Protection Principles Assessment reports; *MicroSave's* SPM; client protection assessment and loan portfolio audit reports of several MFIs; MFI-specific reports available in the public domain; Microfinance State of the Sector Report; the Social Performance Report; and others related to the 36 selected MFIs (***Refer to Annexure 2:*** *List of 36 MFIs selected for the purpose of secondary study*).

Profile of MFIs Selected for Secondary Research

A representative sample of 36 MFIs was selected for secondary research, based on parameters such as number of clients, legal form, operational region, and lending methodology.

Figure 1 Geographic Representation of the Selected MFIs for the Secondary Research

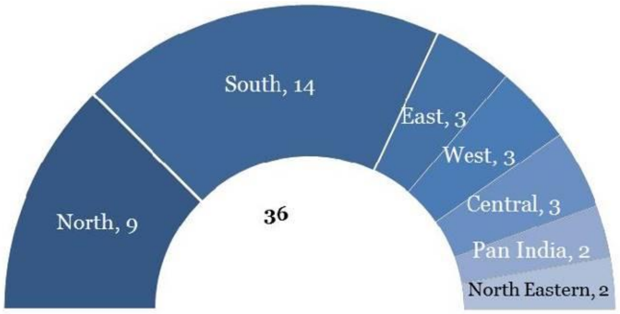


Figure 2 Break-up of the Selected MFIs by Legal Form

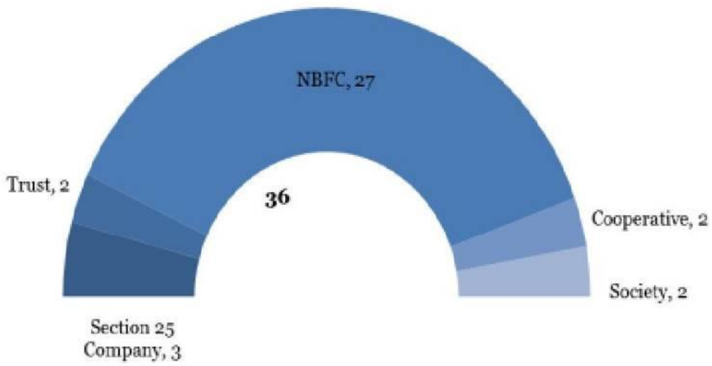


Figure 3- Break-up of the Selected MFIs by the Number of Clients Served

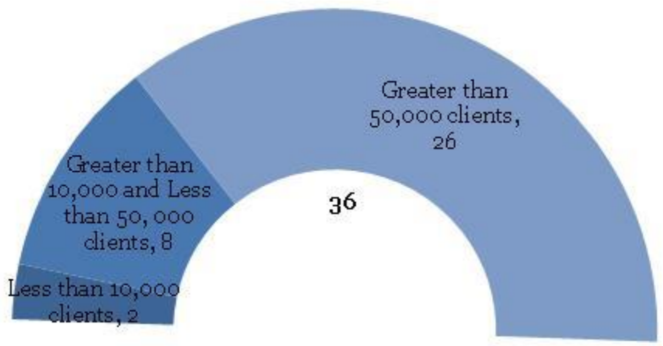
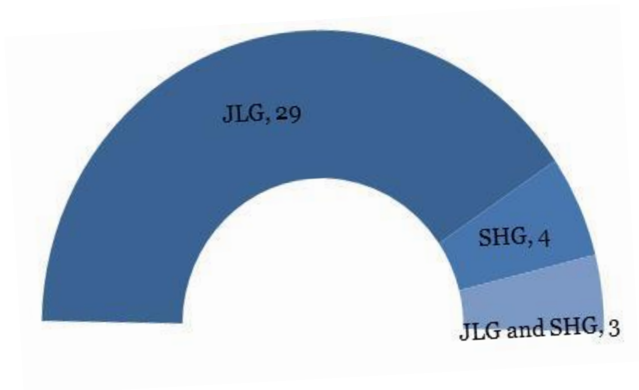


Figure 4: Break-up of the Selected MFIs by the Lending Methodology



Phase III: Primary Research

The team conducted primary research with 10 MFIs and key stakeholders in the sector to gather their thoughts on the impact of RF practices on the sector and more specifically on the clients. The team also gathered insights from various stakeholders and MFIs to get a deeper understanding of the level of compliance with RF practices.

These 10 MFIs were selected out of 36 MFIs chosen for secondary research. Operational size, legal structure, geographical representation, and lending methodology were the selection parameters (***Refer Annexure 3***: List of 10 MFIs chose for secondary research).

In addition to the MFIs, the *MicroSave* team also interacted with senior officials of SIDBI, MIX Market, MFIN, and Equifax to gather insights on current RF practices and recommendations for further enhancement.

The study team used interviews to collect information from MFI's official field staff and clients as well as stakeholders. (***Refer to Annexures 4:*** *Interview guide for MFI* ***5:*** *interview guides for stakeholders* ***Annexure 6****: List of interviewee*).

Phase IV: Policy Workshop and Development of Action Plan

After accomplishment of the draft report, the study team conducted a policy workshop with key stakeholders including policy makers, MFI networks, donors, lenders, multilateral agencies, and MFIs to obtain their feedback on the study findings and to refine the recommendations.

Key Findings

2. Key Findings

This chapter presents the key findings from the study. The first part contains the findings around the implementation of responsible finance practices by MFIs (based on both primary and secondary research) and the second part contains findings on the impact of implementation of these initiatives on clients, staff, institutions, and the sector as a whole. The impact of the implementation is mainly derived from the primary research in which 10 MFIs were visited across the country to understand this issue better.

Part A: 'As-is' Status of Implementation of Responsible Finance Practices by MFIs[4]

The primary and secondary research of the study corroborated the following findings:

1. Improving responsible finance practices – Adherence to the code of conduct drawn by the industry associations and RBI norms

The common practices in responsible finance in the Indian MFIs[5] tended to focus heavily towards the implementation of code of conduct and client protection. The increased focus on these aspects was largely due to the need to comply with regulatory provisions set by RBI. Since COC and RBI norms have been fairly comprehensive, the industry's responsible finance practices have improved over last three years. NBFC MFIs being directly supervised by RBI – for whom many of the regulatory norms directly apply – have shown better adoption of practices especially in submission of data to credit bureaux, setting up client grievance redressal procedures, training of staff and so on.

"Ninety-one per cent of MFIs have a documented policy of client grievance redressal. These MFIs have at least one mechanism to receive customer grievance. However MFIs, on the whole, have to strengthen the system of recording, analysing, and addressing the customer grievance effectively."

Reporting client data to credit bureaux and using credit bureau reports to ensure that borrowers are not over indebted has been a significant responsible finance practice adopted by NBFC MFIs and even by some of the Section 25 companies and NGO MFIs. MFIN has played a crucial role in ensuring that their member NBFC MFIs submit and use credit bureau data. However, there are few non NBFC-MFIs who still lag behind in the adoption of these practices, which undermines the rigour of the credit bureau checks. Lenders to MFIs

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4 Refer to annexure 7 for the RF initiatives in India

5 For the specific responsible finance practices of the 10 MFIs included in the primary research of the study, please refer to annexure 8

need to ensure that their partner MFIs adopt responsible finance practices.

The other significant initiative has been setting up of client grievance redressal mechanism. Several good practices have been seen in the studied MFIs.

Organisations like Ujjivan and SKS have invested in technology to collect and analyse data generated through client grievance redressal mechanism. Utkarsh has devised a system that captures missed calls from clients whereby the customer grievance officer calls the clients back to listen to their grievances. Actual usage by clients of the grievance redressal varies across institutions. However, there is overall realisation that customer satisfaction and retention enables MFIs to increase their portfolio with the least credit risk, thus enabling improvement of their profitability.

The other key initiative that has been undertaken is client education, especially related to product literacy and also on specific processes of the institution.

Product development has been largely lagging behind. While individual lending product is picking up pace to meet client needs, JLG group product continues to be the predominant offering from most MFIs. However, during field visits it was seen that the Annapurana Co-operative, perhaps because it is a member-owned institution, offers considerable flexibility with a wide range of products. Many main stream MFIs could be more innovative in this aspect.

"Average COCA rating for the MFIs is 78%. Score is given on eight broad parameters. The score on individual parameters ranges from 72% to 85%. Compliance with RBI guidelines scored the highest while client grievance redressal mechanism has scored lowest."

Two significant industry level initiatives provide information on the level of compliance by MFIs. SIDBI initiated code of conduct assessment reports through third-party assessors. SMART Campaign has also been carrying out SMART assessments and certifications that corroborate some of the findings of the primary research.

Out of 36 MFIs selected for secondary research, COCA reports (spanning years 2011 to 2013) of 26 MFIs were available in the public domain (on SIDBI website). These reports were analysed to understand the level of adherence to code of conduct.[6] The average adherence levels of all the types of organisations with respect to code of conduct stands at 78%. This is a reasonably good score, especially considering the recent vintage of most of these initiatives.

The level of compliance with code of conduct has been assessed and rated on eight broad parameters that include:

- Integrating social value into operations;
- Client origination and targeting;
- Loan appraisal;

[6] For more details on this, please refer to the findings of Part B

- Client data security;
- Staff conduct and understanding of code of conduct;
- Client grievance redressal;
- Customer education and understanding;
- Compliance to RBI's guideline.

The score on these parameters ranges from 72% to 85%. Compliance with RBI's guidelines scored highest and the client grievance redressal mechanism has scored lowest.

The bigger MFIs are capable – both in terms of financial and human resources – to take up RF activities by themselves or at least seek help where required. However, the challenge remains for smaller MFIs as they receive limited or no support from industry associations, donors, or social investors. As smaller MFIs struggle to build sustainable microfinance operations, they also find it difficult to integrate RF practices into their operations.

It is desirable that MFIs look at responsible finance not just in terms of compliance but go beyond, especially since their clientele comes from vulnerable segments of society. MFIs need to integrate RF practices into their institutional systems and processes, by absorbing the costs as 'investments' instead of 'expenses'; it is also a fact that smaller MFIs face challenges in implementing robust RF processes.

2. The board monitors and guides the organisational practices on responsible finance

An active board plays a key role in helping the organisation define its strategic intent towards responsible finance practices, and also helps in executing and/or complying with the practices in both letter and spirit. A proactive board uses data – both financial and social – to drive the decisions at a strategic level, maintaining a fine balance between financial and social parameters (refer ***Annexure 10*** – Unified Code of Conduct and Universal Standards of Social Performance Management and expected roles and responsibilities of the board).

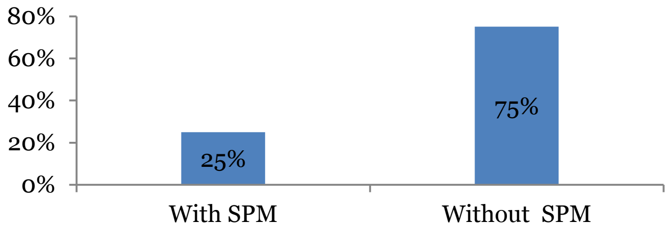
Some of the key findings from the primary research and desk review are as follows:

1) The boards of directors across the organisations focus mostly on compliance with the code of conduct and RBI fair practice code.
2) Customer-level issues (clients' complaints and resolution) are also being routinely discussed, more than ever before. There is not much evidence of discussions around product development and innovations or around customer satisfaction.
3) Boards have started to focus on institution- and client-level risks. For instance, the boards, especially in the case of large MFIs, review the concentration risk of activities, submission of data to credit bureaux, delinquencies and the system of managing these delinquencies, frauds committed by the staff

etc.

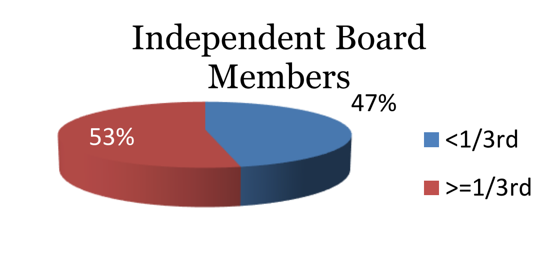
4) MFIs are struggling to improve the data-based reporting on responsible finance practices. Integrating social performance aspects (defining social goals, measuring and monitoring poverty level of clients, and measuring outcomes in client lives to assess whether the social goals are being met) pose considerable challenges for MFIs and their boards.

5) About 25% of the MFIs either have established social performance management departments or have set up a sub-committee of the board. These MFIs keep SPM as an agenda for board meetings.



Source – COCA reports

Fifty three per cent of the MFIs have more than one-third of directors as independent directors. Independent board members bring in objectivity, thus helping in providing governance that is more balanced, promoting independence, challenging behaviour, and pushing for a longer-term perspective by the management/boards.[7] However, on some of the boards the independent directors are chosen in such a way that they protect management/promoter interests, which defeats the very purpose of independent directors.



Source – COCA reports

6) As NBFCs are registered and governed under the Companies Act, their governance standards tend to be higher as compared to other legal forms. NBFCs also have been found to have more structured governance structures with various sub-committees looking after specialised functions such as risk management, audit, nominations, and compensation.

[7] For more details on this, please refer to the findings of Part B

7) The board of directors of some of the MFIs have played a significant role in ensuring that the organisation sticks to its mission without compromising on values for profits. The return expectations have come down to 15%, but even this is considered high by some social investors. The boards of some MFIs guide the institutions by setting targets/ranges for profit and growth rates. For instance, in an MFI in north India, the CEO and the Board have always followed a cautious approach to inducting new investors and directors to ensure that their intent aligns with that of the organisation. The organisation has, in the past, rejected some commercial investors although they offered good valuation, as they were not a compatible fit.

8) One of the disturbing trends is lack of a majority or clear "owner" of the MFI as promoter stakes become diluted by external equity infusion. With fragmented and diverse holdings, how strategic business planning and responsible finance practices will be taken forward can become an area of concern.

