Microfinance India

Microfinance India
The Social Performance Report 2014

Girija Srinivasan

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ABBREVIATIONS

AABY	Aam Aadmi Bima Yojana
AICI	Agriculture Insurance Company of India
AKMI	Association of Karnataka Microfinance Institutions
AP	Andhra Pradesh
APR	Annual Percentage Rates
ASCAs	Accumulated Savings and Credit Association

ATM	Automated Teller Machine
BC	Business Correspondent
BF	Business Facilitator
BoD	Board of Directors
BPL	Below Poverty Line
BSBD	Basic Savings Bank Deposit
BSBDA	Basic Savings Bank Deposit Account
CAB	College of Agricultural banking
CAGR	Compound Annual Growth Rate
CB	Credit Bureau
CBS	Core Banking Solution
CCFS	Committee on Comprehensive Financial Services
CDF	Common Data Format
CDR	Corporate Debt Restructuring
CEO	Chief Executive Officer
CFRP	Client Friendly Repayment Practice
CGAP	Consultative Group to Assist the Poor
CIBIL	Credit Information Bureau (India) Limited
CMF	Centre for Microfinance
COC	Code of Conduct
COCA	Code of Conduct Assessment
COO	Chief Operating Officer
CPI	Consumer Price Index
CPP	Client Protection Principles
CRAR	Capital to Risk (weighted) Assets Ratio
CRISIL	Credit Rating Information Services of India Limited
CSC	Customer Service Centre
CSP	Customer Service Point
CSR	Corporate Social Responsibility
DBT	Direct Benefit Transfer
DCCB	District Central Cooperative Banks
DFI	Development Financial Institution
DFID	Department for International Development
DHAN Foundation	Development of Humane Action Foundation
DNBS	Department of Non-banking Supervision
EBT	Electronic Benefit Transfer
EC	Enforcement Committee

ED	Executive Director
ESAF	Evangelical Social Action Forum
FD	Fixed Deposit
FI	Financial Inclusion
FINDEX	Financial Inclusion Database
FIP	Financial Inclusion Plan
FIR	First Information Report
FLC	Financial Literacy Centre
FWWB	Friends of Women World Bank
FY	Financial Year/Fiscal Year
G2P	Government to Person
GCC	General Credit Card
GDP	Gross Domestic Product
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit
GLP	Gross Loan Portfolio
GoI	Government of India
GPRS	General Packet Radio Service
GTL	Group Term Life
HDFC	Housing Development Finance Corporation
HR	Human Resource
IAS	Indian Administrative Service
ICT	Information, Communication, and Technology
ID	Identity Document
IFAD	International Fund for Agriculture Development
IFC	International Finance Corporation
IFMR	Institute for Financial Management and Research
IFSC	Indian Financial System Code
IGA	Income Generating Activities
IIBF	Indian Institute of Banking and Finance
ILAL	Insuring Lives and Livelihoods Programme
ILO	International Labour Organization
IMEF	India Microfinance Equity Fund
IRDA	Insurance Regulatory and Development Authority
ISMW	Indian School of Microfinance for Women
IT	Information Technology
JBY	Janshree Bina Yojana
JDY	Jan-Dhan Yojana

JLG	Joint Liability Group
KCC	Kisan Credit Card
KGFS	Kshetriya Grameen Financial Services
KYC	Know Your Customer
L&T	Larsen and Toubro
LIC	Life Insurance Corporation (of India)
LWE	Left Wing Extremism
MAVIM	Mahila Arthik Vikas Mahamandal
MBT	Mutual Benefit Trust
M-CRIL	Micro Credit Rating International Ltd.
MENA	Middle East and North Africa
MF	Microfinance
MFI	Microfinance Institution
MFIN	Microfinance Institutions Network
MGNREGA	Mahatma Gandhi National Rural Employment Guarantee Act
MILK	Micro Insurance Learning and Knowledge Project
MIS	Management Information System
MIV	Microfinance Investment Vehicle
MIX	Microfinance Information Exchange
MNAIS	Modified National Agriculture Insurance Scheme
MoLE	Ministry of Labour and Employment
MP	Madhya Pradesh
MP	Member of Parliament
MPH	Master Policy Holder
NABARD	National Bank for Agriculture and Rural Development
NAIS	National Agriculture Insurance Scheme
NBFC	Non-banking Financial Company
NBFC ND	Non-banking Financial Company Non-Deposit
NCAER	National Council of Applied Economic Research
NE	North-east
NEDFi	North-eastern Development Finance Corporation Ltd
NEFT	National Electronic Fund Transfer
NER	North-east Region
NERFES	North-east Region Finservices Ltd
NGO	Non-government Organization
NOC	No Objection Certificate
NPA	Non-performing Assets

NPS	National Pension Scheme
NREGA	National Rural Employment Guarantee Act
NRLM	National Rural Livelihood Mission
OID	Over-indebtedness
PA	Personal Accident
PAR	Portfolio at Risk
PE	Private Equity
PFRDA	Pension Fund Regulatory and Development Authority
PIN	Personal Identification Number
PLF	Panchayat-level Federation
PoS	Point of Sale
PPI	Progress out of Poverty Index
PPP	Public–Private Partnership
Pradan	Professional Assistance for Development Action
PSB	Public Sector Bank
PSIG	Poorest State Inclusive Growth Programme
PSU	Public Sector Undertaking
PTSLP	Post-Tsunami Sustainable Livelihood Project
RBI	Reserve Bank of India
RD	Recurring Deposit
RFPI	Rural Financial Institutions Programme, India
RGVN	Rashtriya Gramin Vikas Nidhi
RPLI	Rural Postal Life Insurance
RRB	Regional Rural Bank
RSBY	Rashtriya Swasthya Bima Yojana
RSETI	Rural Self-employment Training Institute
SBI	State Bank of India
SEBI	Security Exchange Board of India
SERP	Society for Elimination of Rural Poverty
SEWA	Self Employed Women's Association
SHEPHERD	Self-help Promotion for Health and Rural Development
SHG	Self-help Group
SHPI	Self-help Promoting Institution
SIDBI	Small Industries Development Bank of India
SKDRDP	Shree Kshetra Dharmasthala Rural Development Project
SKS	Swayam Krishi Sangham Microfinance limited
SLBC	State-level Bankers' Committee

SPM	Social Performance Management
SPRF	Social Performance and Responsible Financing
SPTF	Social Performance Task Force
SRO	Self-regulatory Organization
TA	Technical Assistance
TNCMCHS	Tamil Nadu Chief Minister's Comprehensive Health Scheme
UID	Unique identification Document
UIDAI	Unique Identification Authority of India
USB	Ultra Small Bank
USD	US dollar
USSPM	Universal Standard for Social Performance Management
UTs	Union Territories
WBCIS	Weather-based Crop Insurance Scheme
YOY	Year on Year

Foreword

On behalf of ACCESS and ASSIST, I am happy to present the fourth edition of the *Microfinance India Social Performance Report* (SPM report) to be released at the Inclusive Finance India Summit 2014. While it took some time, the microfinance sector, post the Andhra Pradesh Ordinance setback, has gradually recouped its dynamic progress, with flow of funds and higher legitimacy as an alternate channel for financial services delivery within RBI's specialized regulatory mechanism for NBFC-MFIs. Increasingly, MFIs are now consciously developing and embracing better processes and systems for client protection; and various sectoral initiatives such as the adoption of credit reporting and assessment of compliance to the industry code of conduct and client protection principles have supported the efforts of MFIs. Since the SHG bank linkage is community based, not much focus on how it is performing on SPM indicators is evident; but the bigger worry is that its compound annual growth rate (CAGR) over the last 3–4 years has been showing significant slump, along with an alarming rise in defaults.

While the sector was eagerly looking forward to the passage of the Microfinance Bill as a potential development that could further bolster its legitimacy, certain policy changes in favour of MFIs have kindled new promise for this channel. The most important of these includes the grant of commercial banking license to Bandhan Microfinance. RBI has also permitted NBFC-MFIs to work as Business Correspondents of banks and allowed one the MFI associations (MFIN) to set up the SRO function (a first in the financial services industry in India). The game changer for MFIs however could be their eligibility to transform into small banks, making them fully regulated entities offering the full gamut of banking services. These developments auger well for the MFIs and for their next level of evolution in becoming mainstream financial institutions.

The approach of the government however continues to be entirely bank led with the Jan-Dhan Yojana (JDY) envisaging speedy expansion of banking services to the unbanked, beginning with account opening, followed by delivery of other financial services including credit, insurance, and pension. The quality of services delivered to these clients under the mission mode will continue to be a challenge, and issues of client education and client protection will need attention at the policy level and bank level. The role of bank correspondents (BCs) within the JDY will be important in delivering outcomes and in integrating responsible finance in its implementation.

In keeping with the agreed format, the publication continues to report on some aspects such as deeper analysis of outreach, client protection, implications of policy and major initiatives of investors, every year. In addition, some significant themes are identified for deeper reporting. Based on the feedback received in two stakeholder consultations organized to collect reviews on SPM report of 2013 and to generate themes and ideas for the Report of 2014, governance emerged as the 'most-wanted' topic for deeper introspection. An important area agreed upon after much discussion and consideration was to review practices and highlight issues pertaining to responsible finance in financial inclusion through the BC model. Another new sub-theme that the report delves into this year is to review responsible practices and issues in insurance for the poor.

I would like to thank the passionate author, Girija Srinivasan, for continuing to support this initiative and anchoring it with consistent and high level of quality for four years. I would like to thank Sundar Arumugam and the team at

Equifax for providing granular data that enabled more detailed analysis of outreach. We are thankful to DFID and SIDBI for commissioning a study on governance in MFIs and to MicroSave for conducting the study and providing the findings to the author in time for inclusion in the SPM report. MIX's global social performance team as well as the India team continued to provide data and analysis for the report. We value the continued support from other technical partners—Smart Campaign and Social Performance Task Force (SPTF).

I would like to also thank all the MFIs that provided their data for the report, and the institutions—MFIs, banks, BCs, investors, technical agencies, and individuals that Girija visited and interviewed, for enriching the report with information and their experiences and perspectives. We have a new publisher this year; thanks to the team at OUP for their efficient coordination during the publishing process, and bringing the report out in really stiff timelines. I hope that with OUP's partnership, we are able to reach out to a much wider set of readers—within and outside India.

I must thank Prashant and Balaji at Standard Chartered Bank, for facilitating continued support to this document as the lead sponsor, and for providing inputs on its content and structure. Thanks also to IFC and SIDBI for being on board for all the four years that this report has been published; consistent support from these investors gives us the much needed stability and encouragement in operationalizing such an enormous task, and also adds to the credibility of the effort. I also appreciate Maanaveeya's interest and support in this endeavor.

I would like to appreciate the hard work of the new team at ASSIST—Sarthak, Shubhangi, and Anshu—for providing assistance with data collection, collation and analysis; Juhi for providing efficient support to the author in organising meetings; and Tushar for final organizing of the manuscript. Thanks to Lalitha for her excellent logistics management; and others in program support team at ACCESS. Vipin Sharma, as Managing Trustee of ASSIST, entrusts the team with the responsibility and instils faith and confidence in our ability to deliver; and continues to support the effort with ideas, guidance and at times, also trouble shooting.

