

RESPONSIBLE FINANCE PRACTICES IN MICROFINANCE INSTITUTIONS

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ABSTRACT

It is understood that full potential of financial inclusion can be reaped only with integrating responsible lens in financial sector whereas responsibility can be broadly defined as matching clients' needs and preferences. One of the critical dimensions of financial sector responsibility is fair treatment of clients and acting in ways that protect clients' social and economic welfare. In addition, it can correct the imbalances in incentives for financial institutions, investors, and clients to increase lending volumes, especially on low-income segments.

Policy makers, practitioners, donors and investors have started paying greater attention to the issue of responsible finance because of the recent failures of regulatory regimes to fully address the imbalances in financial markets and concerns of rising indebtedness in various countries.

The Indian Microfinance Sector has witnessed a phenomenal growth over the past few years. Micro Finance Institutions (MFIs) act as an important channel for extending financial services to the microfinance sector in the country by raising resources from Banks and other institutions and extending loans to individuals or members of SHGs. The concept of responsible finance and keeping clients at the core of operations is natural to MFIs, given that microfinance emerged from the failure of the formal sector to be client-centric. Except the new-generation institutions, most MFIs have transformed from a development sector background. The aim of this paper is to study the existing scenario of microfinance institutions in India and it also highlights the initiatives taken by microfinance institutions for responsible finance practices.

Key words: Responsible finance, Microfinance, MFIs, MFIN, financial regulations.

JEL Code: G21, G28

INTRODUCTION

Consumer protection and financial literacy are the main responsibilities of the financial regulators. Financial system of any country is more responsible and equitable in allocating resources among all counterparts for creating economic balances. The World Bank Global Program on Consumer Protection and Financial Literacy was launched in November 2010 with the objective of helping countries achieve concrete measurable improvements in consumer protection in financial services. As per CGAP's survey, 'Financial Access 2010', many developed and emerging economies are actively strengthening their financial consumer protection regulatory regimes, more than 80 percent of economies (118) responding to the survey have laws

and regulations addressing at least some aspects of financial consumer protection and most of these laws were passed in the last two decades.

Financial literacy and consumer protection programmes bring together public and private sector institutions, financial regulatory and supervisory agencies, industry associations and consumer organizations to find the best solutions for each country.

It has been realized that full potential of financial inclusion can be reaped only with integrating responsible lens in financial sector whereas responsibility can be broadly defined as matching clients' needs and preferences. One of the critical dimensions of financial sector responsibility is fair treatment of clients and acting in ways that protect clients' social and economic welfare. In addition, it can correct the imbalances in incentives for financial institutions, investors, and clients to increase lending volumes, especially on low-income segments.

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RESPONSIBLE FINANCE FRAMEWORK

Responsible finance has proved to be an important issue for the financial sector, especially during the last few years. It has been emphasized by governments, global financial regulatory bodies, NGOs, and the private sector worldwide for transparent, inclusive, sustainable, and equitable financial practices. Responsible finance can be understood as a guiding principle for delivering financial services to live up to the challenge of promoting sustainable development. So, it work must incorporate social, developmental, and environmental dimensions with support from governments, investors, consumer organizations, educators, and other stakeholders.

Responsible finance refers to coordinated public and private sector interventions that assist financial services providers and their clients in improving their understanding and approaches, practices, and behaviours for creating more transparent, inclusive, and equitable financial markets.

The financial inclusion sector is seeing paradigm changes. New institutions, new programs, banks downscaling, technology, and favorable ecosystem in terms of digital initiatives, electronic KYC, and almost universal coverage of Aadhaar have strengthened the belief that inclusion of all is a distinct possibility in near future. It needs to be ensured that the new players and initiatives remain committed to responsible finance.

India's financial inclusion landscape has never looked more promising as in current times. Last few years have ushered in paradigm changes. The policy has shifted from being bank-led to channel-neutral, and new initiatives in the form of Pradhan Mantri Jan Dhan Yojana (PMJDY), small finance banks (SFBs), payment banks (PBs), Micro Units Development & Refinance Agency Ltd (MUDRA), and banking correspondents (BCs) have been added to the existing canvas of commercial banks, regional rural banks (RRBs), cooperative banks, and microfinance (MFIs and SHG-Bank Linkage Programme [SBLP]).

NABARD's experiment in SHG-BLP established the credibility of groups as a bankable proposition and rural people capable of financial discipline. It created a new set of clientele with untapped appetite leading to several NGOs acting as financial intermediaries for on-lending to groups buoyed by the success of SHG-BLP.

Till the 90's large section of the rural population was unbanked and austere overlooked by the mainstream banking institutions. Most of them had to take recourse to informal sources for credit because as compared to formal sources, the informal sources have highly flexible terms and it is easy to obtain loans for consumption needs and also for marriage and other purposes. With least documentation and accessibility as well as availability at any time, the village money lenders are the last resort to many ruralites whose needs are emergent and they don't hesitate to agree to pay exorbitant interest rates during the hour of crisis without realising the deleterious consequences. A new breed of micro lenders was born, the Micro Finance

Institutions (MFIs). Micro Finance Institutions (MFIs) act as an important channel for extending financial services to the microfinance sector in the country by raising resources from Banks and other institutions and extending loans to individuals or members of SHGs. The Indian Microfinance Sector has witnessed a phenomenal growth over the past few years. The number of Institutions providing microfinance services has gone up from a few to several hundreds. The quantum of credit made available to the poor and financially excluded clients has gone past Rs 60,000 crore and number of clients benefitted is close to 40 million as of March 2017.¹

MFIs AND RESPONSIBLE FINANCE PRACTICES

The concept of responsible finance and keeping clients at the core of operations is natural to MFIs, given that microfinance emerged from the failure of the formal sector to be client-centric. Except the new-generation institutions, most MFIs have transformed from a development sector background. The service delivery of MFIs is rooted in creating a positive impact in the lives of their clients who have been bypassed by the financial sector.