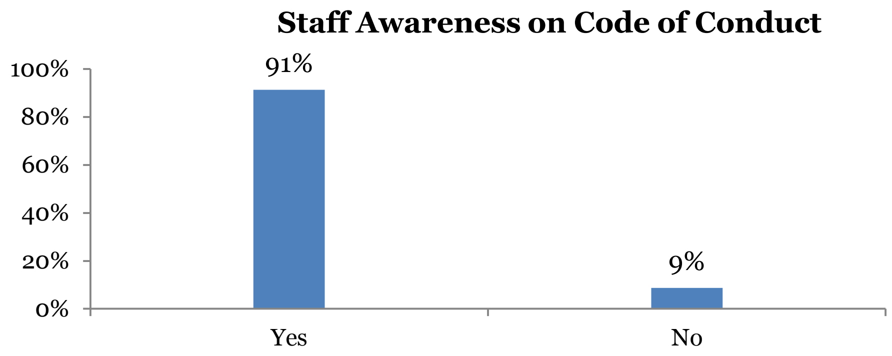
9) Overall, boards need perspective building and capacity improvement in responsible finance practices and also on corporate governance.

3. Being a fair and responsible employer

Human resources (HR) management has now become more important than ever in the Indian microfinance industry. With high staff attrition rates and intense competition from within and outside the sector for the same resource pool, it has become important to focus on HR issues.

Some of the common HR practices observed in the sector are as follows:

- Most MFIs have a well-defined HR policy that outlines a gamut of HR functions, policies, and benefits for the staff.
- A few large MFIs also have policies on sexual harassment.
- The general benefits provided by the MFIs to their employees include accident insurance and ESI/mediclaim etc. However, the communication of benefits to employees needs to be improved.
- Some organisations have instituted disciplinary committees that look into frauds and misconduct by the employees. A few organisations have a whistle-blower policy as well.
- With the introduction of code of conduct over two years ago, the familiarisation with industry code of conduct has become a part of the induction and regular/refresher training for staff. In 91% of the MFIs, staff members are aware of the code of conduct.
- Although some organisations have staff grievance redressal mechanisms, usage of it by employees is low. In some organisations, the communication about making complaints as a right of employees is yet to be strongly conveyed.



Human resources is yet to attain the same strategic importance in the functioning of MFIs as operations or finance. A significant proportion of the time of HR managers is spent on administrative or transactional functions such as payroll management, leave administration, and benefits management instead of focusing on strategic issues such as organisation development and talent management.

There is huge competition for human resources at field level and at the senior-management level. This is not just from the microfinance industry but also from other sectors such as retail, BPOs, and other NBFCs (which offer better salaries and incentives compared to the microfinance NBFCs). However, much of this competition is observed in urban markets.

The microfinance sector in India is still grappling with gender imbalance at employee level. MFIs are struggling to attract and recruit women employees, mainly for field-level positions, and, to some extent, at managerial levels. Many organisations have made efforts to recruit women but the result is not encouraging as the nature of work (which requires regular, almost daily, travel to the field, long working hours, tough geographical terrains etc.) acts as a deterrent for women to participate in the sector.

Capacity building continues to be the biggest challenge in the microfinance sector, both in India and across the world. Training/capacity building is considered as an expense rather than as investment – particularly for mid and senior management. This may stem from several (mis)conceptions that:

- ✓ Senior management does not really require training;
- ✓ Senior management does not have the time to attend training; and
- ✓ Inadequate capacity of senior management to implement the output of training within MFIs.

MFIs are increasingly facing the challenge of managing the expectations of staff with respect to compensation. During their rapid growth phase, many MFIs gave fast promotions and high performance incentives to their staff. With the drop in industry growth rates over the last few years, coupled with the RBI’s margin cap of 12%, there is a pressure on MFIs to keep their operating expenses low. In such a scenario, sustaining the pace of promotions and high variable pay is difficult. However, the expectations of staff keep increasing due to historical growth and payouts plus the attractive salary packages offered by other sectors.

On the other hand, the challenges of compensation at the middle-management level are different. With changing regulatory scenarios and the diversification of MFIs into related financial and non-financial businesses such as microenterprise lending, housing loans, vehicle finance, and pensions), MFIs are hiring professionals from banks, business schools, or other financial-sector institutions. Even as this brings in new talent, it also causes comparisons (and thereby dissatisfaction) of compensation levels between the old and new staff, as professionals command higher salaries than the non-professional staff members from within the MFIs' organisations.

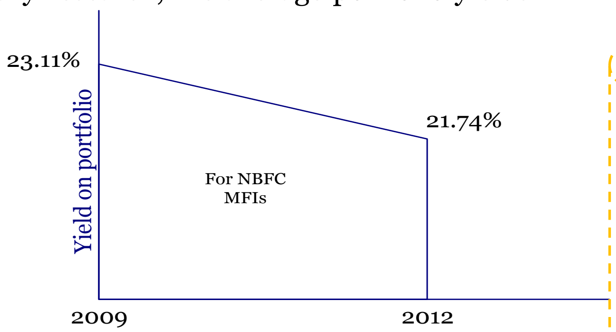
Performance management is considered resource intensive and costly. Hence the focus of most performance management systems is on measuring the quantitative performance (PAR, loan outstanding, caseload etc.) of the staff with little regard for qualitative performance evaluation (such as customer service, client retention, people skills etc.). The limited understanding of staff members, especially at the field level, about performance management concepts also restricts the use of sophisticated tools like 360-degree performance assessment. In many MFIs, there is no system where employee strengths and weakness are assessed and support offered to improve weakness. A few organisations have started to use the 'performance improvement plan', but there is a need for effective implementation of such initiatives.

Due to growth pressures, sometimes staff members with better performance on sales, client acquisition, and business development are promoted irrespective of their people-management skills. This can lead to problems at a later stage when they are unable to manage teams, leading to demotivation and staff turnover.

4. Balancing social and financial performance

Balancing social and financial performance basically requires MFIs to put in place mechanisms to take care of customer interests alongside improved profitability and return for equity holders. Balancing involves some of the following actions: lowering interest rates through improved efficiencies and moderating return expectations of equity investors; investing a portion of profits to increase value to customers; adding to or improving the bouquet of products and services; organizing client welfare programmes; working with investors whose expected time horizon and exit strategies are aligned with MFI's social goals and so on.

For MFIs studied under the secondary research, the average portfolio yields have shown a downward trend for almost all legal entities. The fall in portfolio yield is most significant for NBFC-MFIs, which have shown a reduction from 23.11% in 2009 to 21.74% in 2012. This is primarily due to compliance with RBI's interest rate and margin cap condition.



Source – Mix Market

"The average yield on portfolio for NBFC-MFIs has fallen from 23.11% in 2009 to 21.74% in 2012. This is primarily on account of RBI's cap on interest rate/margin."

Through interviews with senior management, it was observed that the average returns promised to shareholders has come down in the recent years when compared to the years pre-2010. Based on the discussions that the *MicroSave* team held with CEOs of the selected MFIs, their focus has clearly shifted towards maintaining operational excellence and recording steady growth. Consider the growth rates reported by MFIN partners[8], as stated in the MFIN's annual report for 2012-13: the microfinance sector witnessed a 23% rise in gross loan portfolio (GLP) on a pan-India basis with non-AP MFIs witnessing a growth of 39%. Typically, in the microfinance sector, a growth rate of 100% is considered to be optimistic and good.

Many MFIs interviewed during primary research claimed that additional expenditure incurred on improving responsible finance practices was not significant. Given that several MFIs included such practices in their existing processes, the incremental cost was considered negligible. Although the majority of the MFIs did not mention cost of implementing responsible finance as a serious concern, there were a few, smaller MFIs that did bring up the issue of added costs. They felt that additional costs incurred on client acquisition and verification, staff training on COC, verification of compliance with COC by auditors, and rejections due to credit bureau referencing are some of the items that further push up their operating expenses. Staff members are spending more time explaining the terms and conditions to clients than before.

None of the MFIs covered under the study have done a separate costing exercise to understand the expenditure of responsible finance practices. It was overwhelmingly clear that while the costs have been added to operations, MFIs have balanced this by perceptions about their practice in client and at sector levels. The large and medium-sized MFIs also considered the expenditure on responsible finance as an investment or cost of doing business, and as such considers it an integral part of operating expenditure.

5. Offering non-financial services including consumer education and financial literacy

[8] MFIN's annual report for 2012-13

Under non-financial services, client education or financial literacy seems to be the preferred intervention option for MFIs. Over the years, MFIs have tried to use innovative ways to deliver financial literacy programmes, including the adoption of audio-visual media. Notable examples in the field of financial literacy include Ujjivan's Diksha programme (which is implemented in collaboration with its non-profit organisation, Parinaam Foundation) and Suryoday's use of portable recorders to enable clients to listen to audio recordings every week. The Ujjivan-Parinaam Foundation financial literacy programme targets five areas of financial literacy:

- Why financial planning;
- How to plan personal finances;
- How to save;
- Borrowings;
- Rupee Rani (which summarises all the previous modules and provides an introduction to formal financial services including use of ATMs and so on).

With Suryoday, recordings played at the end of group meetings include a wide range of topics such as: the importance of savings, childcare, kitchen gardening, risks of multiple borrowing, and health.

Organisations like Cashpor and Annapurna have implemented initiatives around health, community development, and education. For instance, Cashpor has implemented a health and wellness programme with support from the Healing Fields Foundation. This programme, as on date, is being offered on a small scale at certain branches; once it is streamlined it will be scaled across the organisation.

Annapurna uses a combination of external grants, individual sponsors and its internal profits to accrue health and wellness programmes. In terms of the scale of non-financial services, Annapurna reaches out to 160 young women through its infrastructure of women's hostels; over 1,000 children have been extended education scholarships in 2013; and 500 children are being taken care of in crèches or day-care centres (refer ***Annexure 9:*** for details of financial and non-financial services offered by the MFIs considered for primary research).

6. Reporting to external stakeholders on social and financial performance

Of the 36 MFIs researched for the study, 31 MFIs report submission of complete financial and operational data to MIX Market, three MFIs report submission of operational data only and two do not report any data. However, very few MFIs submit social performance data to MIX Market. A major reason cited almost unanimously by all MFIs is that the social performance data requires them to report on some sensitive parameters such as poverty, client drop out, and staff attrition, and also on outcomes such as employment generated by their clients.

Microfinance Transparency (MF Transparency) is another initiative that seeks data from MFIs on transparent pricing. In India, MFIN tied up with MF Transparency and has been submitting pricing data. In 2013, MF Transparency collected a fresh set of data (the last data collection was done in 2010 before the crisis) and analysed it in partnership with MFIN India. This constitutes 85% of the microfinance market and 90% of regulated MFIs in India, covering 24.4 million borrowers[9]. It plans to include non-MFIN members to refresh its pricing data.

Part B: Impact of Responsible Finance Practices on Clients, Staff, Microfinance Institutions, and the Sector

One of the key objectives of the study was to understand the impact of various responsible finance practices, initiatives, regulations, and guidelines on microfinance clients, staff, microfinance institutions, and the sector as a whole.

The impact of responsible finance initiatives on various stakeholders was assessed by having direct discussions with the clients, staff, and management of the MFIs; other sector stakeholders such as SIDBI, MFIN, MIX Market; and by observing certain parameters in the field.

When analysing the impact of responsible finance, the different contexts, size, geographical presence, years of existence of MFIs, etc. have been taken into consideration. The specific parameters assessed for impact for each of the stakeholder are presented in their respective sections.

B.1 Impact of RF on the Clients

To understand the impact of responsible finance practices on clients, a series of focus group discussions (FGDs) were conducted with microfinance clients from nine MFIs[10], which participated in the primary research. Around 80 clients participated in the FGDs. The clients chosen for the FGDs were from different MFIs across various geographic locations and have been microfinance borrowers for different lengths of time.

During the focus group discussions, the clients were asked to comment on the practices of MFIs and its impact on them. The parameters for impact included:

- products and service delivery;
- responsible pricing;
- transparency and financial education;
- over-indebtedness;
- respectful treatment of clients; and
- privacy of data.

Products and Service Delivery:

The loan tenure of two years for loans above Rs.15,000 was considered as

[9] Source: http://www.mftransparency.org/refreshed-india-data-now-available/

[10] Considering the AP portfolio being still not active, *MicroSave* team could not interact with SKS clients in Andhra Pradesh

excessive. The target clients of MFIs are mostly small traders who prefer to rotate loan capital much faster than the specified two years. In addition, clients perceived that longer the tenure, the higher the interest burden on them.

To overcome this, some MFIs (even those beyond this study) have devised alternative ways to accommodate client requests. While one MFI collects one additional weekly instalment every week from those clients who are willing to close the loan in one year, another MFI structured its loan in a way that ensures 80% of the loan gets repaid within the first year, with the remaining 20% being repaid in the second year and thus allowing the client to take a parallel loan.

There was a mixed response from clients regarding the size of the loans. Some observed that while loan size from individual MFIs has increased, the total amount they can access as loans has come down due to the cap on borrowing from multiple MFIs. Clients in general expressed the need for higher loans, considering that the number of MFIs they can borrow from is now limited to two.

There was a mixed response on repayment frequency – clients in rural areas prefer weekly repayments, as the instalment size is lower. However, they do see the advantage of monthly repayments, as these are time efficient because of fewer group meetings.

Clients still prefer doorstep delivery of services, both for disbursement and repayment. Steps taken by some MFIs, in recent times, to disburse loans through cheques or collect repayments at branches are seen as additional costs by the customer.

Responsible Pricing:

Interest rates across the MFIs covered during the primary research have come down over a period of time. Clients from RGVN and Chanura mention that there is a decline in interest rates. Mixed responses were received from clients of Arohan (some claimed interest rates had reduced, while others claimed they have increased), and the clients of Margdarshak perceived no change. Ujjivan and Suryoday clients felt that interest rates have increased, whereas clients from Annapurna felt the rates have decreased over a period of time.