The scope of the SPM report has, over the last four years, broadened from MFI model to including community-based models in 2012, discussing responsible finance in SHG bank linkage model in 2013 and the BC model and insurance this year. It is possibly time to evolve the global SPM framework developed by the SPTF to make it applicable and adaptable to other channels of financial inclusion. I suspect that with the changing landscape of the microfinance sector, the new policy developments, and the merging boundaries of various channels and models in financial inclusion, we may need to further broaden its scope next year beyond microfinance and even rechristen the report to make it relevant to the context and to the stakeholders. The endeavor of bringing out the India SPM report is to ensure that all initiatives and efforts in access to finance integrate the principles of social performance within all programmes, policies, and practices.

Radhika Agashe
Executive Director, ACCESS ASSIST

Preface

This is the fourth and last year of my involvement with this report. It has been a fascinating ride, having a ringside view of how the sector and its stakeholders coped with calls for customer-centric initiatives and ethical considerations in business while dealing with vulnerable customers. I thank Vipin Sharma and Radhika Agashe, Access Assist for this enriching experience.

The past year has seen a resurgence of microfinance institution (MFI) model of business, stagnation in outreach of self-help groups (SHGs), but with higher loan disbursements, a large national programme of financial inclusion and interesting policy and regulatory developments. A report of this type requires cooperation and sharing of information from several stakeholders. As in the past, there was willing cooperation and overwhelming support for the report. I have a lot of organizations and people to thank, for providing data, sparing time for discussions, sharing study findings and reports, pointing towards useful sources of information and actually helping with advance drafts relating to certain parts of the report.

I commenced the discussions with Kalpana Sankar and Jeyaseelan, Hand in Hand/Belstar who were generous with their insights and time. Hand in Hand arranged for discussions with key bankers in the state. Suresh Krishna, Grameen Financial Services, not only spent substantial time in sharing his experiences and thoughts on what further needs to be done but also ensured that I could meet with senior executives of banks. Executives of Institute for Financial Management and Research (IFMR) group—Bindu Anand, S.G. Anil, Anand Sahasranamam, and Bama Balakrishnan—shared the key developments in their groups and innovations that are needed to meet client needs. Satyajit Das, Annapurna Microfinance; Mukul Jaiswal, Cashpor; P.N. Vasudevan, Equitas; Paul Thomas, Evangelical Social Action Forum (ESAF); Samit Ghosh and his team, Ujjivan; Rangarajan, Janalakshmi, and M. Naryanan, Madura Microfinance; Rupali Kalita, Rashtriya Gramin Vikas Nidhi (RGVN); Ritesh Chatterjee, Swayam Krishi Sangham Microfinance Limited (SKS); and G.V.S. Reddy, Stree nidhi, spent a lot of time in sharing their experience and concerns despite their busy schedules. North-east MFIs—Nightingale, Asomi, Chanura, RGVN, NERFES, Arohan, Unacco, North-eastern Development Finance Corporation Ltd (NEDFi), and Grameen Sahara—participated in the round table and shared their experiences and anguish.

The deep insights of the industry leaders Brij Mohan, Y.C. Nanda, N. Srinivasan, Frances Sinha and Manoj Sharma have enriched the report. Bhavana Srivastava, MicroSave; Microfinance Information Exchange (MIX) market team; Hema Bansal, Smart Campaign; and Ananya Finance for Inclusive Growth provided substantial information for the report. Atul, M2i, shared the progress in Code of Conduct Assessment (COCA) and other assessments. Grameen Foundation shared their work on Progress out of Poverty Index (PPI) and human resources (HR). I am thankful to N. Srinivasan for his contribution on regulatory aspects as also inputs on Governance. Without the inputs of Karunakaran Krishnaswamy and Aniruddha Shanbhag, Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), the chapter on micro-insurance would not have shaped up.

Girish Bhaskaran Nair, Sakshi Varma and their team in IFC, Viswanath Prasad, Caspian, Ranjani and her team in Dia Vikas, Abhijit Ray, Unitus Capital brought in the perspectives of the investors and their work. My special thanks to

Ragini Chaudhary, Department for International Development (DFID), for not only sharing her insights on the sector but also in ensuring that inputs from the Governance study was made available in a timely manner for this report. Prakash Kumar, SIDBI and his team from PSIG, and Ramakrishna, Amit Arora, Jonna Bickel, GIZ, provided valuable inputs. Usha Gopinath shared the work of Accion in financial education.

Sundar Arumugam, Equifax shared rich data on microfinance and also his insights into how the sector is shaping up. I am thankful to Parijat Garg, High Mark; and Sridhar, Experian for sharing information and deep insights on credit bureau functioning.

MFIN shared the work that has been carried out by the industry association and also insights of the recent studies carried out. Association of Karnataka Microfinance Institutions (AKMI) helped in mobilizing responses from their members for the Assist Survey.

Chief General Managers (CGMs) of the National Bank of Agriculture and Rural Development (NABARD)—P. Satish, Head office, Jiji Memon, Andhra Pradesh, G.R. Chintala, Karnataka—were liberal with their time and resources for which I am thankful. Ramalakshmi, APMAS, Vikram Kapur, IAS, and his team in PTSLP, Sonali Vayagankar, IAS, and her team in Mahila Arthik Vikas Mahamandal (MAVIM), bring in the perspectives of Self-help Promoting Institutions (SHPIs) and large scale government programmes in SHG bank linkage. Manohar Singh, Tamil Nadu State Rural Livelihood Mission (TNSRLM), and the Kudumbashree team in Alappuzha district shared the progress being made under NRLM.

S.S. Barik, Regional Director, RBI, Gauhati, Thyagarajan, DGM, RBI shared the policy directives and role of RBI in financial inclusion. Several bankers shared their work and concerns in areas of financial inclusion, financing of SHGs and lending to MFIs. I am thankful to A.R. Samal, Rahul Rohatogi, SIDBI, Balachander, IOB, Manoharan, Indian bank, Suresh, Pallavan Grameena Bank, Balaji Iyer Standard Chartered bank, Bonam Srinivas IndusInd Bank, Kunal Desai, Ratnakar Bank, Sathiayamoorthy, State Bank of India, Hariharan, Yes bank, Praveen Kumar ADFT, Vimal Tripathi HDFC bank, Virupaksha, Canara Bank, officials of Vijaya Bank, Syndicate bank for sharing their experience. Abhinav Sinha EKO India and Streenidhi shared their insights on working as BC.

ASSIST provided all necessary support to make the report development a smooth affair. Radhika Agashe backstopped the report technically. Juhi Natu arranged for my meetings. Sarthak Luthra and Shubhangi helped in analysis. Lalitha Sridharan as usual has been her efficient self and enabled the logistics.

After four years of intensive work of authoring this report I am clearly finding tremendous change in the practice of microfinance. The AP crisis has proved to be the trigger that made institutions change the perception regarding the customers and their operational methods. But many of the changes relating to responsible finance and social performance were not entirely out of external pressure. Many MFIs have gone beyond the minimum expectations in several aspects where the regulator, investors and lenders had imposed their benchmarks. The one area that remains to be dealt with is that of products and their alignment to customer needs, including savings. In my reckoning the sector has achieved 90 per cent of customer protection, responsible finance and social performance objectives. The remaining 10 per cent is much more complex and will take extraordinary effort, time and accompanied with high costs. Some field occurrences show that responsible finance practice has become routine. The sector should spend as much resources in sustaining what has been achieved as in pursuing the seeming unattainable. Banks, self-help promoting institution (SHPIs) and insurance providers should also ensure that principles of customer protection are well imbibed in their work with vulnerable customers.

As I sign off from authoring this series of reports, I am happy to have witnessed radical changes in the external perceptions of the sector. Let me finally thank all those who helped me put the reports together and those who motivated me by using the report in their work.

Girija Srinivasan

1

Responsible Inclusive Finance

Silver Lining Has Clouds Too

The year has seen several positive developments in and for the sector. Microfinance institutions continued to grow at a steady pace with adequate funding support from banks and other financial institutions. Financial inclusion measures received further fillip with key policy changes by Reserve Bank of India (RBI); an important change being the permission to Non-banking Financial Company Non-Deposit (NBFC ND) institutions to act as Business Correspondents (BC) of banks. RBI sanctioned an 'in principle banking license' to Bandhan, the largest MFI. This gives hope for other well-functioning MFIs to graduate to small banks, which will enable them to offer full suite of products for the clients. Impact assessment studies using the rigorous randomized control methodology have found positive impact of microfinance on clients. However, a disappointment was that MF regulations bill was not passed by the Parliament before its tenure came to an end.

Reserve bank has been pursuing a bank-led model for financial inclusion with the firm belief that only the mainstream financial institutions have the capacity to provide full breadth of services. Committee on Comprehensive Financial Services (CCFS) for Small Businesses and Low Income Households has estimated that as of March 2012, only 36 per cent of the population have a bank account at an All-India level with 45 per cent of the urban residents and 32 per cent of the rural residents having bank accounts.[1] The position would have improved with the special drives taken during the past year but only marginally considering the mammoth numbers involved.

The decade long inclusion effort, continues to be driven by the Government of India (GoI) and RBI. While some banks see longer term business opportunity and are serious about their efforts in ensuring that clients use the services, for many others it is social banking to meet the targets set by RBI. Banks have developed their financial inclusion plans up to 2016; however, these plans need to be broken down and integrated into branch-level plans, so that branches own this process and targets and performance management for financial inclusion is measured and monitored.

Though several modes of increasing access such as opening of branches, BCs, Kiosks, off-site Rural ATMs, mobile vans etc., are being deployed by the banks, the financial inclusion drive is largely through the BC channel; of the 268,000 outlets nearly 221,000 (82 per cent) are BCs. BC model is sought to improve financial inclusion levels by taking banking nearer the location of the customers at low costs. The field observations depict a poor picture of customer service person (CSP)/BC availability and capacity, readiness to transact, technology reliability, transaction completion and liquidity adequacy.

Financial inclusion measures continue to be driven by opening of basic savings accounts, remittance and government payments. Savings accounts have a high level of dormancy. Credit offered through BC channels has been negligible except where MFIs act as BCs. Some of the banks are offering government-sponsored and subsidized insurance products; servicing of these policies will be critical for clients to develop trust in insurance as a reliable means of mitigating risks. Pension products are not offered by most banks through BCs.

Banks are yet to ensure that within a reasonable time of putting in place CSPs, basic banking products relating to savings, credit, remittance and payments are offered. As such banks cannot be deemed to be practicing responsible finance in respect of vulnerable customers. If customers have to benefit from financial inclusion, the banking institutions should ensure that there is certainty, continuity and quality in the offered services. Banks should take responsibility and ensure its customer is well served by the BC. Fair practice code for BCs should be framed and monitored.