Technology, in the form of connectivity or cloud-based big data analytics, is going to be a game changer. This combination of finance and technology termed as FINTECH or Digital Financial services, needs to adopt global best practices in responsible finance from the start. Along with these new trends, significant progress has been made by both MFIs and SBLP, by bringing nearly 100 million clients to the fold of financial inclusion. NABARD attempted digitisation of SHGs under a project called EShakti to take advantage of the available technology to address the problem of book keeping, capturing the credit history of SHG members, generating SHG grading report based on its financial and nonfinancial records and making them available to all important stakeholders.

The stakeholders especially bankers can now take informed decisions for extending credit linkages on the basis of reports generated through EShakti.

The growth in digital infrastructure globally has created a massive opportunity for microfinance to expand its outreach through new business models and alternative delivery channels. MFIs are starting to see the benefits of new digital technologies, which can raise efficiency, reduce costs, lower transaction costs for both institution and client, and expand outreach to new markets. At the same time, digital financial services and new technologies are complex and put demands on overall operations, as well as introduce new processes that clients need to learn. New business models and partnerships provide opportunities to leverage the experiences of established MFIs and digital financial service providers such as FinTechs, telcos and payment gateways.

The MFIs sector started changing in the decade of the 2000s, as the limited nature of donor funds and the desirability of moving the sector toward sustainable operations was realized early. The profitability of microfinance was demonstrated, operational model was by external assessments, leading to flow of funds from banks, and the constraint of equity mobilization was met through transformation of the larger and medium MFIs into NBFCs, enabling the MFIs to attract shareholder equity. The transformation gave a big fillip to microfinance in India, with the sector touching an outreach of 26.7 million clients by March 2010. The growth of NBFCs also brought about a separate industry association, 'Microfinance Institutions Network (MFIN)', in 2009.

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

¹ NABARD, Status of Micro Finance in India, 2016-17

proactively complying with the code. As per MFIN, as on 31.03.2017, the Microfinance industry has a total loan portfolio of Rs 106,916 crore.

The significant work undertaken by MFIN in areas of responsible finance can be seen across five pillars, namely

- (a) monitoring compliance with code of conduct,
- (b) grievance redressal of clients,
- (c) data collection and dissemination,
- (d) CB ecosystem monitoring, and
- (e) client education.

During 2016-17, despite the impact of demonetisation on credit disbursement and repayments, combined efforts and initiatives of NABARD, banks and Government agencies have given great boost to the SHG-BLP movement. There was a net addition of 6.73 lakh SHGs during the year increasing the number of SHGs having savings linkage to 85.76 lakh as on 31 March 2017. The savings outstanding of SHGs with banks as on 31 March 2017 has reached an all-time high of Rs 16114.22 crore. During the year, banks have disbursed loan of Rs 38781.16 crore, recording 4% increase over the last year despite the impact of demonetisation which slowed down loan disbursement post October 2017. The total bank loan outstanding to SHGs also increased by 7.81% and stood at Rs 61581.30 crore against Rs 57,119 crore as on 31 March 2016. The gross NPA of bank loans to SHGs marginally increased by about 5 basis points from 6.45% as on 31 March 2016 to 6.50% as on 31 March 2017. This was achieved in a year when there was overall deterioration in quality of assets and mounting NPAs in the banking sector.²

ASPECTS TO BE IMPROVED

Most MFIs and stakeholders mentioned that there have not been significant challenges in implementation of responsible finance practices. However, there are some aspects that require improvement³:

- i. 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.
- ii. Boards need to strengthen their efforts in guiding and monitoring responsible finance initiatives.
- iii. 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.
- iv. Excessive reporting requirements due to demand for similar sets of data in various formats by various stakeholders, especially lenders and investors.
- v. 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.
- vi. Make balancing between promotion of access to finance and consumer protection regulation.
- vii. The role of banks in taking responsible finance practices into consideration while sanctioning loans and in following the practices themselves.
- viii. The role of industry associations in creating awareness of the financial education is not yet adequate. It should be enhanced.
- ix. There is a need to build more evidence on the effectiveness of various interventions.

CONCLUSION

Traditional MFIs need to adapt to rapidly changing financial services ecosystem. Implementation of Responsible Finance practices was assessed in adherence to the code of conduct established by Industry

² NABARD, Status of Micro Finance in India, 2016-17

³ Microsave, Responsible Microfinance Practices by Microfinance Institutions in India, December 2014

associations, Boards' roles in implementing Responsible Finance 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. Some MFIs have implemented initiatives around health, community development initiatives and education. To enhance board capacity through training and RBI may re-look at some of the policies that cause bottlenecks for MFIs when working on products.

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