Clients do not seem to remember the processing fee being charged by MFIs; although some did mention that security deposits are no longer being collected by MFIs. There is a general perception among clients that the MFIs charge largely the same interest rate, as was done in the past. The clients are clearly more concerned about the instalment size and loan tenure than the interest rate, per se.

Transparency and Financial Literacy:

Despite emphasis on transparency as well as disclosure of prices and terms and conditions to clients, they have not discerned many changes in communication by MFIs. This was reported across all FGDs and may not reflect lack of effort on the part of MFIs but rather the relative unimportance that clients attach to transparency and disclosure.

As long as clients get suitable loans at 'competitive' interest rates, they seem not much concerned about the substance, content, or tenor of the communication. This may also be attributed to low literacy levels amongst clients and the fact that data privacy is a relatively new concept for them.

In MFIs where specific financial education (FE) programmes are being conducted (like in Ujjivan, Cashpor), the clients who have attended FE programmes have found them useful. For example, Cashpor has implemented the Alternative Financial Education programme[11] and has found that clients who have undergone the full training now discuss savings with a more positive attitude; they are able to realize the importance of savings in their life cycle, have been able to identify their own savings goals, and can speak about these more openly.

Impact on Client Over-indebtedness:

The guidelines regarding multiple borrowings have impacted clients the most. The impact is seen mainly in the form of reduced number of MFIs from which clients can borrow as a result of reduced overall debt exposure.

A majority of clients appreciate the condition of borrowing from a maximum of two MFIs. They acknowledge that, in the past, there have been instances where they borrowed from many MFIs and had difficulty repaying their loans. However, some clients – especially those in urban areas – feel that a cap on Rs.50,000 is unrealistic. As some need to borrow higher amounts to meet their business needs, the cap on maximum loan size compels them to raise balance loans from informal sources. This trend is observed across different regions of the country. However, a small proportion of clients feel that it is good to have such a cap as it discourages them from taking loans beyond their repayment capacity.

In all the regions and across all MFIs, the client awareness level of credit bureaux is high. Although many of them do not know the term 'bureau', they are aware that MFIs check for their names in machines (computers) to ascertain if they have borrowed from or defaulted to other MFIs.

Respectful treatment of clients:

Across the MFIs visited, clients mention that there is no perceived change in staff behaviour. The staff behaviour, as per clients surveyed, has always been good and it remains so even now. In a few MFIs, the clients feel that staff communication has improved and they are more willing to share information. Staff members visit them on pre-fixed schedules and there are no unexpected visits to collect the dues. Staff behaviour seems to be good even during periods

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[11] For more details about the programme and its impact, please refer to: http://www.microsave.net/files/pdf/Alternate_Financial_Education_Project_2014.pdf

of delinquencies or delayed payments.

Privacy of data:

Privacy or security of their data is not perceived as important by many clients. From a privacy angle, they are aware that their data is being shared with credit bureaux and by extension with other MFIs, but they are not concerned with privacy of the data as they have neither understood nor experienced any negative implications of it.

B.2 Impact on the Staff:

Under the impact of responsible finance initiatives, the study focused on issues like training and communication received by staff, impact on their work load, efficiency, impact on the work environment and so on.

Around 35 staff members from 10 MFIs were interviewed. Almost all mentioned that the employee engagement levels or buy-in for RF practice has increased. Many staff members believe that the guidelines on responsible finance practices and code of conduct have brought a stability factor into the microfinance sector. Staff members feel that MFIs are not only doing well but also being seen to be doing well.

In some of the MFIs, staff member caseloads have been capped to ensure optimal workload while delivering quality of customer service. Some MFIs have capped the caseload at 700-750, while others are looking at 800-900 as ideal. The caseload seems to be fine as most MFIs are shifting to monthly group meeting. To balance the workload of staff members, a few MFIs have attempted to re-schedule their field activities. For instance, at Ujjivan, the first 15 days of the month are dedicated to collections only and the last 15 days for group formation, group training and so on. Such balancing of activities has helped the staff members in managing their workload. The caseload limit does not seem to have a negative impact on the responsible finance practices, thanks to the efficiencies achieved in terms of time and work planning.

The level of awareness among staff on code of conduct is good, which to some extent indicates that training in this issue has been effective and that COC has been institutionalised amongst MFIs. Branch managers and other branch staff have a good understanding of the details of code of conduct. MFIs have been able to deliver the message about adherence to the code of conduct among their staff.
Some staff members mentioned that the RBI guidelines and code of conduct have had a positive impact on them, mainly in terms of reducing workload, which have been optimised due to the shift towards monthly group meetings (which seem to be the predominant model now).

Staff members believe that they are more professional now and that they are also considered as such by clients and management. The strict guidelines around behaviour and the training provided have both helped them to follow the guidelines effectively.

Even though the current staff attrition rates are higher than the corresponding figures five-six years ago, the rates seem to have stabilised across the sector. The staff attrition rate for the sampled MFIs stood at 39.19% in the year 2012, while it was at 36.7% in the years 2010 and 2011. This could be on account of staff lay off by Andhra-based MFIs.

B.3. Impact of RF on the Microfinance Institutions:

Responsible finance practices in the long term are expected to demonstrate certain outcomes for the MFIs implementing such practices.

Some of the expected outcomes in the long run are: improved customer satisfaction, customer loyalty leading to better client retention rates, better staff satisfaction and retention, better portfolio quality, better products, balanced social and financial performance, and lower operating costs.

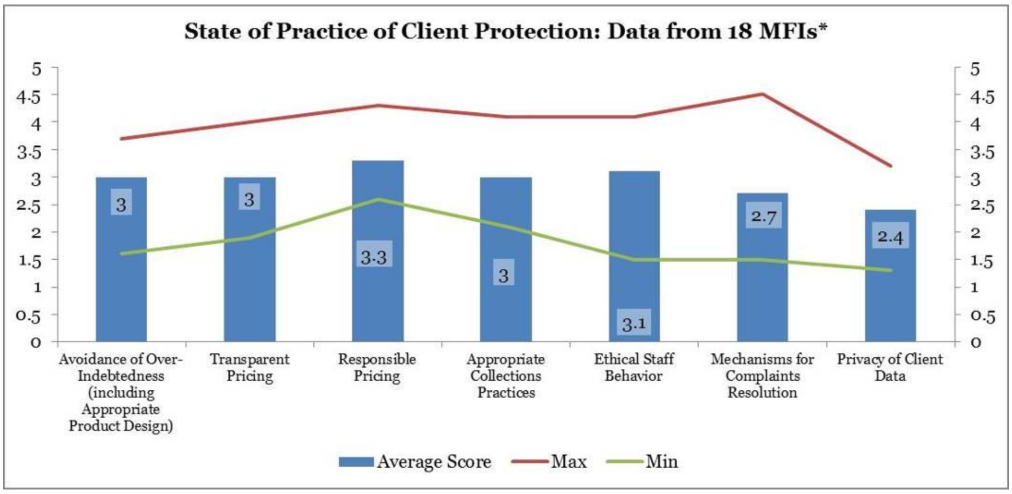
The following trends have been observed among MFIs:

Reduced Operating Costs:

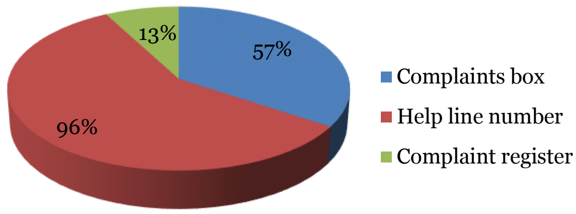
The average operating cost for the NBFCs reduced from 23.4% in 2009 to 11.35% in 2012 and reduced again in 2013. Some practices adopted by MFIs towards this end include: increase in caseload, use of technology and bank networks for loan disbursement, and the shift to fortnightly or monthly group meetings.

Customer protection has become a norm:

Implementation of customer-protection principles has taken precedence in several MFIs in India irrespective of their legal form and size. One of the reasons for this is the integration of client-protection practices with the code of conduct. The results from COCAs conducted by several firms and the client-protection assessments by SMART Campaign indicate good performance by the MFIs.



The state of the practice report[12] "Implementing Client Protection in Indian Microfinance 2013" released by SMART Campaign is an update on the status of implementation of client protection principles by Indian MFIs. The results of 18 assessments conducted by SMART reveal that the average performance of the MFIs is generally around adequate, meaning they have taken steps towards implementing client-protection principles. There is, of course, a need to further strengthen the implementation of client-protection principles in specific areas such as complaint resolution and privacy of client data. Almost all the sampled MFIs have at least one system to receive customer complaints – 96% of the studied MFIs have a helpline number, 57% have a complaints box and 13% have a complaints register. However the effectiveness of these mechanisms in terms of encouraging customers to use the grievance redressal system, documentation and analysis of the grievances, and grievance resolution needs to be improved upon.



There is very little focus on the privacy of client data as neither the MFIs or their clients see this as a priority.

Improved client repayment rates:

The average repayment rates in the year 2012 remained at 98.86% across all the MFIs that report data to MIX market. However, the sampled MFIs had slightly higher (5.69% in 2012) PAR (>30 days) due to inclusion of a couple of MFIs that had maximum portfolio concentration in AP. However, if only non-AP MFIs are included, the PAR is lower at 1.33%.

B.4. Impact of RF on the Sector:

Overall, the impact of responsible finance practices has been positive on the sector. Evidence of this is improved borrower retention rate, which increased from 64.72% in 2011 to 77.46% in 2012[13]. The Reserve Bank of India also contributed to the growth of the sector by making priority sector norms applicable to all legal forms of MFIs, not just NBFC-MFIs. The recent announcement of RBI of issuing a bank licence to Bandhan, an NBFC-MFI, can be seen as an indicator of renewed confidence in the microfinance sector.

The following are some of the trends observed in the microfinance sector:

Increased credibility of the sector among lenders and investors:

Equity investments in the sector have resumed with 12 MFIs[14] (all MFIN

[12] Source: http://smartcampaign.org/storage/documents/SOP_India_Booklet_Final_16-12-2013_Hi-Res.pdf

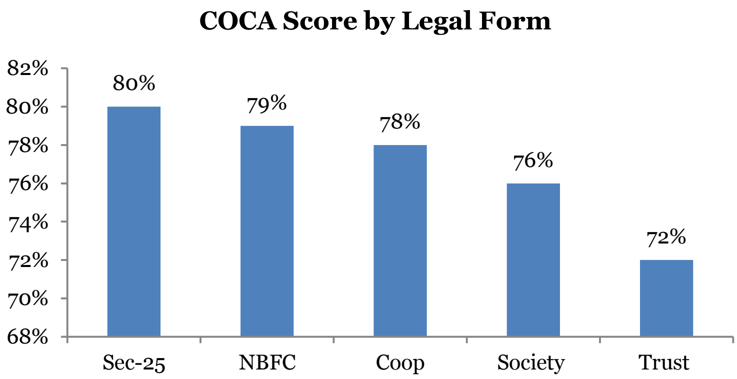
[13] Source: www.mixmarket.org

[14] As reported by MFIN in its annual report 2012-13

members) receiving equity from institutions such as the International Finance Corporation, ACCION International, Citi, Aavishkar, Lok Capital, MicroVentures, HDFC, and Norwegian Microfinance Initiative's (NMI) Frontier Fund. Although only the larger MFIs have been able to attract such investments, it is still a positive trend. Lending from banks to the sector has also improved as the bulk loan disbursement from banks to MFIs increased[15] by 51% during 2012-13 as against the year 2011-12. According to Sa-Dhan, the total debt outstanding with MFIs comes to Rs.10,000 crore during 2012-13, and according to MFIN its members received bank loans worth Rs.788 crore during April–June 2013 alone. Funds from other financial institutions to the MFIs stand at Rs.210 crore[16]. One of the main reasons for this positive trend is the increased credibility of the sector due to the RBI guidelines and the efforts made by the industry in implementing and adopting responsible finance practices. The efforts made around code of conduct, client-protection principles, and establishing systems around these principles have all been appreciated by investors and bankers.

Higher adoption of client protection and code of conduct among the MFIs:

The focus of MFIs on client protection has definitely increased since the introduction of the code of conduct. This is largely due to the assessment initiatives taken by SIDBI and SMART Campaign. The adherence levels to client protection and code of conduct have increased, which is evident from the average COCA score received by MFIs. Of the 26 COCAs conducted in the year 2011-13 and reports made available on SIDBI's web site, the average COCA rating was 78%. NBFCs and Section 25 companies are better performers as compared to all the other three legal forms viz. cooperative, society and trust. The possible reason for this might be due to the bigger scale and size of NBFC MFIs and Section 25 companies, which enables them to have better resources and hence better systems in place.



"Sec 25 companies and NBFCs have scored better in COCA. This is largely because of their scale of business. Business scale has enabled these MFIs to maintain margin and invest to institutionalise responsible finance practices."

Improved perception about the sector, mainly on the interest rates, regulations:

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[15] Source: Microfinance India, State of the Social Performance Report, 2013

[16] Source: Microfinance India, State of the Sector Report 2013

RBI's guidelines, particularly on margin cap, have brought a change in perception among stakeholders. Beliefs that MFIs charge usurious interest rates have reduced significantly. In addition, the perception that MFIs are regulated seems to comfort the sector and the various stakeholders associated with it. With the establishment of credit bureaux, the microfinance sector has become more transparent and formal. MFIs, on their part, are also comfortable in sharing and sourcing information to and from credit bureaux.

Only serious and committed players operate in the market now:

There is an increased perception that only serious and committed players have remained in the market as the rules of business have become tougher with the introduction of various responsible finance practices. With the introduction of NBFC-MFIs as a legal entity, the entry norms and monitoring criteria have also become stringent and regulated.

More awareness of clients on credit bureau and other guidelines:

Clients are aware of RBI guidelines such as the number of MFIs that they can borrow from, reference checks from credit bureaux, and the maximum borrowing limit from all MFIs put together (Rs.50,000). With increased awareness levels, the average number of loans taken by clients from MFIs has come down significantly. However, a set of clients, particularly in urban areas, may still be resorting to informal sources of funding if they need higher loan amounts. There is a need to study this aspect in greater detail.