Government of India has launched Jan-Dhan Yojana (JDY) to ensure every habitation across India (barring hill states and the 82 Left-wing extremism affected districts) has a banking point (branch/BC) within a 5 km radius, by 15 August 2015. The rest of the country is to be covered by August 2016. The scheme aims to ensure that every household has at least two bank accounts, with RuPay ATM enabled debit cards, Rs 5,000 overdraft, Rs 1 lakh accident insurance cover, and an additional Rs 30,000 life insurance cover. The government's Direct Benefit Transfer (DBT) payments will flow into these accounts. A special drive to open accounts has commenced; however, going by past experience ensuring transactions in these accounts, operationalizing overdraft facility and processing of insurance claims will be a challenge since the basic problems affecting financial inclusion are not being addressed. There is a valid concern that the JDY might increase multiplicity of accounts in the hands of some customers that are nearer banking points of presence and also increase the number of inoperative accounts as was the case in such large campaigns in the past. There is also a concern about the ability of banks to service the large number of new accounts that are being opened as the quality of branch infrastructure has not improved. The recent initiative to open small banks to serve the vulnerable people and the hitherto excluded population is a welcome one. The JDY may make the situation competitive for the small and payment banks by taking in some of their potential customers.

SELF-HELP GROUP BANK LINKAGE PROGRAMME: SIGNS OF STAGNATION

Self-help group (SHG) bank linkage programme has achieved considerable outreach at 7.43 million SHGs, being savings linked with a membership of 96.58 million.[2] There is an increase of 1.5 per cent in number of savings linked groups over the previous year which is not an impressive growth considering that in poorer states there is still potential to form groups. These groups had savings of Rs 98.97 billion (Rs 9,897 crore) in their bank accounts which is an increase of 20 per cent as compared to previous year. However, the actual savings is likely to be considerably higher since the groups use their savings for internal lending.

During the year 1.36 million SHGs were disbursed loans to the tune of Rs 240.17 billion registering a growth of 4 per cent in number of groups and 17 per cent in amount of disbursement. The per-group loan disbursed is Rs 175,768 which translates to per member loan of Rs 13,500.

However, the disturbing trend is in the number of groups with an outstanding bank loan. As compared to 40 per cent groups who did not have an outstanding bank loan in 2013, as of 31 March 2014 there was deterioration of this figure at 44 per cent of SHGs did not have an outstanding bank loan. There was reduction in the number of SHGs that had a loan facility from banks by 254,000. As of 31 March 2014, about 4.2 million SHGs had outstanding bank loan of Rs 429.27 billion; loan outstanding was Rs 102,273 per group and Rs 7,867 per member.

The portfolio quality in terms of Non-Performing Assets (NPA) as a percentage of loan outstanding improved from 7.08 per cent as of March 2013 to 6.83 per cent as of March 2014. However, absolute amounts of NPA increased by 5 per cent year on year (YOY). In all regions the NPA situation has worsened except in south. However, in all the states in the South the situation has worsened except in Kerala which has vastly improved the NPA position from 12.38 per cent in 2013 to 5.34 per cent in 2014. Gujarat probably saw the worst fall in portfolio quality from 3.76 per cent NPA in 2013 to 19.81 per cent in 2014.

Dormant groups are one of the reasons for the difference between savings-linked and credit-linked groups. States like Odisha, Rajasthan, and Tamil Nadu reported large numbers of dormant groups. The National Bank for Agriculture and Rural Development (NABARD) has developed an incentive scheme for banks to engage suitable agencies for revival of dormant SHGs; the grant for revival is Rs 3,000 per SHG. However, banks have not come forward. Saturation of SHGs is stated to be other reason for decline in new loans. After mobilizing people to form groups and save money, if the groups are not taken to the next levels of financial services through credit linkage with banks, then their best interests are not well served. The implicit promise made to people while forming groups should be fulfilled through appropriate linkages, failing which the confidence of people in these types of non-formal structures is getting impaired.

There has been a decline in loan outstanding in 26 out of the 32 states and union territories. Andhra Pradesh witnessed increase in loan outstanding of 20 per cent YOY and almost exclusively contributed to the overall increase in loan outstanding. 50 per cent of the country's bank loan outstanding to SHGs is in Andhra Pradesh.

Several bankers in the south have raised concerns that SHGs are no more cohesive: there is large-scale breakage of groups, multiple memberships are leading to members borrowing beyond their capacity, and weak leadership and governance is eroding the creditworthiness of groups. The original savings-led model is giving way to a credit linkage driven model. The monitoring of SHGs after they are credit linked is continuing to be weak. While SHPIs are expected to play this role they are not remunerated for this work. Private sector banks such as ICICI bank, Yes bank, and HDFC bank have scaled up models which leverage the core competence of Self-help Group Promoting Institutions (SHPIs) in nurturing the groups and adequately compensating for such services ensuring that incentives are available not just for promotion of groups but also for continued monitoring and nurturing. However, they are also able to lend on an average to only 60 per cent of groups of a SHPI; the others are not of adequate quality. There is decline of banking sector's involvement in the programme with primacy being attached to financial inclusion programmes which have almost excluded SHGs from their focus (RBI 2014).

Promotion of Women SHGs (WSHG) in 150 backward/Left Wing Extremism (LWE) affected districts, implemented by NABARD in association with GoI, has had limited success. As of 31 March 2014, around 1.49 lakh SHGs were savings linked; but only one third—49,773 SHGs—were credit linked as on 31 March 2014. The scheme had an inbuilt mechanism to be sustainable since anchor NGOs engaged as business facilitator. These NGOs were to be paid[3] for forming and nurturing the groups, tracking and monitoring the SHGs and loan repayments. However, in most districts there have been inordinate delays on the part of bankers (Sa-Dhan 2014a).

National Rural Livelihood Mission (NRLM) has made slow progress during the year. In the southern states the efforts have been focused on inclusion of left out poor and also poorest of poor into SHGs. Even better managed programmes like Kudumbashree in Kerala, have found that many poor are left out of groups. Renewed efforts on including the left-out poor are on. Recruitment and training of staff have been receiving attention in the states; but the ground work in terms of creating institutions has been progressing slowly. The programme being government led faces challenges in ensuring quality, member rootedness, ownership and building self-governance capacity. The programme has the potential to promote financial inclusion; however that will require a shift in mind set from the credit push approach to offering holistic financial services. The original vision and philosophy of the SHG bank linkage programme has to be reinforced.

The major issues confronting SHGs include inadequate number of quality agencies required for capacity building and hand holding; governance and leadership challenges; lack of management information systems; inconsistent reporting, supervision, and management capacities; excessive dependence on promoter agencies for essential services; and skewed distribution of SHGs across the regions.

The Union Budget 2014–15 extended the subsidized bank credit to SHGs to another 150 districts. The Andhra Pradesh loan waiver announcement by political leaders prior to elections saw the repayment rates of SHGs and also farm loans plummeting in the state. The programme, which was built on the foundations of credit discipline among the poor and their creditworthiness with banks, faces a major setback on account of government scheme actively encouraging undisciplined financial behaviour. Subsidized credit does not incentivize prompt payment and prudence in fund management at member level. Instead of interest subsidy, the funds can be used for setting up promotional funds and risk fund. As H.R. Khan, Deputy Governor, RBI has pointed out:

It is important to underscore that government-sponsored initiatives should not crowd out agencies already doing good work in the field as there is enough space for multiple stakeholders and SHGs to function. Focus on credit at the cost of savings should also not be over emphasized and distortions leading to misuse and abuse of the system through interest subvention also need to be avoided (RBI 2014a).

Government's initiatives should be such that promote financial discipline among SHGs; reportedly with large quantum of bank loans being made available at zero to 4 per cent interest SHG members are hesitant to borrow at 'higher cost' from their own savings and also Community investment funds at federation level.

SHG members desire opportunities in terms of skills and marketing for income generation and enterprises. However, neither government programmes nor the other SHPIs are able to address these needs. Groups and federations have to move to the next level to remain relevant and meaningful to the members and retain their interest. The sector expects NABARD to take more affirmative action in this regard. While NABARD has promoted joint liability groups (JLGs) and producer collectives to address the needs of producers, the institutional transformation of member of SHG to member of JLG to individual producer borrower or SHGs and federations to float producer collectives has not happened. There has to be a strategic shift in institution building strategy to ensure credit is used to increase the income of the SHG members.

Banks should be free to price, told to lend only to quality groups, there should be a correlation between continued support to well-functioning groups. SHG movement is a community-based one. Responsible practices and social relevance of groups and their activities is presumed. But field developments and government interventions at different levels seem to erode the quality of outcomes and reduce the protection levels available to members. Members of SHGs incur cash and non-cash costs in coming in to the groups and unless they get viable and sustained access to financial services the promoters, banks and governments cannot justify their involvement with the movement. It is high time that fair practice codes applicable to different stakeholders are developed and enforced so that individual member interests and community benefits are fully protected.

MFIs REGISTER HIGH GROWTH: WILL THEY GROW HEALTHILY

Forty-six members of Microfinance Institutions Network (MFIN) achieved a client base of 28 million, an increase of 20 per cent over the previous fiscal. During the year 2013–14, NBFC-MFIs disbursed Rs 350 billion, to 24 million loan accounts, an increase of 48 per cent in disbursement amount and 31 per cent in loan accounts as compared to last year. Average amount disbursed per loan account was Rs 14,300, an increase of 12 per cent over last year. The disbursals would have been more but for the model election code, which came into force for the Lok Sabha polls during a peak disbursement month in several parts of the country. Gross loan portfolio of the industry stood at Rs 379 billion with 35 per cent growth over fiscal 2012–13.

The top three states in terms of number of operating MFIs have been Maharashtra (22), Madhya Pradesh (21) and Tamil Nadu (20). However, West Bengal with Rs 38.85 billion gross loan portfolio (GLP) and 3.89 million clients and Tamil Nadu with Rs 38.25 billion GLP and 3.89 million clients are topping the loan portfolio and number of clients. Maharashtra, Karnataka, Uttar Pradesh, and Madhya Pradesh followed in terms of both loan portfolio and number of clients. In terms year on year growth in loan portfolio Punjab followed by Gujarat, Dadra and Nagar Haveli, Sikkim, and Uttarakhand registered the highest growth rates. Though West Bengal tops the list in MFI loans, many MFIs in the state face liquidity issues and insufficient funding (Microfinance focus 2014) from banks since Bandhan alone accounts for more than 80 per cent of the funding.

Portfolio quality of MFIs (excluding Andhra portfolio) has been excellent with portfolio at risk (PAR 30 days) below 1 per cent.

Bandhan Financial Services, which recently received an in-principle approval from the Reserve Bank of India to commence banking operations, led with disbursements of Rs 9,200 crore, followed by SKS Microfinance (Rs 4,788 crore), Janalakshmi (Rs 2,381 crore) and Ujjivan (Rs 2,105 crore). MFIs based in Andhra Pradesh such as Spandana, Share and Asmita witnessed a drop in gross loan portfolio, branches and clients. SKS reported increase in its clients' base, but a decline in branches and number of employees. MFIs mention that some of their existing markets are saturated.

Mid-sized tier 2 MFIs (gross loan portfolio, or GLP between Rs 1 to 5 billion) have registered robust year on year growth rates as compared to tier 1 and tier 3 MFIs in terms of gross loan portfolio, loans disbursed, number of branches and number of employees. Tier 3 institutions as a group continue to struggle and register lower growth rates than tier 1 and tier 2 MFIs in terms of growth in gross loan portfolio and number of loans disbursed. Client outreach declined by 4 per cent for tier 3 MFIs whereas tier 2 MFIs increased their client outreach by 32 per cent. Similarly employee strength also declined marginally for tier 3 MFIs. However, 5 MFIs each in each tier have grown their gross loan portfolio by more than 100 per cent. Among the larger players Janalakshmi has been growing at more than 100 per cent year on year for last three years.

With such rapid growth, few of the not so desirable practices are also being reported in few pockets: (a) many lenders crowding in an area and thus increasing debt level of clients and (b) agency system returning to the industry. Agents are reportedly prevalent in some pockets of Rajasthan, MP, and Tamil Nadu. Agents are in possession of KYC documents and in some cases the clients may not even be aware that loans have been taken in their names. This practice has to be curbed. Though these incidences are sporadic and confined to very small pockets, the industry has to take proactive steps to avoid the past mistakes. SROs and state-level associations have to act as watch dogs.

MFIs are improving their productivity by increasing the business per branch and also client load per staff. Client retention measures, higher number of repeat loans at higher ticket sizes for mature customers, centralizing of loan processing to increase case load per staff, mobility support to field staff to cater to larger area and ensuring each group has the designated number of clients, are some of the measures undertaken by MFIs.

RBI has now permitted non-deposit-taking NBFCs to act as business correspondents of the banks. Since NBFC NFIs are largely providing credit, this is the service that may gain immediate acceptance. Small NBFC-MFIs that have faced difficulties in raising loans from the banks will be in a position to meet their client loan needs. Banks will have to ensure that BC engagement for lending will be well targeted to increase outreach in more of unreached areas and not heat up already crowded markets. The good practices followed by IndusInd Bank and SIDBI in the poorest state Inclusive project need to be emulated by others.

The experience so far in credit-led BC model has not been very encouraging as far as appropriate pricing is concerned—the pricing on these loans is usually 26 per cent—the maximum limit prescribed by the regulator for MFI loans. Since cost of funds for the bank is lower, the risk is borne by MFIs in the form of first loan default guarantees; the loans can be priced to end clients at much lower levels. Under this model banks can provide loans to the clients at lower rates than what the MFI does in its own books. As the capital requirements of generating loans for the books of the banks are relatively small MFIs can achieve more outreach with limited capital as BC for banks.

The policy change by RBI has been to improve financial inclusion measures and enabling the customers of NBFCs to access wider range of products. Savings is often considered as the service most in demand from microfinance clients. There are very few MFI BCs (both NBFC and non-NBFC) that offer savings products since past experience of savings services have not been encouraging. Except Cashpor not many other MFIs are offering individual savings products on a scale. The arrangement has been found useful by the customers and effective by the banks but not so cost effective for Cashpor, which is cross subsidizing the service. MFIs' core competence of customer engagement and management as compared to other BC channels need to be fully utilized by the banks in devising appropriate business models for providing a range of financial services that customers need.

LENDERS INCREASE THEIR SUPPORT, BUT NO SUCCOUR FOR THE SMALL MFIs

Bank borrowing continues to be the sole/major source of lending for MFIs. Banks and other financial institutions stepped up their lending to MFIs during the year; as per NABARD data, during 2013–14 banks and SIDBI lent Rs 10,282 crore to MFIs and the loan outstanding was Rs 16,517 crore. There is 30 per cent increase in bank loans disbursed and 15 per cent increase loans outstanding to MFIs year on year. Non-performing assets have decreased both in absolute amounts (from Rs 268 crore in 2013 to Rs 240 crore in 2014) as well as percentage of loan outstanding (from 6 per cent in 2013 to 4.5 per cent in 2014).

As per MFIN data, banks' lending to NBFC-MFIs grew by 54 per cent on YOY basis. NBFC-MFIs received total debt funding of Rs 15,030 crore, of which 79 per cent was from the banks and rest was from other financial institutions (FIs). In Fiscal Year 2013, total debt funding stood Rs 10,115 crore, out of which 85 per cent came from the banks. Funding to tier 2 MFIs grew by 100 per cent, followed by tier 3 MFIs at 50 per cent and tier 1 MFIs at 44 per cent. NBFC-MFIs have also done securitization/sale of assets worth Rs 2,792 crores. Tier 1 MFIs' securitization portfolio grew by 294 per cent. When both direct lending and securitization figures are taken into consideration it becomes clear that tier 1 MFIs have been favoured by the lending institutions.

SIDBI's disbursements grew 50 per cent during the year (from Rs 408 crore in 2013 to Rs 646 crore during 2014) but funding has been directed at underserved areas. Some of the public sector banks have doubled their lending to MFIs; State Bank of India almost halved its disbursement. Private sector banks, especially ICICI bank, IndusInd bank, and Ratnakar bank, have stepped up their lending to MFIs in a big way. Some of the large public sector banks that are burdened with NPAs have turned risk averse and their appraisal norms have turned stringent (Khan 2014). (During the quarter ended December 2013, banks collectively held loan provisions of about Rs 1 lakh crore, an increase of 13 per cent over the year, indicating that loan asset quality of banks in India deteriorated considerably. The PSBs continued to register the highest level of stressed advances at 11.3 per cent of the total advances as at end March 2014.) Failure of a few NBFCs has not augured well for NBFC-MFIs. Turnaround time for loans has increased. The appraisal norms have become stringent with an emphasis on good credit rating. This is skewing lending by public sector banks—that had so far supported smaller MFIs—towards larger players who have better rating.

Banks especially those in private sector, are lending largely to about 15 MFIs in tiers 1 and 2 because they are well capitalized, better governed and there is also an impression that they are too big to fail. Banks have become selective with the result that unregulated small MFIs are finding it difficult to raise loans.

During 2013–14, tier 3 NBFC-MFIs had only 44 per cent of their funding from banks where as for other tiers it was 84 per cent. Tier 3 MFIs had to depend on other lenders including bulk lenders for lending to their clients. Bankers have preferred to lend to MFIs with multi state exposure limiting single state/territory concentration. Bankers are also lending to institutions with substantive promoter stake and multiple bank lending. Banks are insisting on personal guarantees of promoters. Some of the small MFIs mention that unless the senior executives are known who can influence the decision making, their loans are not getting sanctioned. SIDBI has commissioned a study on the viability of MFIs which looks at the measures needed for ensuring viability of small MFIs.

North-east MFIs (NE-MFIs) are forced to compete with Pan-India MFIs for bank funding. Banks often deny loans or sanction small amounts to NE-MFIs since their exposure limits to North-eastern states has been reached with Pan-India MFIs. Due to high risk perception, banks have been lending at more than 15 per cent rate of interest to NE-MFIs, whereas MFIs in other regions have been able to raise funds at cheaper rates. Thus NE-MFIs are unable to compete with other MFIs on loan size as also interest rate.

Lenders have a responsibility to ensure that MFIs do not over heat certain pockets. Lenders to MFIs also should use the credit bureau information to ensure that some portion of the MFI's lending reaches the unreached areas for which they can incentivize the MFIs.

Banks have been hesitant to lend to bulk lenders (such as Ananya, Maanaveeya) since this will not be classified as priority sector lending. Bulk lenders like Ananya (erstwhile FWWB) have a key role to play in nurturing small MFIs offer operating in remote areas/ niche market; their lending to tier 3 MFIs especially in the under banked districts need to be classified for priority sector lending.

MFIs mention that banks have become more stringent in their due diligence processes; given the margin cap in place, banks are assessing whether the MFIs are adopting adequate cost controls. Banks are closely monitoring the field-level compliance of code of conduct. Banks are also checking the loan utilization checks being carried out by the MFIs since for qualifying assets 70 per cent of the loans should be for income generation activities. Aspects such as ever greening of loans, prompting clients to prepay to give larger loans, using different identification documents of clients for different loan cycles to by-pass credit bureau checks are aspects which have been pointed out by bankers to MFIs as aspects to be improved upon. While some banks insist on external assessment of compliance to code of conduct (COCA reports), others carry out field visits themselves. A few banks have norms of visiting 5 per cent of the ultimate clients as part of their monitoring.

The focus on code of conduct compliance and regulatory guidelines on customer selection and excessive debt adds other another layer of protection to customers and ensures that MFIs conform to requirements. The issues relating to denial of support to small MFIs operating in remote areas is not a socially appropriate practice on the part of banks, given that as part of financial inclusions efforts these are the areas and customers that bank need to pay attention.

INVESTORS: WILLINGNESS TO FOCUS ON CUSTOMERS

During the fiscal year 2014, 10 MFIs raised equity worth Rs 5,300 crore. The valuations have been reasonable at an average 1.6 times of book value. Globally investment allocations are returning to microfinance[4]. Despite an increase in the number of investors in the MFI sector, the interest is highly selective. The key reasons for investor interest have been regulations put in place by RBI which has ensured client protection, better field behaviour and diversification of mature MFIs—all pointing to an asset pool with lower risks (Natarajan 2014). Well-run MFIs have proved that sustainable return on equity of 15 per cent or more can be made. The opportunity of graduation of well managed MFIs to become small banks provides comfort to investors. A few investors[5] exited from some of the MFIs during the year due to their investment goals being achieved in a time frame of 4 to 5 years (Natarajan 2014). However, investors like Caspian/Bell weather stay invested for 7 years.

CRISIL, in its medium term outlook of the sector that is based on analysis of 25 MFIs, has concluded that in order to grow at 30 per cent per annum, MFIs need to raise equity periodically since the gearing ratio is 5.4 (CRISIL 2014). Two concerns that can affect future equity flow into MFIs are: (a) Promoter shareholding has declined significantly, following repeated infusions of capital. Low promoter stakes, and the absence of a dominant shareholder could disrupt strategic direction and decision making, (b) Potential reduction in investor appetite because profitability of the large players is set to decline by around 30 basis points annually over the next two years, with interest margin capped at 10 per cent from April 2014.[6]

Investors are looking at high standards in corporate governance with independent board, high calibre audit committee of the board, high transparency levels through engagement of reputed audit firm, and depth of management. They are looking at corporate governance as the most important differentiator for taking investment decisions.

According to Unitus Capital, private equity players are the major set of investors in tier 1 MFIs; MIVs and social investors are investing more in tier 2 and 3 MFIs. They are investing in institutions that have part of their operations in underserved states and that is forcing some of the south based MFIs to expand to underserved states. Investors are not keen to invest in MFIs with single state operations. As the MF sector has grown, some of the bigger MFIs have seen investments made by core mainstream sector investors/Private Equity (PE) firms. Private Equity Investors largely are interested in 15 MFIs in India who are considered as investment grade with good governance, management and systems and geographically well diversified operations. MFIs especially the tier I MFIs acknowledged that though the commercial investors come in with a profit motive, they have been able to balance both the social and commercial agenda of the investors (MicroSave 2014).

Most of the medium and small MFIs are struggling to raise equity. Indian Microfinance Equity Fund, set up by Government of India and managed by SIDBI, has been augmented by another Rs 200 crore and the corpus now stands at Rs 300 crore. SIDBI has committed Rs 126 crore to 44 MFIs so far through various instruments such as equity, subordinated debt and optionally convertible preference shares. This funding is aimed at tier 2 and tier 3 MFIs, working in underserved areas. MFIs have been able to leverage the funds to service their clients in the underserved areas. The present size of Rs 5 crore capital per MFI is too small to be growth capital. MFIs serving remote areas such as North-east would like the return expectations to be scaled down so that they can use the capital and leveraged loans. Community ownership in MFIs has not found favour with investors especially through MBTs; since there is no level playing field for individual investors who do not have a clear exit route. Homogeneity of governance is another issue raised by them.