Increased and improved roles for industry associations like MFIN and Sa-Dhan, plus unified regulation or practices around the code of conduct and client protection:

The crisis in 2010 led to a positive development in the coming together of MFIN and Sa-Dhan to work on the unified code of conduct. This has resulted in significant adoption levels among MFIs. The unified code of conduct, drawn heavily from best practices across the globe and RBI's Fair Practice Code for NBFCs, has gone a long way in influencing the individual code of conduct of all the MFIs, irrespective of the legal type or size of operation. The period also saw initiatives like the 'Responsible Business Index' (RB Index, see below) introduced by MFIN for its members. Initiatives of evaluating compliance to responsible finance practices of MFIs encouraged MFIs to adhere to industry codes and norms. The work of industry associations (including their state chapters and state-level associations like AKMI and Karnataka) has resulted in improved perception among state governments.

RB Index Introduced by MFIN

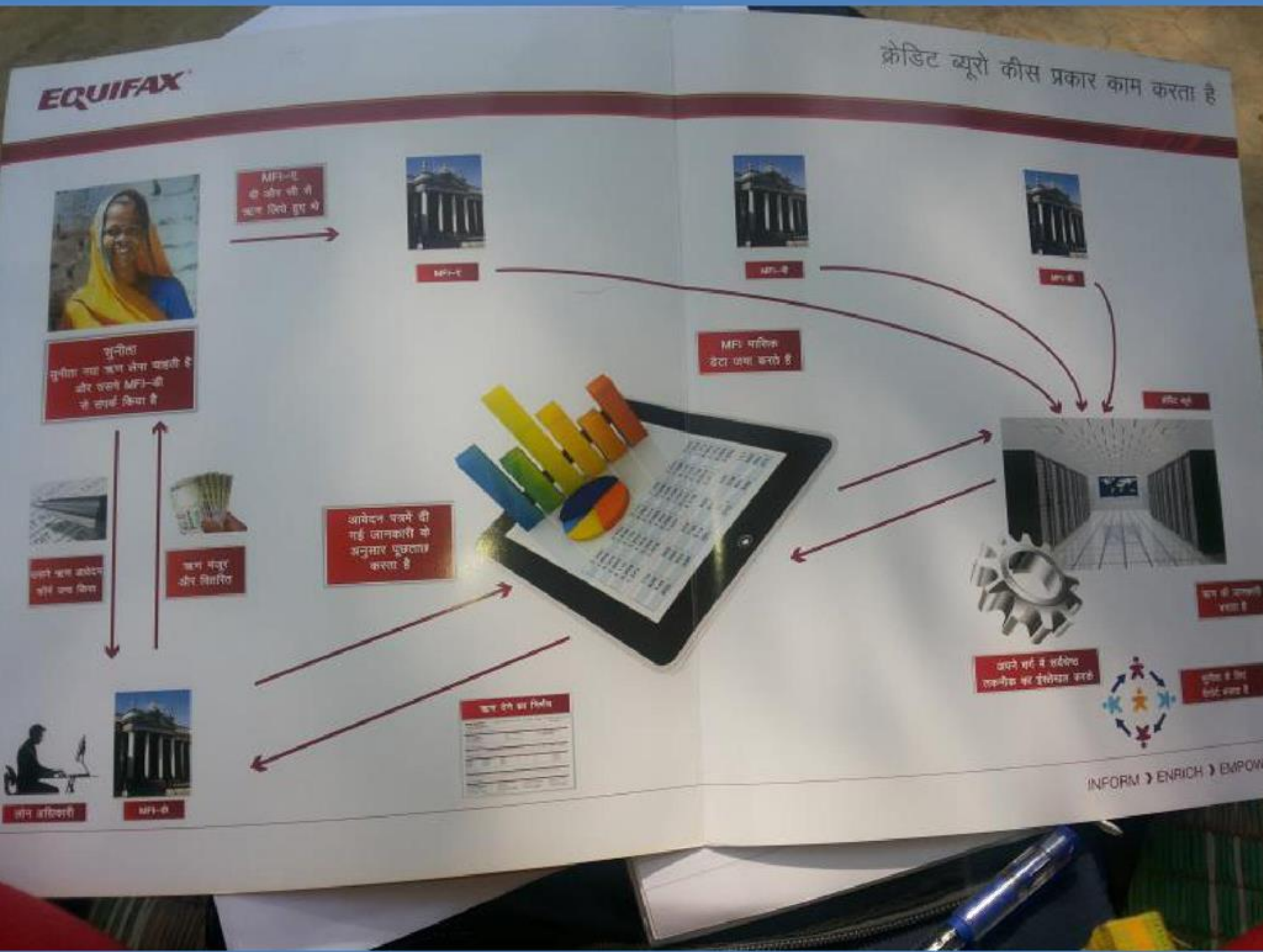
The RB Index aims to support the industry and individual MFIs in their collective effort towards building a responsible business framework by evaluating responsible business principles and practices.

The index is an exercise by the industry to collectively assess its responsible business principles and practices. It is also a tool to help individual MFIs systematically measure, manage, and integrate responsible business practices in the following ways:

- Gap analysis, helping MFIs identify both the strengths in their management and the gaps where future progress can be made;
- Benchmarking, performance against sector peers, and leading practice from across the RB Index;
- Tracking progress, reinforcing good practice, and driving continual improvement.

The RB Index comprehensively covers RBI Fair Practice Code and Industry COC under five broad areas of a) Disclosures to Clients, b) Client Engagement, c) Institutional Processes, d) Transparency, and e) Violation History.

Key Challenges in Implementation of the RF Practices



3. Key Challenges in Implementation of the RF Practices

Most MFIs and stakeholders claim that they did not face any significant challenges in implementing responsible finance initiatives. One of the main reasons cited for this was the realisation of the fact that responsible finance is not an option, but a necessity to be sustainable and profitable in this business.

However, there are a few challenges where the sector still needs attention along with efforts to implement responsible finance practices.

"RBI's regulations – 85% of the MFIs assets should be qualifying assets – is perceived as a bottleneck in product innovation."

1. *Following the guidelines only in letter by a few MFIs:*

A major perception within the sector is that a few MFIs do not submit data to credit bureaux or do not follow the guidelines in letter and spirit. If this continues for long, it might discourage the MFIs that are now practicing responsible finance. For instance, the guidelines on keeping loan tenure for two years for loan above Rs.15,000 is not viewed positively by both clients and the MFIs. Hence, there are a few MFIs that have structured the loan in such a way that majority gets repaid in the first year, allowing clients to take an additional loan out in the second year. MFIs following the guidelines exactly state that the purpose of the guidelines will be lost if other MFIs continue to adopt these practices. Some practitioners claim that practicing responsible finance has become similar to following a checklist.

The limited ability of industry associations to curb half-hearted or inadequate practices through their enforcement committee adds to the challenges. Given the size of the sector and the sheer number of initiatives to be monitored, industry associations have their task cut out. The initiative towards giving them the status of 'Self-Regulatory Organisation' has since fructified but real changes on the ground, as a result of the devolved regulatory authority, seems to be still be work in progress.

2. *Few regulations and policy guidelines need revision:*

The annual income cap (of clients), set by the Reserve Bank of India for MFIs to enable their loans as "qualifying assets" for priority sector classification, is still at the levels set in the year 2010 – Rs.60,000 for rural areas and Rs.120,000 for urban areas. This has become a challenge for four reasons: (1) despite inflation and the rising income levels of the segments that MFIs target, the income criteria set by RBI remains the same since 2010; (2) the income levels do not consider the regional differences of the country. The income levels of clients in cities such as Mumbai are higher in comparison with someone's income in Bhopal for instance; (3) the difficulty of establishing or verifying the actual income of clients. This is the reason why MFIs settle for a simple undertaking from clients; (4) As clients move into higher loan cycles, their income levels tend to rise. In the current guidelines this is not taken into account, thus forcing the MFIs to look for leeway to be in compliance with

RBI's guidelines. As a result, MFIs merely collect an undertaking from their clients; they do not want to lose custom and many clients will not fit into the income criteria.

The second guideline challenging the NBFC-MFIs is that 85% of their assets (other than cash and bank balances) must be made up of qualifying assets and income-generating loans must not be less than 75% of the total loan given by the MFI. This has restricted the MFIs from looking at product innovation in areas such as housing, enterprise, consumption, and emergency loans.

Another guideline that has implications for both the MFIs and their customers is the prescription of 24 months loan tenure for loans exceeding Rs.15,000. This has prevented customers who have fast cash rotation in their business from accessing higher loans payable within one year. As a result, they resort to informal sources to fulfil their additional credit need.

3. Product innovation is a challenge for MFIs with 10% margin cap:

One of the areas that Indian MFIs lag behind is in innovative product development. In the coming years, with the guideline of 10% margin cap, there will be increased pressure on MFIs to reduce operating costs to maintain profits. The challenge would be even greater for small MFIs, who would have to keep reinventing their roles to sustain. Limited margins would not encourage MFIs to seek product innovation. To overcome the challenge, MFIs can explore business correspondent (BC) models to expand their product range.

Cashpor, being a Section 25 company, works as a business correspondent of ICICI Bank and offers saving services to its clients. This provides additional income to the organisation and allows it to offer a bouquet of products, which also helps in increasing customer retention.

4. Applying the same standards of measurement for all types of MFIs:

One of the challenges highlighted was applying the same standards of measurement for social ratings or code of conduct assessments for all legal types of MFIs. This was considered as stringent by non-profit MFIs or co-operatives, given the context in which they operate.

5. Limited funding support to smaller MFIs to comply with certain practices:

The smaller MFIs, which typically have higher operating costs, face challenges when it comes to absorbing costs for implementing responsible finance practices. While some funding is available for subsidising the costs of social ratings or COC assessments, there is a dearth of resources for certain practices like reporting to credit bureaux or training staff in areas like code of conduct. Similarly, technology is a major challenge for many smaller MFIs, which makes it difficult for them to report to credit bureaux or generate social performance data reports for balanced decision making.

In the past year, the sector has seen a few initiatives from entities such as SIDBI, IFC, and Ananya Finance to support MFIs in building their internal capacity and to improve social performance practices. SIDBI is spearheading the DFID-funded PSIG project[17] (2012-19) in which small and medium-sized MFIs are helped to conduct loan portfolio audits and social performance assessments. Ananya supports its partner MFIs in integrating responsible finance management systems and IFC offers technical assistance, through its advisory arm, to its investee institutions to strengthen their responsible finance practices.

However, the efforts require scaling up and the inclusion of more MFIs, especially non-NBFC MFIs, with greater emphasis on streamlining and capacity building. The support programme should be monitored and its impact evaluated. Before extending support to the small and medium MFIs, a structured gap analysis needs to be done to determine the nature of support required to implement responsible finance practices.

6. *Excessive reporting requirements:*

Reporting requirements of various stakeholders, especially lenders and investors is another challenge MFIs face. The stakeholders have different formats to seek data from the MFIs. In most cases, the same information is sought in different ways, leading to duplication of effort and time. There had been efforts at one stage, through the lenders' forum, to streamline and synchronise data reporting templates. However, this initiative needs to be revived and taken to a logical conclusion.

7. *Multiplicity and competitive initiatives by several agencies to certify or rate the MFIs:*

The efforts of firms and agencies that rate or certify MFIs' compliance on responsible finance practices are overlapping and competing. This has an implication on the time, efforts, and resources of MFIs to accommodate different assessors and ensure compliance with different requirements[18]. This was cited as a challenge by MFIs, given the time and efforts required for assessments and/or certifications. There is a need to synchronize such certifications and initiatives and come up with a common framework.

8. *The role of industry associations in creating awareness on the financial education:*

One of the challenges cited by MFIs is that activities such as financial education to clients can be better supplied by industry associations or a common forum. This would help MFIs leverage support and focus on the core activity of microfinance rather than on activities for which they do not have

[17] The project has supported 15 MFIs with Rs.45 million sanctioned grant

[18] The Microfinance India, State of Social Performance Report 2013

expertise. MFIN was at one point planning to come up with a series of client-education programmes to ensure support to MFIs.

9. Weak role of governance in guiding and monitoring responsible finance initiatives:

Across the MFIs studied, it was observed that the boards play only a limited role in monitoring and guiding them towards implementation of responsible finance practices. The limited understanding of the board members further impacts the implementation of responsible finance practices.

10. The role of banks in (a) taking responsible finance practices into consideration while giving out loans and (b) in following the practices themselves:

While there is a growing recognition and support of various responsible finance initiatives by the lenders and investors, banks do not yet seem to recognise compliance to these initiatives by MFIs. Considering that banks are still the largest lender group for MFIs in India, recognition of compliance on these initiatives, on their part, will go a long way in motivating MFIs. In addition, with some banks such as HDFC and Axis Bank coming directly into retail microfinance, they will be required to follow RF guidelines themselves. For example, adherence to guidelines on over-indebtedness or credit bureau reference checks are an area in which these banks are lagging behind.

Recommendations and Policy Implication

4. Recommendations and Policy implications

Various recommendations have emerged during the course of discussions with MFIs, other stakeholder interviews, and the deliberation workshop conducted with different stakeholders. It is clear from the findings and the discussions around the way forward that responsible finance implementation in India has progressed significantly post 2010. However, although the first level of compliance – such as establishing institutional systems and processes – has started to be implemented, the sector needs significant concerted efforts to reach the next level.

In the section below, categorical recommendations are made with an indicative responsibility of implementation.