Investors are asking for monthly detailed reports covering operational and financial parameters in depth and also on RBI regulatory compliance which consist of client protection aspects. Some investors like Dia Vikas, Maanaveeya, and Caspian ask for reports on social performance management. Many investors realize that responsible business is good business and hence these investors are encouraging the MFIs to undertake client-centric welfare/development programmes and build customer relationship.

RESPONSIBLE INSURANCE: A LONG WAY TO GO

India leads other Asian countries in terms of insurance outreach (Munich Re Foundation and GIZ RFPI 2014). Regulatory framework developed by IRDA for micro-insurance and mandating social and rural sector coverage have been enabling factors in increasing outreach. Central and state governments have supported micro-insurance by providing premium subsidy across sectors such as life, health, and agriculture insurance which contributes to large outreach. Insurance companies have a variety of distribution channels; NGOs, MFIs, community-based institutions and banks.

However, the substantial outreach of life and personal accident insurance products may not be attributed to the informed demand for such products. Life insurance products are found relatively easy to distribute since they are linked with other products such as credit and also distributed through channels which have relatively high touch with the clients (MFIs and NGOs). Moreover, the selling point in schemes like Aam Aadmi Bima Yojana (AABY), which has a large outreach, is the Government subsidy on premium and the promise for scholarships for school-going children.

Though health insurance accounts for large numbers in outreach, it is largely for tertiary care and hospitalization. Central and several state governments have welfare oriented health insurance schemes for hospitalization where premium is heavily subsidized. While Government schemes have large coverage by outsourcing many operations, the schemes can face challenges in the future because of a high claims ratio and dependence on political will.

Government schemes account for a majority of the policies sold to poor and low income households. Compulsory enrolment of clients in credit life insurance accounts for bulk of life insurance where clients bear the full premium charges.[7] The outreach in terms of voluntary enrolment for products for which clients pay full premium is minimal largely due to issues relating to suitable products, delivery channels, regularity of income of target customers and their low awareness levels. The limits of sum assured for the target groups should be increased substantially as the risk cover that can be achieved under the existing limits are meagre and will not offer adequate compensation to the insured.

Micro-insurance is a difficult business segment and developing viable products and delivery models for poor and low income households is a challenge. The sector is yet to attain a level of development in which well-designed products are widely available and effectively used by clients. The current environment of micro-insurance market is far from being responsive to customer needs. The state of business practice has to improve before it can be assessed to be responsible. Customer protection and customer comfort have not yet become priorities in the insurance market for vulnerable people. While the insurers are struggling with viability issues, responsible practices in design, marketing and servicing of policies are yet to gain recognition as important requirements.

REGULATION: WILL RBI DEMAND MORE RESPONSIBILITY TOWARDS CUSTOMERS?

The RBI regulation largely covers NBFC-MFIs, which are licensed and regulated separately by RBI. The other forms of MFIs especially those under not for profit legal forms are not well regulated. Regulation should ensure parity especially in terms of capital adequacy and improving governance standards. The Microfinance Institutions Bill 2012 has lapsed; the Government will have to revive the efforts of enacting the Bill. Finance Minister has indicated that consultations on the Bill with wider stakeholders have commenced (*The Economic Times* 2014). Sa-Dhan had arranged for interface of micro credit borrowers and Members of Parliaments (MPs) who were members of the Parliamentary Standing Committee in their own constituencies which enabled MPs to get first hand feedback on importance of micro credit for the clients. Similar interactions will have to be continued. The enactment of the Bill will protect MFIs from multiple regulations and interference from local legislation, bringing stability to business operations.

The Reserve Bank has recognized Microfinance Institutions Network (MFIN), the industry association, as a Self-regulatory Organization (SRO). This also shows the trust RBI has reposed in the industry to regulate itself. Setting up SRO is likely to deepen the responsible lending and client protection measures being undertaken. N.S. Viswanathan, ED, RBI explaining the need for SRO has said 'The fundamental principles behind SRO are: (a) to curb over indebtedness, (b) ensure code of conduct since borrowers are not financially literate, and (c) low income and vulnerable status of borrowers' (Sa-Dhan 2014b). According to MFIN, grievance redressal mechanism at SRO which genuinely captures and addresses the client grievances will be given priority. SRO also plans to invest in customer education.

The Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households (CCFS) has made a number of recommendations which are microfinance client friendly. The requirement that financial service providers should treat total indebtedness of borrowers in terms of their ability to service debt and not just their absolute total debt will go a long way in enabling adequate credit flow. The recommendation that all the lenders report to the Credit Bureau will enable building the credit history of clients and bring in credit discipline; lenders being aware of debts of clients will curb tendencies to over lend. CCFS rightly recognizes the role of credit for consumption smoothening and has recommended doing away with the policy differentiation between consumption and income-generating loans. The recommendation to raise the borrowing limit to Rs 100,000 will enable the MFIs to meet the client demand, especially of mature clients. To ensure that MFIs continue to focus on poorer clients, average loan size for MFI as a whole will have to be prescribed.

The committee's recommendation—that vendors should be made liable for providing suitable products and services, and ensuring that these do not harm the customers—is a far-reaching one. Professor M.S. Sriram, IIM-B, observes 'While it has been a challenge to open plain vanilla accounts and get the direct benefit transfers for these customers rolling out, the task of offering a product that passes the suitability criteria is daunting indeed' (Sriram 2014). How far the microfinance players will pass the 'product suitability' test has to be examined.

IMPROVING GOVERNANCE

The Social Performance Report 2012 discussed governance of MFIs and brought out issues in state of practice of governance in the sector. At that time, the major concerns listed were the need for separation of ownership from governance structures, composition of boards and need for more independent directors, trade-offs in balancing social goal achievement with financial performance and board supervision over reporting and monitoring of responsible finance. The sector has made significant changes in governance aspects not only because of external compulsions but also on account of genuine internal motivation to improve. Reflecting the improving governance environment in South Asia in general and in India in particular governance risks is ranked thirteen by Microfinance Banana Skins 2014 survey. Investors who invest across different sectors mention that corporate governance standards of MFIs is high in terms of quality of information presented to boards, management responsiveness and boards' willingness to commit time.

MicroSave (2014) had undertaken a study of governance in MFIs commissioned by the Poorest State Inclusive Growth Project. The study surveyed governance practices in 40 MFIs across India. The study findings confirm the improving situation in governance of MFIs. A large proportion of surveyed MFIs have constituted boards with directors of wide ranging expertise. More than 75 per cent of the MFIs had independent directors on their boards. 39 per cent of MFIs surveyed had an independent director as the chairman. To a large extent, independent directors chaired audit committees.

But there were some persisting problems and challenges. The promoters were highly influential in boards with friends or family represented disproportionately. In most companies microfinance expertise was located in the promoter or CEO (in 23 out of 28 MFIs that shared this information) and other directors did not have a good understanding. 21 per cent of MFIs in the survey did not have a single independent director. MFIs currently find it difficult to attract persons with expertise and experience to take office as independent directors due to stringent regulations on number of directorships and the capping of tenure of directors. The introduction of the concept of liability of independent directors for actions of the company (for which they were a party either actively or negligently) could dampen the enthusiasm of persons of repute to become independent directors. On account of too few independent directors being available it was difficult to constitute the committees of the board required by the regulator—such as the nomination and remuneration committee. The regulator might have to issue a fit and proper criterion for nominee directors identified by financial institutions to represent their interests on MFI boards.

Business strategy, capital mobilization, risk management and internal controls rightly occupied the attention of almost all the boards. But key issues relating to customer protection, responsible finance and social performance were not focused in a number of boards. Only 60 per cent of the boards seemed to consider issues relating to responsible finance, grievance redressal and human resources. Around 18 per cent of the sampled MFIs have Social Performance Management (SPM) sub-committee at board and have included SPM as agenda in the board. Boards need to be provided with improved capacities that will make them focus intensely on all aspects of MFIs working such as on financial soundness, operational efficiencies, responsible finance, and social performance.

CUSTOMER RETENTION: THE KEY TO PROFITS

With squeezed margins, customer retention has become a key aspect of keeping costs under control and sustaining profitability. There are several reasons for customer drop out. Some members in a group are dropped by the members in the next cycle. Some customers are lured away by competition with larger loans, etc. Some customers do not have the patience to wait the long turnaround time involved in dealing with loan applications and shift to quick disbursing MFIs. Clients of small MFIs are moving to larger MFIs since small MFIs have faced funds constraints and are not in a position to make larger loans. MFIs are monitoring the customer preferences and what the competition is doing. MFIs have reduced the frequency of meetings, improved on loan processing times, avoided imposing group liability in case of defaults, increased the size of loans, etc., in a bid to retain customers. Since lending larger loans to new clients is risky for the MFIs, they are focused on client retention.

Ujjivan's supervisory team from all departments visited more than 96,000 centres to seek client feedback directly from the field. Another client-centric initiative by Janalakshmi—Kaleido, a tool developed in conjunction with CGAP—analyses clients' perceptions of services, cash flows, and other indicators to perform a need- gap analysis and evaluates how products meet clients' needs and the process experience. The next phase of research will entail a longitudinal impact study of impact from the institutional client service perspective with the intent to attribute outcomes to the company's services.

PRODUCTS: GOOD INTENTIONS YET TO TRANSLATE IN TO CUSTOMER RELEVANCE

With RBI permitting MFIs being appointed as BCs, there was an expectation that a number of banks and MFIs will enter in to agency arrangements. However this has not been witnessed on a significant scale. MFIs have found that selling a liability product is very different from a credit product. While many MFIs are facilitating opening of bank accounts for their clients, they are yet to show their keenness to become BCs. Some MFIs that encouraged the non-profit group firms to become BCs of banks have found that the arrangement is not working well. BCs have to maintain a service presence for a given number of hours in each location without regard to whether any transactions would be put through. This has been found to be cost intensive and uneconomical. Using the same human resources MFIs can increase their loan business without the uncertainties of liability products.

MFIs are spending time on product development and refinement. The main product being a 12-month or 24-month loan with equated repayment instalments; not many new products have come in to existence. The new products have been more related to the purpose and some changes in repayment period and rate of interest. Many MFIs have introduced water and sanitation loans as a new product.[8] But these loans mimic the normal MFI loan and the interest rates charged are high when seen against the fact that the loans are not income generating. MFIs already are of the view that the existing product has a limited shelf-life and needs to be replaced with more suitable products acceptable to a range of activities and customers. The next generation of products should be more closely aligned to customer needs and livelihood activities. As stated in the earlier paragraph, MFIs are carrying out analysis of customer data to take on board demand-side requirements in product design. Average loan disbursed by MFIs has been increasing steadily over the last two years. The increased loan size is part of a strategy to reduce the operating cost and improve margins.

OVER-INDEBTEDNESS

MFIs, banks and even large poverty reduction programmes adopting SHG methodology like NRLM adopt a credit push approach. Some recent studies show that multiple borrowing is widely prevalent in the country (Centre for Microfinance 2013; Lahkar et al. 2012). The Global Microfinance Banana Skins Survey 2014 (CSFI 2014) ranked the risk of over indebtedness as the number one risk. In the last two decades, the industry has travelled a long distance from having clients who did not have access to the present situation where clients have excessive access.

The regulator has played a significant role by prescribing absolute limits and persuaded the MFIs to subscribe data to credit bureaus and make use of credit reference reports. Significant investments have been made by the industry especially MFIN with IFC playing an advisory role in establishment of credit bureaus and streamlining the data flow from MFIs to credit bureaus in order to provide borrower-specific debt-related information. MFIs are largely depending on credit bureaus to comply with regulatory norms.

However, reporting to credit bureaus is not complete. There are NBFC-MFIs (not members of MFIN) and also large NGO-MFIs like SKDRDP that are not reporting data to credit bureaus. Banks and RBI should seriously take up the issue of non-participation and unwilling participation by some MFIs and ensure that orderly conduct ensues in the sector. SHGs have a client outreach that is twice as big compared to the MFIs but the SHG member data is not shared with the credit bureaus. RBI needs to ensure that banks share data of all small loans and SHGs with credit bureaus.

Effective credit bureaus can be an important tool to gain information about the debt levels of their clients and can assist in making responsible lending decisions. However, they are not the sole answer to measuring the indebtedness of clients or repayment capacity of the households. Some of the MFIs go beyond the credit bureau checks to truly measure the indebtedness levels and the repayment capacity of clients. The others (especially banks that also lend to same segment of customers and all other programmes and projects that lend to SHGs) should take a cue from MFIs and ensure that customer interests are better protected through avoidance of excessive debt.

Clients should be educated about management of loans, cash inflows and outflows since often they have irregular income. Many are in seasonal businesses which have peak demands which may or may not coincide with the loan disbursement and there can be mismatch between the cash flow of the client and the loan term. They also need to be prudent borrowers.

INSURANCE PRODUCTS

As of March 2014, 28 out of 44 NBFC MFIs that are MFIN partners reported that 30 million microcredit clients were enrolled in mandatory credit-linked life insurance for a total sum assured of Rs 508 billion (MFIN 2014) through partnerships with insurance companies. Many MFIs cover the lives of the borrowers' spouses as well. Most NBFC MFIs sell group term life policies while only five NBFCs sell Credit-life.[9] The GTL cover is usually for a fixed amount and often does not provide adequate cover for the client.

Almost all MFIs have, at some point, piloted and sold health, livestock, crop or other products but at present very few of them sell non-life insurance. Most NBFC-MFIs work as a master policy holder for one or more of companies and they receive reimbursement for some expenses. Marketing voluntary general insurance is a difficult and losing proposition. This has partly dampened enthusiasm to sell more general insurance products.

Life insurance policies marketed now are usually short term. Unlike banks and post offices, MFIs can close down branches and clients can also drop out and customer servicing can be an issue if longer term products are offered. Banks and post offices are better placed to offer individual products with long-term tenure. Many insurers report increasing distribution through banks, RRBs, cooperatives, and other aggregators like dairies rather than through MFIs and Self-help Promoting Institutions (SHPIs). The expansion of the micro-insurance agent network will take points of sale nearer customer's habitat and improve customer comfort.

PENSION

Several MFIs and SHPIs distribute pension products with the intention of securing a minimum post-retirement income for their client. Most of them act as aggregators for Pension Fund Regulatory and Development Authority (PFRDA). As of 31 March 2014, MFIN members have facilitated opening of 1.2 million pension accounts out of which 28 per cent are under government-sponsored Swavalamban programme (MFIN 2014). Bandhan has 0.3 million subscribers (25 per cent of the pension account holders among MFIN members). MFIs mention that with scale they are able to cover their costs of distribution. Some of the MFIs like Ujjivan mention that the demand for pension is tapering and is not as high as expected. ESAF finds the renewal rate in the second year is less than 50 per cent. A few large institutions like Equitas do not offer this service since pension is a long-term product and ensuring that clients continue to get service for this product can turn out to be an issue.

Many poor clients have enrolled largely for NPS—Swavalamban, to avail of the matching contribution available to those individuals who reach the minimum threshold of Rs 1,000 of savings. However, this matching contribution is available only for a definite time. During field interactions, many clients are not clear about the long term benefit of pension plans. Motivating the clients to continue their contributions beyond the period of government contribution will require special efforts; the clients also need to be informed of where to make the pension contributions in case they drop out of the MFI or if the MFI closes operations.

PRICING OF CREDIT

RBI has removed the 26 per cent interest rate cap on loans disbursed by microfinance companies regulated by it and linked the interest rate to the cost of funds, providing a greater leeway to the lenders. As a result, such lenders will be able to charge more than 26 per cent if their cost of borrowing from banks is higher. On the other hand, the lending rate will fall if the cost of borrowing goes down. RBI said the MFIs should arrive at the lending rate by calculating their cost of funds plus a maximum 10 per cent margin or the average base rate of the five largest commercial banks by assets multiplied by 2.75 times, whichever is lower. The Mor committee noted that the regulations on the interest rate and margin cap have led to no reduction in the interest rates for borrowers.

Even with the regulatory caps, the interest rates are high in the hands of the borrower for a variety of livelihood activities where the capital not turned over a number of times during the year. The large MFIs have dropped interest rates in the first two quarters of the current year to comply with the reduced margin cap of 10 per cent. Even with this the rates are around 23 to 24 per cent per annum. Where loans are invested in long-term assets for income generation or used for production activities that have a thin profit margin such as cropping, interest rates of 24 to 26 per cent may not be suitable. However, there is no leeway to reduce the interest rates as MFIs have high funding costs and operating costs at their efficient best. A dedicated funding facility at low rates of interest should be set up for MFIs so that they can offer credit at lower rates to vulnerable customers. This will not entail the high costs of subsidized credit programmes and avoid the moral hazard issues associated therewith.

PERCEPTIONS OF CLIENTS OF THE SERVICES OF MFIs

A few internal studies by MFIs[10] and a study by SIDBI[11] have gathered information on clients' perception about the changes in the products and practices after introduction of code of conduct. One major impact of all the responsible finance initiatives is clearly an increase in the awareness of clients. Their understanding of loan terms and conditions has improved. Increased awareness levels on the functioning of credit bureau and the number of loans they can take from MFIs has reduced incidence of multiple and over-borrowing from MFIs. Clients find that the cap of number of MFIs that they can borrow from is good as it avoids the temptation to take loans from many MFIs. Though the interest rates have declined, the clients do not see the reduction as material and frequently mention further reduction of interest rate as one key change they would like to see. Clients desired flexibility in choosing the loan tenure irrespective of the loan size. A higher loan size has been a persistent demand. In urban areas, clients had little time for group meetings, lengthy procedures and long turnaround time for loans. More importantly, clients do not perceive differentiating features that make one MFI stand out from another.

HUMAN RESOURCES

Two MFIs, Ujjivan and Equitas continue to be ranked high by the independent research, the Great Place to Work[12] survey, which covered about 600 companies spanning 20 industries. Ujjivan Financial was ranked 9th. Among the best companies in fairness in performance management system Equitas was ranked second.

Gender equality and women's empowerment is a common goal amongst 60 MFIs reporting to MIX, with 80 per cent citing it as an explicit institutional objective. However, gender composition at both the leadership and staff levels of Indian MFIs and also other South Asian MFI trails far behind those of other regions of the world. India and South Asia each had the lowest percentage of female staff at 18 per cent, or nearly less than half of that of Middle East and North Africa (MENA), the region with the next lowest figure. As per MIX data, women constituted 17 per cent of loan officers, which could reflect safety considerations in addition to socio cultural ones. However, women make up a mere seven per cent of Indian MFI managers; gender diversity at the higher echelons of organizational hierarchy lags significantly in the Indian microfinance sector.

With growth rates steadily increasing, total number of employees working in NBFC-MFIs stood at 67,838 as of March 2014—growth of 10 per cent over FY 2012–13. Loan officers constitute 66 per cent of the employees. Medium sized MFIs have recruited 19 per cent more staff as compared to the previous year. Training of freshly inducted staff especially field staff has been receiving attention; however COCA reports indicate that a few MFIs are not paying adequate attention for staff training. Staff turnover has continued to climb amongst Indian MFIs. Increasing levels of turnover often signal that there are areas of concern in treatment of staff. High levels of staff turnover translate to higher costs for MFI since extra resources must be allocated to hiring and training new staff, and exiting loan officers in particular often take 'their' clients with them to other institutions.

Lack of expertise in critical areas like risk management, credit appraisal, data analytics, absence of succession planning for key middle and senior management positions, ad hoc responses to capacity building and poor performance management system are some of the major HR challenges MFIs are reportedly facing. The study on HR practices in MFIs (ACCESS ASSIST 2014), the preliminary findings of which were covered in last year's report, has since been completed. The study finds that apart from stressing efficiency and productivity, HR processes from recruitment to incentives focus on various aspects of customer protection, responsible finance and social performance. Training integrates conduct in the field as much as business and operational factors. The culture and values of the organization largely drive the balancing of the staff and client interests. For some of the institutions, clients were primary stakeholders. These institutions must, however, understand that if they have to be sustainable in the long run, they have to strike equilibrium between the interests of clients and that of the staff.

EXTERNAL EVALUATIONS AND ASSESSMENTS

The number of COCAs has scaled down during the past year as compared to previous years; unlike ratings COCAs do not have specified validity. Moreover, except SIDBI many other banks are not insisting on COCA for loan sanction. Lenders forum has to be more active and decisive in making the member banks base their lending decisions on the results of COCA. Follow up of COCA findings with the MFIs has to be done by the lenders and investors. Some of the MFIs are voluntarily commissioning COCAs to see their own progress. COCA reports indicate that overall compliance of Code of Conduct and RBI stipulations is high. Some common areas of improvement include training of staff especially entry-level staff on responsible financing practices, loan appraisal processes, and client awareness building.

Smart Campaign's state of client protection practices report (Smart Campaign 2013) indicates that assessed MFIs demonstrated high scores in the principles of responsible pricing, ethical staff behaviour and appropriate collections practices. Smart Assessments demonstrated gaps in complaints resolution and privacy of client data. More mixed results were found for preventing over-indebtedness and transparency, where about half of the SMART-assessed institutions performed well. On the positive side, MFIs demonstrated strong practices around monitoring over-indebtedness specifically when expanding to new geographies, offering product flexibility in terms of loan conditions and sharing of data with the nascent credit bureau system. The assessments noted an important industry change in loan officer incentive structures, shifting away from growth incentives to better balanced incentives based on portfolio quality as well. In terms of transparency, most MFIs communicated interest rates on a declining basis, and disclosed full fees and insurance charges. The areas of improvement needed are in assessing repayment capacity and prevention of over indebtedness and ensuring effective use of grievance redressal system.

Client protection principles (CPP) assessments by Smart campaign help MFIs benchmark against international standards and the assessments and certifications are supposed to be strict. While CPP assessments and certifications are important, the fact that lenders in India do not attach much importance to it during their credit decisions, constrains demand for the assessment. This is further compounded by the fact that COCAs overlap several aspects of CPP evaluations, though not in a comparable level of detail. However, there are some international investors who attach importance to CPP while making investment decisions.