Recommendation	Description	Responsibility
Improving Governance in MFIs	MFIs need to focus on strengthening governance by inducting independent directors, especially women, who will be able to balance the interests of different stakeholders, especially those who are not represented on the boards, like clients (who are largely women) and staff.	**MFIs, Investors, Lenders**
	For steering responsible finance practices within MFIs, board members will need periodical capacity development and awareness building (examples – short specific training, lectures, and interactions with thought leaders).	**MFIs, Board Members**
	SIDBI can facilitate development of and periodical updating of tool kits on “MFI Board’s induction and training on microfinance policies and practices” to improve the skills and knowledge of the boards on setting policies, planning, and monitoring responsible finance practices within the MFI.	**SIDBI**
	MFIN can develop and maintain a database of qualified, experienced, and eligible board members. MFIN will need to do basic due diligence as part of creating the database. SIDBI can support this initiative.	**MFIN, SIDBI**
Measuring Indebtedness Levels of Clients	Irrespective of the legal form, operating model, or size, all MFIs and banks serving this segment need to share data with the credit bureaux.	**MFIs, Banks**
	As a responsible lender, MFIs need to build robust credit appraisal policies and processes such that clients do not dupe the prescribed system and do not access loans beyond	**MFIs**

Recommendation	Description	Responsibility
	regulatory prescription by producing fake or duplicate IDs. Only strict and diligent enforcement of these policies can check such malpractices at the field level.	
	SROs and lenders must ensure that MFIs share client data with the credit bureaux as well as using it for their credit decisions. This needs to be followed in letter and spirit. SROs should take action against those violating the regulatory norms.	**SROs, Lenders**
	Banks engaged in retail microfinance should also follow the unified code of conduct, particularly on issues such as over-indebtedness set by industry associations, and subscribe to data from the credit bureaux just as they do for their retail banking business. RBI should instruct banks lending to this segment to share data of the clients with credit bureaux.	**RBI, Banks**
	Since outreach of the SHG bank linkage programme is much bigger than that of the MFIs, RBI needs to issue directives to banks to share SHG member wise data (at least for bank loans) with the credit bureaux. Leaving out a massive proportion of loans accessed through SHG linkage programmes affects the accuracy of credit bureau data and defeats its purpose.	**RBI**
	MFIs need to go beyond the customary credit bureau check and carry out analysis of household indebtedness and repayment capacity for larger loans. Staff members need to be given extensive training in appraising higher-ticket loans and assessing the repayment capacity of the household.	**MFIs**
Product Diversification and Process Improvement	Since group loan products have limited shelf life, MFIs must explore offering more client-focused products. Individual loan products for microenterprises is one area for which there is demand and MFIs require technical assistance and capacity-building support to offer this product.	**MFIs, TA Providers**

Recommendation	Description	Responsibility
	In order to promote financial inclusion and the asset building of clients, MFIs need to consider partnering with banks under the BC model to offer savings products to clients. They can start with recurring deposits and enhance the range of products gradually.	**MFIs, Banks**
	Public-sector banks are lagging behind on engaging MFIs as BC/BF. Given the high penetration of public-sector banks in remote areas, they could consider partnering with MFIs under the BC model as it enables both credit and savings products to be offered to the low-income client segment.	**Public Sector Banks**
	RBI needs to provide flexibility to MFIs in fixing loan term for loans of more than Rs.15,000, since many clients are keen on one-year loans.	**RBI**
	There is a potential to offer developmental loans – home improvement, water and sanitation, education, emergency, and health are some such purposes for which clients demand loans.	**MFIs**
	RBI can consider suitable relaxation in the criteria for qualifying assets (85% limit of qualifying assets may be brought down to 70%) so that MFIs can offer such developmental loan products and develop other innovative products.	**RBI**
	MFIs need to strengthen their post-disbursement monitoring processes including random checks and internal audit systems. This will help to ensure that clients are using the loans appropriately and will also shore up the confidence of the regulator and lenders.	**MFIs**
	The current pricing for loans offered through the BF model is as high as the loans offered by MFIs under owned portfolio. Banks should price their loans appropriately in order to reduce the price of such loans to ultimate clients (in both BC and direct lending model).	**Banks, MFIs**

Recommendation	Description	Responsibility
	There is a huge potential to offer both life and non-life products that are designed to meet the needs of the clients. The micro-insurance product currently on offer is designed to protect the portfolio of MFIs and fails to provide adequate life cover for clients. Further, not many MFIs offer non-life products since the regulations on agency arrangement is not yet favourable for MFIs. Awareness of insurance products scores low in COCA assessments, which reiterates the need to step up client education on this front.	**MFIs, Insurance Companies, IRDA**
Client Education	Clients have been long used to taking only credit products from MFIs, hence are unable to comprehend the need for other products and services from them. Multiple borrowings and over-indebtedness seems to be a constant threat for the sector. Financial education will not only enable the client to know more about other financial products and services but would also make them capable of taking better informed financial decisions. While designing financial education programmes, MFIs and donors should look at scalability and financial viability of the programme.	**MFIs, Donors**
Proactive Assessment of Client Needs and Satisfaction	MFIs must consider creating a system for client interface where they can gather feedback on product, service quality, and grievance redressal at regular intervals.	**MFIs**
Measuring Client Outcomes	Although MFIs collect a lot of data regarding clients, a systemic approach to analysing the data and measuring client outcomes in order to improve products and processes is lacking. PPI as a tool has the potential to understand the poverty level of groups of clients and also measure their progress; however often MFIs need to collect data points in addition to PPI to understand changing needs of the clients and their view points on MFIs services. MFIs need technical assistance to understand what are good indicators, how to capture and analyse data to understand the specific needs of their clients, and to measure their satisfaction.	**MFIs, Investors, SIDBI,**

Recommendation	Description	Responsibility
Support to Small MFIs	While large and mid-sized MFIs have been able to absorb the additional costs involved in adhering to RBI norms and adopting the unified code of conduct, the small MFIs are still struggling to establish the necessary systems, capacity development of staff, and the measurement and monitoring of responsible finance practices. SIDBI can set up a dedicated TA fund to support small MFIs by providing performance-based grants for such activities.	**SIDBI**
	Social investors and India Microfinance Equity Fund (IMEF) may consider support for smaller, well-managed MFIs that have robust systems and processes and are in compliance with regulatory guidelines. These MFIs may be supported with equity, quasi-equity, and subordinated loan funds until they reach a critical mass where they can attract bank funding.	**SIDBI, Social Investors**
Responsible Financing by Lenders	Banks may consider COCA score as one of the lending criteria for MFI loans. Banks, based on COCA reports and their own due diligence, should highlight the aspects that the MFIs need to improve. Bank should also have systems to monitor the highlighted aspects.	**Banks, Lenders**
	Banks need to schedule and plan their loan disbursement pattern over the year to avoid pushing loan towards the end of the financial year. This creates immense pressure on MFIs to disburse the loans, very often compromising on client selection, training, credit assessment, and disbursement criteria. Target pressures on MFI staff members make them overlook responsible finance practices. MFIs on their part also need to plan their annual disbursements targets to ensure an even trend throughout the year.	**Banks, MFIs**
	Banks may also revisit the benefits offered to MFIs offering saving products on behalf of the bank as their BC. Benefits can be made attractive by: • Sharing initial cost of operations until the savings business reaches sustainable volume; • Offering term loan at discounted rate to MFIs that support the liability business.	**Banks**

Recommendation	Description	Responsibility
	Lenders may conduct special portfolio audits of those MFIs that register growth rates exceeding 70% during the previous year. The focus of the audit should be on the portfolio quality as well as on the level of compliance with established credit policies and responsible finance practices.	**Banks, Lenders**
Identifying Areas with High Credit Concentration/High Growth Rate	MFIN may consider taking up data analytics on district wise/block wise/pin code wise debt concentration/growth rate. This will provide useful information on the concentration/distribution of portfolios across geographies. Based on the data analytics, debt concentration/high growth rate areas can be analysed and red flagged in case over-heating is happening in any geographic area.	**MFIN**
	This could become a reference point for investors and lenders to incentivise MFIs working in low portfolio concentration districts and discourage those lending in districts with high portfolio concentration.	
Servicing Clients in Underserved Districts	Investors and banks must encourage MFIs to establish operations in underserved districts by means of: • Stipulating a condition that a minimum proportion of the MFI's portfolio should be in underserved districts; • Encouraging and incentivising MFIs by way of extending equity support and credit on soft terms to enable them to lend in underserved districts. **Note:** ***District can be called underserved if neither a Tier -1 nor Tier-2 MFI is present.***	**Investors, Banks**
Defining Client Income	Rural and urban household income limit needs to be re-assessed in the light of following facts: • Inflation has impacted clients' income; • Client household income generally tends to go up with the number of loans consumed; • Income level varies across regions.	**RBI**
External Assessments	The industry associations and SIDBI should look into the possibility of developing one comprehensive rating tool that covers both financial and social rating, including	**SIDBI, MFIN, Sa-dhan**

Recommendation	Description	Responsibility
	assessment of compliance with code of conduct. This will help MFIs avoid multiple assessments with very little incremental value addition to the state of practices.	

Annexures:

Annexure 1: Assessment and Analytical Framework

The assessment and analytical framework consists of both subjective and objective parameters to analyse secondary and primary data of shortlisted MFIs. Parameters have been decided based on Industry Code of Conduct for MFIs; Corporate Governance (applicable to NBFCs) circular issued by RBI; USSPM advocated by SPTF; and SMART Campaign CPP indicators. The framework also captures financial and operational data of MFIs and assessments or certifications taken up by MFIs. The information captured in analytical framework was used to depict the responsible finance adoption trends in the microfinance sector and establish linkages between them.

Assessment and analytical framework consists of the following components:

1. **Financial and Operational Parameters:** It contains various financial and operational parameters like return on equity, return on assets, OSS, PAR, loan officers to client ratio, growth rate, equity structure etc. to understand the growth strategy of MFIs.

2. **Governance:** To understand what good practices of governance have been adopted by MFIs and compliance of governance guidelines in Industry Code of Conduct, Corporate Governance circular of RBI for NBFCs, and Universal Standards of Social Performance Management advocated by Social Performance Task Force (SPTF).

3. **Responsibility to Employees:** It analyses attrition rate in MFIs, gender balance, clarity of communication to employees, steps taken by MFIs to monitor staff satisfaction, and performance evaluation system adopted by MFIs.

4. **Client Protection and Responsibility to Clients:** It analyses whether the internal audit and monitoring divisions of MFIs have taken steps to check compliance of client protection principles in operations. This section also analyses MFI performances across seven client protection principles of SMART Campaign and the steps taken by MFIs to ensure compliance:
   a. Principle 1: Appropriate Products and Services Design and Delivery;
   b. Principle 2: Prevention of Over-indebtedness;
   c. Principle 3: Transparency;
   d. Principle 4: Responsible Pricing;
   e. Principle 5: Fair and Respectful Treatment of Clients;
   f. Principle 6: Privacy of Client Data;
   g. Principle 7: Complaints Redressal Mechanism.

5. **Financial Capability or Client Education:** It contains training initiatives taken by MFIs to inform client about loan terms and conditions, communication clarity to clients about terms and conditions, and financial education/client

education programmes undertaken.

6. **Reporting to External Stakeholders:** It analyses whether MFIs reporting their financial and social performance data to external stakeholders like MIX Market, MF Transparency, funders, and credit bureaux.

7. **Assessments – SPM, CP, or COCAs:** It captures assessments and certifications like COCA, SPM assessment, social audit, SMART Campaign certification etc. undertaken by MFIs and what has the result been of these assessments of MFIs.

8. **Balancing Social and Financial Performance:** It captures the measures or steps adopted by MFIs to align their financial performance with social goals. For example: investing a portion of profits to increase value to customers; lowering interest rates or adding or improving products and services; working with investors whose expected time horizon and exit strategies are aligned with MFI's social goals; considering total cost of capital when deciding on a financing structure in order to understand what cost would be passed on to the clients.

9. **Strategic Intent on Responsible Finance:** It focuses on strategies developed by MFIs to achieve their social goals, whether mission and vision of MFIs mentions target clients, asks if MFIs collect data specific to social goals

Annexure 2: List of 36 MFIs Selected for Secondary Research

S.No	Name of MFI	Client Base as on 31st March 2013	Legal Form	Region	Lending Methodology
1	Sahayog Microfinance Ltd	86,710	NBFC	Central	JLG
2	Samhita Microfinance/SCDS	45,552	Section 25 Company	Central	JLG
3	Anjali Microfin Private Ltd)	2,643	NBFC	East	JLG
4	Saija	30,489	NBFC	North	JLG
5	ASA India	125,358	NBFC	South	JLG
6	Arohan	113,665	NBFC	East	JLG
7	GFSPL	346,519	NBFC	South	JLG
8	Ujjivan	1,006,052	NBFC	South	JLG
9	Equitas	1,344,361	NBFC	South	JLG
10	ESAF	384,250	NBFC	South	SHG
11	Sanghmitra	131,183	Section 25 Company	South	SHG
12	Bandhan	4,433,885	NBFC	Eastern	JLG
13	RGVN (NE)	155,026	NBFC	North-Eastern	JLGand SHG
14	Chanura MF	5,790	Society	North-Eastern	JLG
15	Fusion Microfinance	66,806	NBFC	North and Central	JLG
16	C-Dot	11,782	Society	North	JLG
17	SVCL	118,217	NBFC	North and Central	JLG
18	Satin Credicare network Limited	485,033	NBFC	North	JLG
19	Margdarshak	31,848	NBFC	North	JLG
20	Utkarsh	198,181	NBFC	North and Central	JLG
21	Sonata	191,594	NBFC	North and Central	JLG
22	Cashpor Micro Credit	548,934	Section 25 Company	North	JLG
23	BWDA	106,696	NBFC	South	SHG and JLG
24	Chaitanya	28,097	NBFC	South	JLG
25	IDF	89,430	NBFC	South	JLG and SHG
26	Suryoday	156,204	NBFC	South	JLG
27	Janalakshmi	695,974	NBFC	South	JLG

28	Future Financial Services	179,620	NBFC	South	JLG
29	SKDRDP	2,314,075	charitable Trust	South	SHG
30	SKS	4,308,301	Public Limited Company	Pan India	JLG
31	Annapurna Mahila Credit Co-op Society	27,106	Multi-State Credit Co-operative Society	West	JLG
32	Spandana	2,383,594	NBFC MFI	Pan India	JLG
33	Samastha Microfinance	51,351	NBFC (applied for NBFC MFI Status)	South	JLG
34	Swadhaar Finaccess	103,722	NBFC	Central	JLG
35	Prayas Gandhinagar	14,812	Trust	West	JLG
36	Sewa Bank	29,969	co-operative Bank	West	SHG

Annexure 3: List of 10 MFIs Selected for Primary Research

S.No.	Name of the MFI	Client Base (as on 31st March 2013)*	Legal Form	Region	Lending Methodology
1	SVCL	118,217	NBFC	North	JLG
2	Margdarshak	31,848	NBFC	North	JLG
3	Cashpor	548,934	Section 25 Company	North	JLG
4	SKS	4,308,301	NBFC	South	JLG
5	Ujjivan	1,006,052	NBFC	South	JLG
6	Annapurna Mahila Credit Co-op	27,016	Cooperative Society	West	SHG
7	Suryoday	156,204	NBFC	West	JLG
8	RGVN	1,55,026	NBFC	North-East	SHG and JLG
9	Chanura	5,790	Society	North-East	JLG
10	Arohan	113,665	NBFC	East	JLG

Annexure 4: Interview Guides for MFI

1. a. Interview Guide for the CEO and Ops Head

S. No	Core Question/Issue	Probe Questions
1	What responsible finance initiatives have your organisation implemented?	• Probe for client protection, SPM, code of conduct, and other initiatives.
2	When did your organisation start responsible finance initiatives?	• Which year? • What are the specific initiatives each year (for last three years)?
3	What triggered the initiation Of responsible finance initiatives in your organisation?	• Probe for internal and external factors; • Probe for the effect of microfinance crisis (2010) on the RF initiatives; • Effect of regulation and priority sector norms.
4	What are the challenges faced by your organisation while implementing RF?	