The year also saw increase in tools both within India as well as globally. SPI4, an assessment tool, has been pilot tested this year and the tool tries to align with and enable reporting on, different initiatives within the SPM sector, including client protection, the universal standards, green microfinance, and gender. In attempting to be comprehensive, the tool reports to have more than 400 indicators which MFIs pilot testing have found overwhelming. Global initiatives have to work together and give way to simple, common tools rather than being proprietary about the indicators each one has developed. CRISIL has developed SPRF grading matrix tool to evaluate an organization against peers on two distinct dimensions—social performance and responsible financing. Reportedly this also includes code of conduct and client protection aspects.

For the MFIs, as was observed in last year's report, there are far too many tools and assessments in the responsible finance/SPM space with marginal difference from one to another. Overall, assessment fatigue is setting in. MFIs find multiple evaluations time and resource intensive. MFIN has under taken an initiative to unify the tools and methodologies. In the short term, the Responsible Finance forum is likely to discuss with lenders forum the present usage of the tools and assessments and prioritize those aspects which will enable lenders/investors make lending/investing decisions. Based on the identification of key aspects, the different assessment tools can be merged and harmonized. The institutions which have designed various Social Performance/Client protection/COCA tools need to work on the commonalities and synergies between their differing approaches, methodologies and parameters. Time-bound action plan for harmonization should be planned at the sector level and implemented.

Eventually, Microfinance MFI rating needs to be the primary (and only) tool; this should have the components of social rating. This will incorporate all the aspects included in the harmonized tool described in the earlier paragraph. Since only one on-site visit is needed for the institutional rating, it would be far less burdensome (and importantly avoiding confusion) for MFIs. It is important to remember that real intent and commitment towards social performance should not be lost in the maze of certifications and evaluations, but must be a continuous exercise towards building a lasting relationship between the MFI and its clients.

CAPACITY BUILDING FOR SOCIAL PERFORMANCE MANAGEMENT

While assessments point out areas of strengthening, MFIs often need capacity building, especially technical assistance, for improving their products and processes to be client centric. EDA Rural System is supporting 10 MFIs (mostly partners of Dia Vikas) in integrating USSPM in their operations which includes training of board, senior management and staff in the social performance principles and improving data collection on client poverty levels and client outcomes, analysis and usage of reports for measuring social outcomes. PSIG being implemented in four of the poorest states in the country has provided well-designed need-based support to partner MFIs which include confidence-building measures such as loan portfolio audit, social performance management review, and client protection assessment. The project supports partners in expansion of other financial services, technology upgrade, human resource development, strengthening risk management, and also governance.

The Smart Campaign has cumulatively trained 93 MFIs in India ranging from NBFCs to NGOs in aspects of client protection principles, RBI regulations related fair practice as well as the Code of Conduct. The Campaign has also helped improve ground-level practices in 7 MFIs especially in the area of strengthening complaint resolution mechanism.

Anaya Finance for Inclusive Growth adopts a need based approach for providing capacity development support to 24 partner MFIs most of which are in tier 3. During the year, apart from various trainings and workshops in the areas of Small Business Financing, Risk Management, Social Performance Management, Corporate Governance, Management Development Programmes for MFI field managers, Ananya provided technical support to some of the partners for carrying out market survey for individual lending. Ananya follows up on the initiatives and finds that training of staff should be conducted more systematically and frequent reinforcing of learning is required. The other area of improvement needed is in analysis of data and reporting to board and donors/funders. Ananya finds that in small- to mid-size organizations the senior management and the boards need guidance on this.

OUTCOMES AND IMPACTS

Most institutional efforts on client information so far have focused on analysing clients at the time of entry. Though MFIs collect a lot of data these are not systematically used for tracking clients' assets, liabilities, and well-being. This is an area of weakness. Tracking of outcomes, such as changes in clients' well-being, requires additional resources and capabilities. MFIs, on account of scarcity of resources, generally monitor outputs, such as the number of female or rural clients and average loan size. Some MFIs have endeavoured to evaluate outcomes and/or have engaged third-party experts to analyse the outcomes of their interventions, but these methods are expensive, take time, do not cover a statistically representative sample of the total client base, and are often inconclusive (IFIF 2014).

However, a recent CGAP focus note mentions that despite the still relatively small, albeit growing, number of randomized evaluations (some 25 cited in this overview), the body of evidence suggests that financial services do have a positive impact on a variety of microeconomic indicators, including self-employment business activities, household consumption, and well-being (Bauchet et al. 2011). According to the randomized impact evaluations of microcredit to date, two main patterns stand out: small businesses do benefit from access to credit while the linkage to broader welfare is less clear. Savings help households manage cash flow spikes, smooth consumption, as well as build working capital. Access to formal savings options can boost household welfare. Insurance can help poor households mitigate risk and manage shocks. New types of payment services can reduce transaction costs and improve households' ability to manage shocks by sharing risks. Research also suggests that financial access improves local economic activity. At the macroeconomic level, the empirical evidence shows that financial inclusion is positively correlated with growth and employment (CGAP 2014).

The biggest impact study so far finds that microcredit helps the poor after all. The recent World Bank study (Khandkar and Samad 2014), covered more than 3,000 households in 87 villages across Bangladesh, and lasted more than 20 years. The study showed that 'group-based credit programs have significant positive effects in raising household welfare including per capita consumption, household non-land assets and net worth'. The study also showed significant positive effects from individual lending on household income and expenditure. Additionally, both boys' and girls' schooling levels as well as labour supply—which indicate the amount of hours workers are willing to work—increased concurrently with lending. However, critics like Roodman (2014), find that the study confuses statistical significance with real world significance and the outcomes do not make significant change in quality of life to motivate donors, socially responsible investors, NGOs, or public policy officials to further support the industry.

To conclude, the past year has seen a resurgence of growth in MFIs, stagnation in SHG outreach and increased policy options for expanding access to financial services for vulnerable people. The policy thinking and institutional models continue to be supply driven, though some initial steps in getting demand side inputs are evident. Customer protection levels have visibly improved in the MFIs. MFIs should get a certain and predictable set of indicators and benchmarks against which their social performance and customer centric practices can be measured, regardless of which institution undertakes the assessment.

In case of SHGs, the presumption of member relevance and comfort should give way to qualitative work for ensuring member protection and safety of savings. While with good intentions governments intervene to alter availability and cost of credit through large credit plans and interest subsidies, these measures distort financial markets and encourage indiscipline. Governments should find better ways of applying these resources through all existing financial institutions in a manner that does not make financial institutions unviable and ensure sustained access to services for poor people.

The financial inclusion effort through Jan-Dhan Yojana (JDY) is ambitious and bold. It also carries the risk that the results could be more inoperative accounts that banks find difficult to service as in the case of past mega schemes in financial inclusion. Avoidance of multiple accounts, building physical capacity of bank branches and BCs to service the new accounts, setting up of adequate infrastructure such as ATMs to honour the millions of new RuPay cards, and engineering a mindset change among bank staff are some key factors that can ensure success of this financial inclusion initiative.

On impact of microfinance, providing access to finance in whatever form is the beginning of a benefit stream to people who did not have a reliable access in the past. Once such a relationship is established between an institution and individual customer, any flaws that develop can be dealt with to improve the environment for both the supplier and customer. While the impact related debate will continue, the fact that the clients borrow repeatedly and continue to be clients for other financial services at least prove that these services are found useful by most of them.

In the following chapters the current year's report deals with issues of high growth, competition, competing institutions and policies, customer protection and responsible finance at the customer level (rather than at specific institution levels) and the role of policy establishments.

NOTES

1. Committee on Comprehensive Financial Services chaired by Nachiket Mor, Director RBI Central Board, 2013.
2. Assuming a membership of 13 per group.
3. Grant assistance of Rs 10,000 per group in four instalments from NABARD and incentive of 5 per cent per annum on net outstanding credit from the banks.
4. J.P. Morgan and Global Impact Investing Network carried out a survey of 125 fund managers, banks, foundations development finance institutions and pension funds around the world. Available at http://www.thinkadvisor.com/2014/05/07/investors-pouring-more-into-impact-investments.
5. Lok Capital, Michael and Susan Dell Foundation, Bellwether, Elevar Equity, Sequoia Capital and AavishkaarGoodwell.
6. http://www.moneycontrol.com/news/market-outlook/microfinance-loan-book-to-grow-to-rs-450-bn-by-fy16-crisil_1112879.html, last accessed on 1 July 2014.
7. Financed as part of the loan and collected as weekly/fortnightly/monthly equated instalments.
8. According to The Bharat Microfinance report 2013 of Sa-Dhan, Rs 377 crore was provided during 2012–13 for water and sanitation purposes.
9. In Credit-life, the cover diminishes as the loan outstanding becomes smaller over time.
10. Annual reports of some of the MFIs like Grameen Financial Services, interaction with MFI senior management.
11. SIDBI had commissioned a study on Responsible Financing Practices in MFIs; MicroSave carried out the study in 2013–14. The report is being finalized.
12. Great place to work is defined as one where employees trust the people they work for, have pride in the work they do and enjoy the company of people they work with.

2

Financial Inclusion through Business Correspondents

Is It More of the Same or Will This Be Different?

> Financial inclusion is about (a) the broadening of financial services to those people who do not have access to financial services sector; (b) the deepening of financial services for people who have minimal financial services; and (c) greater financial literacy and consumer protection so that those who are offered the products can make appropriate choices.
>
> Raghuram Rajan, RBI Governor.

Financial inclusion has been of importance to policymakers due to its potential to contribute to key development objectives such as economic growth and increased welfare. Without access to formal financial services, poor and low income families have to rely on informal mechanisms for their financial needs: family and friends, informal groups, moneylender, money hoarding at home. Though these informal mechanisms represent important and viable value propositions, often, they are insufficient, unreliable, and very expensive. Financial exclusion tends to impose large opportunity costs on those who most need these services (CGAP 2014). While initiatives to expand financial services are in progress across banking institutions and states, whether the services are offered in a manner designed to protect customer interests and prevent harm being done to ill-informed customers through inappropriate products and services? This chapter seeks to examine the current initiatives and the responsible finance and customer protection issues therein.