5	How did you balance between RF practices and financial performance?	• Probe on:
		  • Rate of portfolio growth;
		  • Change in client acquisition;
		  • Caseload changes and relationship management with clients;
		  • Client indebtedness versus increase in loan size;
		  • (Additional) expenditure incurred in improving responsible finance practices, especially training costs;
		  • Staff incentives;
		  • Balanced return to shareholders;
		  • Balancing staff and client needs and welfare;
		  • Impact on profits;
		  • Change in repayment rates;
		  • Client awareness;
		  • Client protection from fraud.

6	How did RF impact your organisation?	• Probe for both positive and negative impact; • Costs and profits; • Probe for coping mechanisms and strategies in case of negative impact; • Compare the growth of the organisation before and after

		implementation of RF activities; • Perception of investors, funders, and bankers plus impact on the resource mobilisation; • Probe on the staff retention and HR challenges; • Reporting requirements.
7	What was the impact of RF activities on the clients and their satisfaction levels?	• Probe for specific examples or cases; • How clients perceive your institution vis a vis other competitors now? • What are client dropout rates in last three years? • Internal study reports and key Findings; • Changes in products or processes carried out to improve client retention and satisfaction.
8	How have various RF related regulations and industry initiatives (COC, FPC, USSPM, CP Certification) impacted the sector?	• Probe on specific impact of each of the guidelines or initiatives.
9	What are the future plans for implementation of RF in the organisation?	
10	What are your recommendations to improve implementation of RF in the sector?	• Probe for what MFIs can do; • Probe for what specific stakeholders can do.
11	What role does the board play in RF?	
12	Are there aspects of RF that may be dispensed with as the cost incurred on them is not commensurate with benefits?	
13	For large MFIs: With the margin cap reduced to 10% from April 2014, will there be continuing emphasis on RF practices?	

1. b. Interview Questions for Internal Audit

- How does internal audit team monitor the compliance of responsible finance practices? Can you please share the internal audit checklist?

- What according to you has been the impact of responsible finance practices on the institution? Can you share some specific examples?

c. Interview Guide for the Field Staff

- What do you know about responsible finance and social performance management or initiatives related to code of conduct? What was the communication to you regarding these?
- What type of support (training, materials, brochures etc.) did you receive from Head Office to implement the RF activities?
- Since the introduction of code of conduct, what changes have you noticed within the organisation, especially with respect to the focus on clients and of the employees?
- What do you know about the client protection principles and code of conduct elements such as data privacy, maintaining transparency with clients, financial education, clear communication, and client grievance mechanism?
- What were you told about this (in each area) and what new things have you done in your branch?
- Do you think these client-focused changes are good for your organisation? How?
- What is the impact of these initiatives on clients (outreach, outcomes, and services) and on their satisfaction levels?
- What is the impact of these initiatives on the staff?
- What more changes do you think we should do within the organisation?
- What is your opinion of customer focused regulations, such as income cap and loan amount cap. Are these acceptable to the customer? Are these operationally efficient in your work?

1. d. Focus Group Discussion Guide

Questions	Probe
Warm-up Questions	
How long have you been with the MFI? What do you do? What is your occupation?	
Did you have any other MFI loans? Why did you join this MFI when you had a previous MFI relationship?	Whether RF practices were weak, or protection levels were not up to the mark in the other MFI.
Appropriate Product Design and Delivery	
1. Do you think the products and terms & conditions offered by the MFI are right for your needs? 2. What changes have you seen in the products, their terms and conditions in the past three years?	• Probe on loan factors like loan processing time, instalment size, moratorium/grace period, extension in case of default payments, top-up loans at the end of loan cycle, cross selling of other financial/non-financial products, two-year term for loans above Rs.15,000.
Transparency and Financial Literacy	
3. What changes have you seen in the communication of products and terms in the past years?	• Probe their observations; • Probe for the level of satisfaction with the transparent communication.
Responsible Pricing	
4. What changes have you seen in pricing of interest rates, processing fees, security deposit etc.?	• Probe for the level of satisfaction and impact of price changes.
Prevention of Over-Indebtedness	
5. How does the MFI verify if you are taking a loan amount you can comfortably pay back? 6. How did the MFI process change in the past three years regarding this? 7. What is your opinion on the RBI restriction that you cannot borrow from more than two MFIs? 8. Is the cap on MFI borrowing at Rs.50,000 adequate?	• Probe for changes in the cap on the no. of MFIs that clients can take loan from, the loan amount ceilings; • Probe for the impact of this change on clients; • Probe whether regulations produce desired results and customer comfort.
Fair and Respectful Treatment of Clients	
9. What changes have you seen in staff behaviour over the past	• Probe for collection practices, especially at the time of delinquencies

three years?	or late payments, visiting during odd hours and so on.
Complaints Handling and Resolution	
10. If you have any complaints – be it against the staff, or any difficulties you face like delayed disbursements, no pass book up – who do you approach?	• Probe about the complaints redressal mechanism; • Probe for the impact of this on client satisfaction.
Privacy of Client Data	
11. Do you know if the MFI can share your information with others outside of the organisation?	• Probe if the MFI staff communicate to clients about sharing of data with external stakeholders or about the data security/privacy; • Probe for impact on the client satisfaction.
Customer Service and Impact	
12. What is one thing you want them to change about the MFI?	

Annexure 5: Interview Guides for Stakeholders

- What is the role of your organisation in the RF domain in India?
- What are the responsible finance practices that your organisation/institution has supported?
- How do you align your activities with other similar organisations and ensure that MFIs do not need to do the same exercises multiple times?
- What according to you has been the impact/changes in the sector due to the RF practices?
- What do you think are the gaps in the current practices? And what do you see is the role of various stakeholders?
- If you implemented or supported implementation of RF in your work, how did you monitor and evaluate the responsible finance programmes?
- Are there any guidelines that you developed for your investees? (Ask this only to social investors/funders.)
- When you complete your RF initiative, will the MFIs be able to sustain the same on their own, from both technical and cost points of view?
- What, according to you, are the challenges of implementation of RF practices in the MFIs or organisations such as yours?
- What are your recommendations to improve implementation of RF in the sector?

Annexure 6: List of Interviewees

S. No	Name of the Interviewee	Organisation	Designation
1	Ashok Ranjan Samal	SIDBI	General Manager
2	Sundar Arumugam	Equifax India	AVP – MFI Product Management
3	Micol Pistelli	MIX Market	Director, Social Performance
4	Dr Medha Purao Samant	Annapurna	Founder, Chairperson
5	Sujata Bhat	Annapurna	Finance and Liaison Manager
6	Ujwala Waghole	Annapurna	Senior Manager, Microfinance
7	Amita Sonawane	Annapurna	Senior Manager, Community Social Protection Programme
8	Aarti Shinde	Annapurna	Assistant Manager, Microfinance
9	Dinesh Tupkar	Annapurna	Systems Auditor
10	Shubankar Sengupta	Arohan	CEO
11	Amit Dutta	Arohan	AVP
12	Sudhir Kumar	Arohan	General Manger
13	Upasna Srivastava	CASHPOR Micro Credit	Head Monitoring & Reporting
14	Niraj Kumar Sinha	CASHPOR Micro Credit	Head Internal Audit Department
15	Sanjay Srivastava	CASHPOR Micro Credit	Head Human Resource Department
16	Susmita Rai	CASHPOR Micro Credit	Senior Manager Training
17	Ajay Shankar Mishra	CASHPOR Micro Credit	DDO South Zone
18	P K Khuman	Chanura Microfin	CEO
19	Mandakini	Chanura Microfin	Area Manager (Equivalent Operations Head)
20	Anoop Mittra	Margdarshak Financial Services Ltd	SPM Champion
21	Rupali Kalita	RGVN	Managing Director
22	SP Phukan	RGVN	Head in Charge of Internal Audit
23	TC Sarma	RGVN	Internal Audit
24	Gunajit Bayan	RGVN	Zonal Manager (equivalent of Ops Head)
25	Rakesh Dubey	SV Creditline (P) Ltd	President
26	K K Singh	SV Creditline (P) Ltd	Regional Head
27	Subrata Singha	SV Creditline (P) Ltd	Head of Audit
28	Meena Sheoran	SV Creditline (P) Ltd	Human Resource Manager
29	Rashmi Singh	SKS	AVP, Organisational Excellence and Service Quality

S. No	Name of the Interviewee	Organisation	Designation
30	Ritesh Chatterjee	SKS	Deputy COO
31	Kanchan Pandhre	SKS	Executive VP, Internal Audit & Risk Management
32	R Baskar Babu	Suryoday	Chief Executive Officer
33	Narayan Rao	Suryoday	Head – IT/HR/GA
34	Pandurang Dixit	Suryoday	AVP – Process Audit
35	Vikrant Bhagwat	Suryoday	Business Head
36	Sanjay Tiwari	Suryoday	AVP – Finance
37	Tanaji Chavan	Suryoday	Area Manager – Social Initiatives
38	Samit Ghosh	Ujjivan	Chief Executive Officer & Managing Director, Board Member, MFIN
39	Carol Furtado	Ujjivan	Chief Operating Officer – South
40	Suresha C	Ujjivan	CEO, Ujjivan Social Services Foundation
41	Srabanti Rc	Ujjivan	Finance Manager
42	Alagarsamy P	Ujjivan	Head of Audit

Annexure 7: RF initiatives in India

1. Draft Bill on Microfinance:

The effort to introduce a bill for microfinance has been going on since 2007. The government had introduced the Micro Financial Sector Bill in the Lok Sabha in March, 2007. However, the Bill lapsed when the term of the 14th Lok Sabha expired in 2009. In the earlier Bill, it was proposed that the National Bank for Agriculture and Rural Development (NABARD) would be the regulator of the sector.

The draft Micro Financial Sector (Development and Regulation) Bill, 2011, was circulated for public comments in July 2011. In this RBI was proposed to be the regulator of MFIs. The draft Bill had taken into consideration the recommendations of the Malegam Committee, which was set up by the RBI to study issues and concerns in the microfinance sector.

The Union Cabinet approved the Bill ("Micro Financial Sector Development and Regulation Bill") in May 2012. It will regulate the microfinance industry and bring the micro-lenders under the purview of the Reserve Bank. The Bill, which was drafted to the backdrop of problems faced by borrowers of MFIs in Andhra Pradesh and other states, is expected to be introduced in Parliament for consideration.

The Bill brings in the much-required regulation in the microfinance sector. Some of the salient features of the Bill are:

- It would be mandatory for microfinance institutions (MFIs) to be registered with the Reserve Bank and have minimum net-owned funds of Rs.5 lakh.
- A Microfinance Development Council will be set up to advise the government on formulation of policies, schemes, and other measures required in the interest of orderly growth and development of the sector with a view to promote financial inclusion. The council will comprise members not below the rank of Executive Director of NABARD, National Housing Bank, the RBI, and SIDBI. Joint secretaries from the Ministry of Finance and the Ministry of Rural Development will also be its members.
- The Bill ensures that the interests of the clients are protected. The RBI may pass an order directing a microfinance institution to cease and desist from carrying out microfinancing if it is found acting in manner prejudicial to the interest of its clients or depositors.
- The Reserve Bank will cancel the certificate of registration granted to a microfinance institution if it fails to comply with the directives or condition.

2. Initiatives by RBI:

Reserve Bank of India has been taking steps to promote responsible lending since 2003. After the microfinance crisis of 2010, the efforts of RBI have intensified. Some of the steps that the RBI has taken towards inculcating the practice of responsible finance are:

- ***Fair practice code for lenders May 2003***

  These guidelines were formulated by the RBI for all scheduled commercial banks in India. The idea of this was to promote practices of fair lending among organisations. Some of the guidelines included in this code were:
    - Loan application handling;
    - Proper loan appraisal of clients;
    - Timely disbursement of loans;
    - Post-disbursement supervision;
    - Having a proper grievance redressal mechanism.

- ***Fair practice code for NBFC-MFI Feb 2013***

  These guidelines were application to all the NBFCs that were involved in the lending/borrowing business. A new category of NBFCs, namely NBFC-MFIs, was created in Dec 2011. This FPC also included guidelines for this new category. Some of the guidelines for NBFC MFIs were:
    - Display of loan card and FPC in vernacular language;
    - Disclosures in loan agreement and loan card;
    - Non-coercive methods of recovery;
    - Design a strong internal control system.

- ***NBFC MFI guidelines July 2013***

  These are revised guidelines for NBFC-MFIs.
    - Definition of the net owned funds required for NBFC-MFIs;
    - Highlights fair practices in lending such as transparency, track and avoid multiple lending, non-coercive methods of recovery, and corporate governance.

- ***Financial education efforts:***

  The Reserve Bank of India has undertaken a project titled "Project Financial Literacy". The objective of the project is to disseminate information regarding the central bank and general banking concepts to various target groups, including school and college-going children, women, rural and urban poor, defence personnel, and senior citizens.

  The project is designed to be implemented in two modules; one will familiarise the reader with the role and functions of the Reserve Bank of India, and the other module will familiarise the reader to banking concepts.

3. Formulation of Unified Code of Conduct by Sa-Dhan and MFIN:

A key development during 2012 was the unification and strengthening of codes of conduct between the Microfinance Institutions Networks (MFIN) and Sa-dhan. The new unified code includes input from Client Protection Principles (CPPs) of the SMART Campaign, Reserve Bank of India (RBI) Fair Practices Code for Non-Banking Financial Companies (NBFCs), and other RBI guidelines for MFIs. The code emphasises MFI staff training, good governance, borrowers being informed of the code, and the regulations concerning field officer duties when dealing with the borrower. Banks now require MFI compliance with this new code as a condition of lending to the MFI, therefore even MFIs who are not members of associations are proactively complying with the code.

4. Initiatives by SIDBI:

As part of responsible finance initiatives, SIDBI had started lenders' forums comprising key MFI lenders with a view to promote cooperation among MFI lenders to leverage support to MFIs across the sector to promote more responsible lending practices.

SIDBI has developed a Code of Conduct Assessment (COCA) Tool, which applies to providing credit services, recovery of credit, collection of thrift etc. by MFIs to assess their degree of adherence to the voluntary Microfinance Code of Conduct adopted by the MFIs. SIDBI consider COCA scores while sanctioning loans to microfinance institutions. SIDBI started assessing them and linking the COCA score with loan eligibility sometime after the introduction of the code of conduct.

SIDBI has established a longitudinal assessment system on COCA, which will help to understand the progress of MFIs on responsible finance. Until now SIDBI has done COCA of 60 MFIs and is going to conduct a second round of COCA assessment soon. SIDBI wants to make a sectoral map based on COCA reports.

Apart from this SIDBI has also partnered with ACCION and supported SMART Campaign to promote responsible finance in the Indian microfinance sector. As a government institution, SIDBI has also been coordinating body between RBI, other banks, and microfinance institutions to ensure that RBI views on responsible finance practices are taken into consideration. SIDBI has undertaken sectoral-level studies to understand the status of the MFI sector.

SIDBI has also encouraged all partner MFIs to become part of the credit bureau. It has helped MFIs to identify borrowers with multiple loans and protect them from over-indebtedness by refusing them further loans if they have already taken loans from two MFIs.

SIDBI created the Indian Microfinance Platform on Mix Market to ensure MFI data is available on a public platform.

Post the union budget 2011-2012, SIDBI set up the India Microfinance Equity Fund of Rs.100 crore, which has since increased by Rs.300 crore. This fund was set up with the primary function of providing equity and quasi-equity to smaller MFIs to help them maintain growth as well as achieving scale and efficiency in their operations. SIDBI provided equity investment to small MFIs in the aftermath of the AP crisis.

5. Fair Practice Code for Lenders 2003

On the basis of the recommendations of the Working Group on Lenders' Liability

Laws constituted by the Government of India, the Fair Practices Code for Lenders was introduced by the RBI. Many of the guidelines ensure that the practices of responsible lending are followed and that the clients are protected. Some of the important guidelines included are:

Applications for loans and their processing

(a) Loan application forms in respect of priority sector advances up to Rs.200 lakhs should be comprehensive. They should include information about the fees/charges, if any, payable for processing, the amount of such fees refundable in the case of non-acceptance of application, pre-payment options, and any other matter that affects the interest of the borrower, so that a meaningful comparison with other banks can be made and an informed decision can be taken by the borrower.

(b) Banks and financial institutions should devise a system of giving acknowledgement for receipt of all loan applications. The time frame within which loan applications of up to Rs.2 lakhs will be disposed of should also be indicated in acknowledgement of such applications.

(c) Banks and financial institutions should verify the loan applications within a reasonable period of time. If additional details or documents are required, they should let the borrowers know immediately.

(d) In the case of small borrowers seeking loans up to Rs.2 lakhs, the lenders should convey in writing, the main reason/reasons which, in the opinion of the bank after due consideration, have led to rejection of the loan applications within stipulated time.

(ii) Loan appraisal and terms/conditions

a. Lenders should ensure that there is proper assessment of credit application by borrowers. They should not use margin and security stipulation as a substitute for due diligence on the credit worthiness of the borrower.
b. The lender should convey to the borrower the credit limit along with the terms and conditions thereof and keep the borrower's acceptance of these terms and conditions, given with his full knowledge, on record.
c. Terms and conditions and other caveats governing credit facilities given by banks or financial institutions arrived at after negotiation by the lending institution and the borrower should be recorded in writing and duly certified by the authorised official. A copy of the loan agreement along with a copy each of all enclosures quoted in the loan agreement should be furnished to the borrower.
d. As far as possible, the loan agreement should clearly stipulate credit facilities that are solely at the discretion of lenders. These may include

approval or disallowance of facilities, such as drawings beyond the sanctioned limits, honouring cheques issued for the purpose other than specifically agreed to in the credit sanction, and disallowing drawing on a borrowal account on its classification as a non-performing asset or on account of non-compliance with the terms of sanction. It may also be specifically stated that the lender does not have an obligation to meet further requirements of the borrowers on account of growth in business etc. without proper review of credit limits.

e. In the case of lending under consortium arrangement, the participating lenders should evolve procedures to complete appraisal of proposals in the time-bound manner to the extent feasible, and communicate their decisions on financing or otherwise within a reasonable time.

(iii) <u>Disbursement of loans including changes in terms and conditions</u>

Lenders should ensure timely disbursement of loans sanctioned in conformity with the terms and conditions governing such sanction. Lenders should give notice of any change in the terms and conditions including interest rates, service charges etc. Lenders should also ensure that changes in interest rates and charges are effected only prospectively.

(iv) <u>Post-disbursement supervision</u>

a. Post-disbursement supervision by lenders, particularly in respect of loans up to Rs.2 lakhs, should be constructive with a view to taking care of any "lender-related" genuine difficulty that the borrower may face.
b. Before taking a decision to recall/accelerate payment, performance under the agreement, or seeking additional securities, lenders should give notice to borrowers, as specified in the loan agreement or a reasonable period, if no such condition exits in the loan agreement.
c. Lenders should release all securities on receiving payment of loan or realisation of loan, subject to any legitimate right or lien for any other claim lenders may have against borrowers. If such right of set off is to be exercised, borrowers shall be given notice about the same with full particulars about the remaining claims and the documents under which lenders are entitled to retain the securities until the relevant claim is settled or paid.

6. Fair Practice Code for NBFC MFI Feb 2013:

In addition to the above-mentioned guidelines, RBI included a few more guidelines for the NBFCs and more specifically to NBFC-MFI category. The idea was to protect further the interests of the consumers and clients. Some of the additional guidelines introduced by RBI were:

a. In the matter of recovery of loans, the NBFCs should not resort to undue harassment viz. persistently bothering the borrowers at odd hours, use of muscle power for recovery of loans etc. As complaints from customers also include rude behaviour from the staff of the companies, NBFCs shall ensure that staff members are adequately trained to deal with the customers in an appropriate manner.

b. The board of directors of NBFCs should also lay down the appropriate grievance redressal mechanism within the organization to resolve disputes arising in this regard. Such a mechanism should ensure that all disputes arising out of the decisions of lending institutions' functionaries are heard and disposed of at least at the next higher level. The board of directors should also provide for periodical review of the compliance of the Fair Practices Code and the functioning of the grievances redressal mechanism at various levels of management. A consolidated report of such reviews may be submitted to the board at regular intervals, as may be prescribed by it.

c. At the operational level, all NBFCs have to display the names and contact details of the grievance redressal officer prominently, for the benefit of their customers, at their branches or places where business is transacted.

d. The board of each NBFC shall adopt an interest rate model taking into account relevant factors such as cost of funds, margin, and risk premium, etc. and determine the rate of interest to be charged for loans and advances. The rate of interest and the approach for gradations of risk and rationale for charging different rate of interest to different categories of borrowers shall be disclosed to the borrower or customer in the application form and communicated explicitly in the sanction letter.

e. The effective rate of interest charged and the grievance redressal system set up by the NBFC-MFI should be prominently displayed in all its offices and in the literature issued by it (in vernacular language) and on its website.

f. A declaration that the MFI will be accountable for preventing inappropriate staff behaviour and timely grievance redressal shall be made in the loan agreement and also in the FPC displayed in its office and/or branch premises.

g. Loan agreements with all the details such as loan amount, interest rate, processing charge, insurance premium, and assurance of data privacy of the client.

h. Non-coercive methods of recovery: NBFC-MFIs shall ensure that a board-approved policy is in place with regard to code of conduct by field staff and systems for their recruitment, training, and supervision. The code should lay down minimum qualifications necessary for field staff and will have necessary training tools identified for them to deal with the customers.

7. NBFC-MFI guidelines July 2013

The guidelines for a separate category of MFIs came out in December 2011. These were revised by the RBI in August 2012 and again in July 2013, and mainly define the following in a detailed way:

a. The regulatory capital requirements for MFIs in order to register as a NBFC-MFI.

b. The capital adequacy norms for NBFC-MFIs.
c. Provisioning norms for NBFC-MFIs.
d. On the pricing of credit and the stipulated margin cap.
e. Fair practices which have to be followed in lending:
    - Maintain transparency in interest rates;
    - Multiple lending, over borrowing and ghost borrowers;
    - Non-coercive methods of recovery.
f. Corporate governance.

Annexure 8: Responsible Finance Practices of ten MFIs Visited

The responsible finance practices of 10 MFIs that were visited as a part of the primary research are documented here. The 10 MFIs covered for this purpose are:

North	East and North East	South	West
Cashpor	Arohan	Ujjivan	Annapurna Coop
Margdarshak	RGVN	SKS	Suryoday
SVCL	Chanura		

North

1. Cashpor Micro Credit

Cashpor Micro Credit (Cashpor) is a not-for-profit microfinance company with operations in eastern Uttar Pradesh and Bihar. As on 31 March 2013, Cashpor has an outstanding loan portfolio of over Rs.4,680 million with over 548,000 borrowers. It has operational presence in 15 districts of Eastern UP and six districts of Bihar. Cashpor has taken many steps to maintain balanced growth.

Responsible finance initiatives undertaken by Cashpor over a period of time are as follows:

- Pass the benefits of high profits to clients in the form of reduction in interest rates and processing fees. In January 2014, reduced processing fees to 0.5% and interest rate to 21.7% annual declining.
- Conduct client satisfaction surveys annually and based on the feedback received modify/develop product and processes.
- Established client grievance redressal desk at Head Office for resolving client grievances.
- Established staff grievances redressal cell. Staff can lodge complaint either by email or by toll-free number to grievance cell if not resolved by immediate supervisor.
- Apart from JLG loans, it offers other credit and savings products to meet various other client needs like community development loans, Cashpor

  Suraksha loans, WatSan loans, energy loans, savings account of ICICI, and pension. The interest rate charged on these loans is low compared to JLG loans.
- Use PPI and Cashpor Housing Index tools to target clients. Cashpor works with the poorest people, ensuring that at least 90% of new clients are below poverty line. PPI data is collected for new clients and analysis is done annually to understand the impact on the standard of living of Cashpor clients.
- Share data with credit bureaux and get the data of clients verified from credit bureaux before disbursing loans to new clients

2. **Margdarshak Financial Services Ltd**

Margdarshak Financial Services Limited provides microloans to their clients for income-generation purpose. The institution follows the SHG and JLG methodology for lending to artisans, MSMEs, and entrepreneurs both in rural and urban areas. MFSL is operating in 21 districts of Uttar Pradesh, which is the largest state of India, and one district of Bihar. As of March 31, 2013, MFSL microfinance was Rs.252.08 million with the number of active borrowers being 31,848. The company looks to reach around 175,000 members by March 2017, with a portfolio outstanding of around INR 2579 million.

Responsible finance initiatives undertaken by Margdarshak are as follows:

- PPI data collection to identify the poor clients in its operational areas.
- Code of conduct developed and adopted. Has undergone code of conduct assessments by external agencies. It complies with the RBI's fair-practice code and the fair-practice codes are displayed in all the branches.
- Endorses the client-protection principles of SMART Campaign.
- Apart from credit products, introduced remittance and pension products for clients.
- In order to protect clients from frauds, Margdarshak has introduced tele-audit pre disbursement and post-loan disbursement.
- Under responsible finance, Margdarshak has taken a new initiative of defining SPM objectives quantitatively. Two SPM objectives that have been decided are:
    - To provide NPS and remittance services to 75% of members by December 31 2016 (75% of branches have rolled out NPS. It is a voluntary product);
    - To reduce vulnerability of clients by assisting 10% of the members to rise above the poverty line. PPI data will be used for measuring the impact or change in standard of living of Margdarshak's clients. PPI data is captured at every loan cycle and is part of the loan application form.

3. **SV Creditline (P) Ltd.**

SVCL operates across four states of the country: Uttar Pradesh, Madhya Pradesh, Rajasthan, and Bihar. It has 189,901 clients with principal loan outstandings of Rs.213 crores. It is an NBFC-MFI with operations since 2010.

Responsible finance initiatives taken by SVCL are as follows:

- SVCL had plans to work with people of Bottom of the Pyramid and therefore adopted the PPI tool of Grameen Foundation since the start of the operations. All the clients are assessed on this tool.
- SVCL was amongst the first MFIs in India to start sharing the data with credit bureaux as MIS of SVCL was online, therefore sharing of data was not difficult. For two years SVCL has been submitting client data to credit bureaux.

- Implemented customer grievance redressal mechanism.
- Adheres to the code of conduct and got the COCA done.
- Strong internal audit team. It verifies 100% documents of clients. SVCL plans to roll out social audit apart from the regular business audit.

East and North East

4. Arohan

Arohan Financial Services Private Limited (Arohan) started its operations in 2006 with a vision to provide financial services to low-income clients in Eastern India. It has operational presence in West Bengal, Bihar, and Assam.

Responsible finance initiatives implemented by Arohan are:

- Toll-free helpline number for client feedback and grievances is in place since inception of the organisation in 2006.
- Laid down policies on staff conduct in operational manual since inception. Keeps on revising it on a continuous basis.
- Arohan customised its code of conduct in 2009 as per the industry code of conduct and it is displayed in branch offices in English and local languages. It has also been included in operations manuals and client materials.
- It has taken rigorous approach to social-performance management. As a member of Sa-Dhan and MFIN, it consciously works to monitor the way in which its overall operations are affecting its clients in the long run.
- In 2010 Arohan put caps on staff incentives to ensure that staff members do not overdo it in terms of cohesion for repayments. Incentives are also linked to values laid down by the branch. Pushing of other optional products like insurance and micro-pension plans to clients are discouraged; it has to be voluntary. For new clients staff cannot push micro-insurance or pensions for the first 3 months, and for old clients it cannot be sold on the day of disbursement.
- In 2011-2012, Arohan got registered and started sharing data with two credit information bureaux (Equifax and High Mark). It is 100% credit bureau compliant and goes a little beyond with process-oriented household visits.
- It shares pricing data with MIX Market for pricing transparency.

5. RGVN (NE) MFL

RGVN Microfinance started as a socially accountable and responsible microfinance organisation right from the beginning in 1995, when its main initiative was a credit and savings programme for the poor. Then it focussed on the SHG model and both savings and credit needs of the poor were taken care of. Over time as the regulations changed and there were huge changes in microfinance itself, RGVN went on to register a new NBFC (2009-10) with RBI directly. It had an outstanding loan portfolio of Rs.1,171 million with over 155,000 active loan clients at the end of March 2013 and has an operational presence in Assam, Meghalaya, Arunachal Pradesh, and Sikkim.

Even after being a fully fledged commercial entity, RGVN has continued to emphasize its social responsibility; it has at its core the credit plus approach. The highlights of the credit plus approach are as follows:

- It offers training programmes to clients to build their capacity for community development and awareness on various issues like health, sanitation, financial literacy, empowerment of women, environmental risk management, and sustainable livelihood generation.
- To inculcate awareness and basic knowledge about better living, a series of programmes on relevant subjects like environmental issues, leadership roles for women and girls, health and nutrition, education of children and youths, and legal issues of women are incorporated in the core operational process.
- Detailed code of conduct and Fair Practices Code has been displayed and made available on website. The board reviews the compliance of the fair practices.
- Code and the functioning of the grievance redressal mechanism at various levels of management once a quarter.
- Gyan Aroon Trust set up during 2011-12 to take care independently of the SPM and other credit plus activities. A sum of Rs.40 lakh was made available to the trust during 2012-13 for these purposes (which is almost 20% of the profit that year).
- In 2012-13 collaborated with Healing Field Foundation for promoting Community Health Facilitators.

6. Chanura Microfin

Chanura Microfin Manipur (CMM) came into existence in April 2007 with a clear motto “Better economy for a better nation”. The organisation is promoted by Mr P K Khuman, who has been working in the development sector in Manipur with different NGOs for 12 years. Since inception in 2007, Chanura has been offering various services including microfinance, introducing of solar energy, financial literary programme, natural calamities aids, and education support for the betterment of the mass people. At present, the organisation is rendering services to more than 500 villages, rural and urban areas of Manipur.

Some of the other responsible finance initiatives that Chanura has implemented are as follows:

- Complete transparency in pricing and information about the products. A new loan card fulfilling all RBI requirements was put in place with feedback from the board and CEO.

- Adopted the fair-practice code of RBI and trained staff in the code of conduct.

- Participatory monitoring by the board is put in place and every month board members visit clients and take feedback. There is an SPM committee at the board level to monitor SPM implementation.

- Complaint and suggestion boxes are provided in all the branches.

- Field officers are required to discuss some prefixed topics during repayment collection. These pre-fixed topics include progress of the clients, challenges, and discussion about the business of the clients.

- Annual Women Meet is organised by Chanura. The Chanura of the Year Award is given to someone who has made an impact on family and children's education.

South

7. SKS

SKS was started in 1997 and since then transformed into an NBFC in 2005; it has 1,261 branches spread over 19 states. SKS had an outstanding loan portfolio of Rs.2,359 crore as of 31 March 2013.

Some of the responsible finance practices are as follows:

- SKS revised its code of conduct along with relevant policies in line with the RBI's amended Fair Practices Code for NBFCs. The contact details of its grievance redressal officer and the local office of the RBI have been displayed at its branches.
- Code of conduct has been approved by the board and implemented by the organisation. It is a culmination of the industry's COC and RBI regulations. The code of conduct has also been printed in the passbooks of clients and customers are made aware of code of conduct during the compulsory group trainings.
- SKS is a member of both the Credit Information Bureaus and has been regularly submitting information to them and utilising their reports in lending decisions.
- All the loan terms, conditions, and interest rates are mentioned in vernacular language.
- SKS has one of the most well-established call centres in the microfinance sector in India, which acts as the service quality department. 10,000 calls are recorded on an average per month. A ticket number is generated and there is a well-defined process to handle grievances or queries. There is a different number for the Ombudsman and complaints should be resolved within two days.
- Training on code of conduct, over borrowing, and client protection principles is provided both to staff and clients. Training is provided

through pictorial and graphical modules.

8. Ujjivan

Ujjivan Financial Services Private Limited was launched in 2005. As on March 31 2014, it has operations in 48 districts in 22 states with a client base of 1,386,056. With over Rs.16,712 million outstanding, it is one of the largest MFIs in India.

Ujjivan provides a range of loan products to meet its clients needs and offers non-financial services in collaboration with its sister concern, the Parinaam Foundation. It has recently started offering micro-pensions.

Responsible finance practices adopted by Ujjivan are:

- Since the beginning of the industry crisis in October 2010, Ujjivan has undertaken a number of measures to improve efficiency of operations and reduce costs. With a nationwide presence (Ujjivan is the only MFI operating in 20 states) in more than 300 branches, it is able to take advantage of economies of scale and this has resulted in higher levels of profitability for the organization. In accordance with the new directions from the Reserve Bank of India, benefits are being shared with customers in the form of reduced interest rates. Effective December 15th 2012, Ujjivan's interest rates were reduced from 26% to 25% for all new group loans. For repeat loans to existing customers, including individual loans to finance cattle purchases, rates have been dropped from 26% to 24%. Repeat loans constitute a majority of Ujjivan's loan portfolio.
- The Diksha Programme, developed and executed by the Parinaam Foundation, Ujjivan's NGO partner, already provides financial literacy education gratis to 64,500 enrolled Ujjivan customers. Both the Citi Foundation and the Michael & Susan Dell Foundation are funders of Diksha.
- Ujjivan pioneered the concept of a comprehensive service quality programme, which is driven with an intention to improve customer retention rates. In the year 2012-13, Ujjivan adopted several initiatives such as implementation of revised and comprehensive fair practices codes and code of conduct, reinforcing customer grievance redressal procedures and sensitizing staff and customers about them, thereby promoting better customer and community connect by the staff as well as higher customer retention.
- Ujjivan has launched the Customer Connect Programme to bring all employees closer to the vision and social mission of the organisation and encourage better connect with its customers. Under this programme each employee of Ujjivan, whether frontline worker or back-end support, has to mandatorily attend at least a minimum number of centre meetings and interact with customers to seek their feedback on products, process, and services. The observations and customer feedbacks are captured on centre meeting checklists and uploaded on Ujjivan's social web platform

- Uconnect. This programme helps supervisors and leadership teams to understand customer needs better, to help formulate appropriate products and processes, and proactively identify service defects and customer grievances.

West

9. Annapurna Mahila Credit Co-op Society

- Annapurna Pariwar, is a group of five sister NGOs working in Mumbai since 1975 and in Pune since 1993. Annapurna Pariwar has diversified and expanded since 1993, still working with poor self-employed women (90%) and men (10%) in the urban slums in Mumbai, Pune, and rural Maharashtra through a comprehensive package of various services from the five different organisations. Annapurna Mahila Multi State Coop Credit Society handles the microfinance programmes of the Pariwar. Being a cooperative credit society, it offers a range of financial services to its clients including:

- Microcredit, and micro savings. Annapurna Pariwar Vikas Samvardhan offers insurance and risk products such as micro-health insurance, micro-life insurance, micro-asset insurance, and micro-pension. Non-financial services are offered by its other sister concerns and include day-care centres for children as well as special support programmes for single, destitute women and their children.

- Annapurna has an active board with members who have experience in microfinance, banking and law. It offers a wide range of products and services given its legal status and clients are very satisfied with this. Annapurna uses client feedback to design its products and services. Clients are given compulsory training on product terms and conditions before every loan. Despite being a credit cooperative society, Annapurna adheres to the code of conduct and went through a code of conduct assessment in early 2014.

10. Suryoday

- Suryoday Micro Finance Pvt Ltd is a registered NBFC, engaged in providing loans to women from economically weaker sections below the poverty line and to the marginal poor who do not have access to traditional banking, with an objective to reduce poverty in its area of operation. Suryoday has a cumulative disbursement of Rs.785 crores, a gross loan portfolio of Rs.327 crores, and 2.74 lakh active customers. It has 70 branches in Maharashtra, Odisha, Gujarat, Tamil Nadu, Karnataka, and Rajasthan.

- Suryoday adopted the fair-practice code and adheres to the industry code of conduct. It has set up a client grievance redressal mechanism and communicates about such mechanisms in all its client interactions.

- The organisation has adopted several social initiatives mainly to contribute towards the financial inclusion agenda. First, it provides client education and awareness programmes on the inculcation of savings habits and supports clients to open savings accounts in formal channels such as banks and post offices. Apart from microfinance activities, Suryoday also provides means to enhance the economic sustainability of its customers and the community at large. It offers various livelihood or income-generation trainings to its customers.

Annexure 9: Financial and Non – Financial Services in ten MFIs

Sl.No	Name of the MFI	Financial Services Offered	Non-financial Services Offered
1	Arohan	Loans, pensions, life insurance	-
2	Annapurna	Loans, savings, health mutual, pensions, life insurance	Financial literacy, crèches, livelihoods, hostels for working women, mahila mandals, education scholarships, special support programmes for single and destitute women.
3	Cashpor	Loans, savings, energy, water and sanitation loans	Financial literacy, health camps, health education.
4	Chanura	Loans	Solar energy devices, livelihood And employment training, aid during Natural calamities, Education support for The marginalised.
5	Margdarshak	Loans, remittances, Pensions	
6	RGVN	Loans, savings (only for its SHG model).	Community development, financial literacy, health and sanitation, support for livelihood activities.
7	SKS	Loans	Financial literacy .
8	Suryoday	Loans	Financial literacy, livelihood training, kitchen gardening, helping clients with opening of bank accounts, and health-awareness programmes.
9	SVCL	Loans	
10	Ujjivan	Loans	Financial literacy .

Annexure 10 – Unified Code of Conduct and Universal Standards of Social Performance Management and Expected Board's roles and responsibility

As per the unified code of conduct, the following are mentioned as the board's role in implementing code of conduct:

MFIs must incorporate a formal governance system that is transparent and professional, and adopts the following best practices of corporate governance:

1. MFIs must observe high standards of governance by inducting persons with good and sound reputation as members of board of directors/governing body.
2. MFIs must endeavour to induct independent persons to constitute at least one-third of the governing board, and the board must be actively involved in all policy formulations and other important decisions.
3. MFIs must have a board-approved debt restructuring product/programme for providing relief to borrowers facing repayment stress.
4. MFIs will appoint an audit committee of the board with an independent director as chairperson.
5. MFIs must ensure transparency in the maintenance of books of accounts and reporting/presentation and disclosure of financial statements by qualified auditors.
6. MFIs must put in best efforts to follow the Audit and Assurance Standards issued by the Institute of Chartered Accountants of India (ICAI).
7. MFIs must place before the board of directors a compliance report indicating the extent of compliance with the Code of Conduct, specifically indicating any deviations and reasons therefore, at the end of every financial year.

The Universal Standards of Social Performance Management[19] has further described the Board's role as:

- The institution provides board members with an orientation on the social mission and goals and the board's responsibilities related to the social performance management of the institution.
- The board reviews social performance data including mission compliance, performance results, human resource policy, social performance related risks, client-protection practices, growth, and profit allocation.
- The board uses social performance data to provide strategic direction, taking into account both social and financial goals.
- The board incorporates social performance management

[19] The Universal Standards for Social Performance Management ("Universal Standards") is a comprehensive manual of best practices created by and for people in microfinance as a resource to help financial institutions achieve their social goals. For more details, please refer to www.sptf.info.

criteria into its performance evaluation of the CEO/Managing Director.

- The board has a documented strategy to prevent institutional mission drift during changes in ownership structure and/or legal form.
- Senior management and the board are aware of and concerned about the risk of over-indebtedness.
- The board approves the institutional policy on sustainable target growth rates for all branches/regions and all product types, considering the institution's growth capacity and the markets being targeted.
- Equity investors, lenders, board, and management are aligned on the institution's double bottom line and implement an appropriate financial structure in its mix of sources, terms, and desired returns.
- The board monitors whether the institution's pricing levels are consistent with the institution's policies on returns.
- The board ensures that compensation of the CEO and other senior staff is in line with the institution's social goals.