The extent of inclusion has been estimated recently by the Mor Committee on Comprehensive Financial Services for Small Businesses and Low Income Households; as of March 2012, only 36 per cent of the population have a bank account at an All-India level with 45 per cent of the urban residents and 32 per cent of the rural residents having bank accounts.[1] This estimate is not far from the FINDEX survey of the World Bank (2013), based on surveys in 2011, which estimated that only 35 per cent of Indian adults have access to a formal bank account and 8 per cent borrowed formally in the last 12 months. For a country aiming to achieve high growth rates of economic

Box 2.1 Policy Initiative of RBI

- In 2005, basic banking 'no-frills' account with 'nil' balance was introduced to make such accounts accessible to vast sections of the population. With a view to doing away with the stigma associated with the nomenclature 'no-frills' account and making the basic banking facilities available in a more uniform manner across banking system, RBI in 2012 advised banks to offer 'Basic Savings Bank Deposit Account' (BSBDA) with minimum common facilities and no-frills accounts were to be changed to BSBDAs.
- In January 2006, RBI permitted banks to engage Business Facilitators (BFs) and Business Correspondents (BCs) as intermediaries for providing financial and banking services.
- Banks were advised to implement Core Banking Solutions so as to enable them to make effective use of technology, to provide door-step banking services through BCs wherein the accounts can be operated by even illiterate customers by using biometrics, thus, ensuring the security of transactions and enhancing confidence in the banking system.
- To address the issue of uneven spread of bank branches, in December 2009, domestic scheduled commercial banks were permitted to open branches freely in tier 3 to tier 6 centres with population of less than 50,000 with a mandate to open at least 25 per cent of the branches in unbanked rural centres; these can be small intermediary brick and mortar structures between the base branch and the unbanked villages. The idea is to create an ecosystem for ensuring efficient delivery of services, efficiency in cash management, redressal of customer grievances, and closer supervision of BC operations.[2]
- Public and private sector banks advised to submit board approved three year Financial Inclusion Plan (FIP) starting from April 2010, for financial services to unbanked villages.
- About 74,000 villages with populations of more than 2,000 were provided with a banking outlet (either a brick-and-mortar branch or through BC). RBI plans to cover the remaining unbanked villages, numbering close to 490,000, with less than 2,000 population by allocating these villages to banks, for opening of banking outlets by March 2016.
- Guidelines on Financial Literacy Centres (FLCs) required rural branches of scheduled commercial banks to scale up financial literacy efforts through conduct of outdoor Financial Literacy Camps at least once a month.

development, ensuring basic financial services to the majority of the unbanked population is indeed a priority.

The Financial inclusion drive in the country led by RBI is a decade old and is exemplary in its zeal and energy—World Bank recognizes this in the FINDEX survey stating that 'Perhaps more than any other country, India has striven to extend financial access to all its citizens'. RBI has been pursuing a bank-led model for financial inclusion with the firm belief that only the mainstream financial institutions have the capacity to provide the full breadth of services—Savings, Credit, Remittance, Insurance, Pension, Payments, and Transactions.

KEY POLICY MEASURES TAKEN BY RBI

Progress made till 2014[3]

A snapshot of the progress made by banks under Financial Inclusion Plan during the period 2010 to 2014 indicates that:

(a) Banking outlets increased to nearly 383,000 (including about 46,000 branches) by end of March 2014 as against 67,694 banking outlets in villages in March 2010. The BC outlets numbered 337,000.
(b) About 13,000 rural branches have been opened during this period.
(c) Nearly 170 million Basic Savings Bank Deposit Accounts (BSBDAs) have been added taking the total number of accounts to 243 million.
(d) 5.9 million accounts have been provided overdraft facility.

Though several modes of increasing access such as opening of branches, BCs, Kiosks, offsite Rural ATMs, mobile vans, etc., are being deployed by the banks, the financial inclusion drive is largely through the BC channel. The BC model is sought to improve financial inclusion levels at low costs and take banking nearer to the location of the customers. The assumption is that agents, that is customer service persons (CSPs) will carry a much lower cost and will have flexibility to provide basic services to customers nearer their locations. This will obviate the need for setting up expensive brick and mortar branches, which are unlikely to be viable on a large base of small ticket customers.

Responsible Financing Practices and Customer Protection under BC

As BCs play a key role in the expansion of financial services in India, it is important that they observe adequate responsible finance practices. Those who are financially excluded are largely vulnerable populations who are semi-literate or illiterate, not familiar with use of technology, and not familiar with the formal banking sector. RBI has identified special target groups for financial inclusion—'disadvantaged groups such as women, youth, disadvantaged groups of the society and rural communities residing especially in Rural and unbanked/ under banked areas'. The inclusion measures have to be sensitive to the needs of these customers. The products and services and processes need to be suitable. Banks also need to adopt the same standards of due care of the branch-less banking customers as that of the branch customers. RBI and the government have been keen that FI efforts should result in affordable products and services and customers access the services hassle free.

As far as the BCs and CSPs are concerned, they would need to be available on most days of the month, and on predictable days, for customers to trust this channel as one that offers financial services. The agent needs to be trained to offer financial services, and remunerated adequately, for this channel to offer such quality financial services which satisfies customer needs. While growth in BC agents is important to expand physical access to banking services, a poorly functioning BC network can do significant damage to the reputation of the banking services. Technology and operational systems of BC should be such that it builds confidence of the customers to use these services. This chapter explores the responsible financing practices adopted by the banks and BCs/CSPs in financial inclusion.

Appointment and Training of BCs and CSPs

RBI has allowed a wide variety of BCs to be appointed by banks—corporates including for profit entities, telcos, not-for-profits such as section 25 companies, societies, and trusts, and reputed individuals. The list of eligible individuals/entities, who can be engaged as BCs, is being widened from time to time. (In the BC model, there are two types—the first being a savings-led model, which is the predominant model adopted for opening savings accounts and for providing other services. Banks have also been engaging MFIs as BCs for dispensing credit, which is the second, or the credit-led model. The discussions on MFIs as BCs are dealt with later in this chapter.)

Selecting the right agents is critical to the success of BC arrangement, especially during the introductory period where the BC needs acceptance to build trust among the customers.

Banks in general have favoured appointment of corporate BCs who, in turn, appoint the CSPs in the villages. Corporates, especially technology providers, have been appointed as BCs. Banks outsourced the opening of accounts and putting through transactions on the new accounts to technology firms that had the capacity to provide transaction hardware, and software and these corporate BCs have, in turn, appointed their own agents in different villages. Since these corporate BCs did not have ground presence, they relied on individuals with good local credentials to be appointed as their agents/ CSPs. Corporate BCs mostly appointed males as their CSPs who had good references in the local area, such as owners of small businesses and retired bankers. Often, the individuals interested in becoming agents of corporate BCs contacted the village elite and requested references. There have been instances where CSPs were from distant places and did not know the local villagers which led to trust issues especially in savings mobilization.

While appointing corporate BCs, few banks insisted that their branch managers should be involved in the selection process of CSPs who will be attached to their branches. In some of the banks, the disconnect between the BCs and branches has been high, which has resulted in inadequate efforts in financial inclusion and customer care. According to banks and BCs, where ever the branch manager has been involved in the selection of CSP, it has resulted in better ownership of the CSP by the branch and also coordination between BC and the bank. While this system has advantages for the banks in terms of administration and centralized control and also insulates them against operational issues, but many times BCs have not ensured responsible treatment of CSPs.

A few banks such as SBI, Indian Overseas Bank, Pallavan Grama Bank have largely recruited individuals as BCs since they consider that the CSPs are the extended arms of the banks and recruitment and performance management of CSPs are bank's responsibility. The branch managers have been involved and in most branches responsible for the process of selection of the individuals who are locals.

The CSP survey conducted by CGAP and CAB in 2013 also showed a marked change in the nature of employment of CSPs between the years 2012 and 2013. The largest chunk of 42 per cent CSPs was individuals directly engaged by banks. The initial enthusiasm of banks to engage technology service providers as corporate BCs seems to be on the wane. Technology procurement is being kept increasingly independent of CSP hiring.

Women as CSPs

Some of the banks who have recruited individuals have favoured women especially married women because (a) they do not move out, are available in the villages and hence attrition is likely to be low, (b) they are likely to view the income from BC operations as supplementing family income and will not be expecting remuneration to sustain a family as in the case of males.

As per CSP survey of CGAP and CAB, in 2013, less than 13 per cent of surveyed sample were women. States in the North, and North-east had very low female CSP engagement. Comparatively southern states of Tamil Nadu, Andhra Pradesh, and Karnataka had more women as CSPs. The trends in engagement of women as CSPs remained the same as in the previous survey.

Though the SHG movement with millions of women members has been widespread and well embedded in the villages, practice of SHGs acting as BCs has not really taken off. Members of the SHGs, usually leaders and bookkeepers, have been recruited in their individual capacity. The institutional structures of SHGs, Village Organizations, and Federations who are closer to the villages have largely not been appointed as BC/CSPs.

> **Box 2.2** SHG Members as CSPs
>
> In Andhra Pradesh, the government has mandated that the agent for the payment of social welfare schemes of the government must be a member of an SHG. Every month the payments worth Rs 72 billion are delivered through 16 million bank accounts through 26,000 women bank agents. As per CGAP study, the women agents express that their primary motivation is social service and giving back to the community, and not financial incentives.
>
> *Source*: Banerjee 2013.

The appointment process of BCs and CSPs has had an important bearing on the understanding of the CSPs/BCs of the local area and context, orientation of the BCs to generate business, embeddedness of the BC operations in the branches and sustainability of the services to the customers.

Training of CSPs

Training of the CSPs have been largely left to the network managers and supervisors of the BCs. It has been largely confined to operation of the PoS machine, its technology, and banking procedures on opening of accounts. Rarely the trainings have addressed aspects relating to customer interface, products of the banks or customer grievance redressal. Since BCs are already operating on thin margins, they have not invested adequately in training the CSPs. Though IIBF has developed detailed modules for training of the BC agents, very few banks have insisted on such detailed training. Certification of the CSPs is rare. NABARD used to reimburse the cost of training in IIBF modules which has been discontinued; this facility can be revived.

The CSP survey, 2013 also finds that in some states more than 25 per cent CSPs had not been trained. In some others the training durations was too small to be fully effective. Quality of training also needed a thorough examination.

Banks who involved themselves in the selection of CSPs (CSP selection in case of Corporate BCs or individuals BC as the case may be), have been more hands on in the training of these agents. The trainings have been more detailed on customer interaction, products and even grievance redressal mechanism. Few banks arrange refresher training periodically. Apart from classroom training, the senior management meets the BCs and CSPs at regular intervals to understand the operational issues they face and offer solutions.

The Rural Finance Programme of GIZ has carried out a pilot programme in enrolment of SHG members as BCs in collaboration with Grameen Bank of Aryavrat and Rajiv Gandhi Mahila Vikas Pariyojana in 16 Gram Panchayats. The Indian School of Microfinance for

Women (ISMF) has provided training to the SHG women to act as BCs which has developed/customized three modules for training of the CSPs (bank *sakhi*s).

Training material, explaining the technical process involved in enrolment process, is in simple language and is imparted through extensive use of diagrams, demonstrations, posters, etc. Content has been customized in a simple and lucid language. Bank Sakhis are provided innovative tools such as role plays, animated movies, posters so that information can be easily understood in the local context and which they can transmit further to the community members (see Table 2.1).

The early results of the pilot are very encouraging – all households in the panchayats have savings bank account with 60 per cent of the accounts having more than 2 transactions per month. Each sakhi has, on an average, 16 transactions per day and this is likely to go up with full rollout of products.

Since RBI regulations specify that banks are ultimately responsible for the conduct of their agents they need to take keen interest in developing the capacity of the agent network.

Some of the key lessons learnt so far have been:

(a) technology providers may not be the right choice for appointment as BCs since they do not have the experience in agent management or customer interface,

(b) Involvement of local branches in the CSP selection and orientation is critical for promoting trust and ownership among the customers.

(c) CSPs have to be credible persons from local area in order to have the trust of the customers.

(d) CSPs need to be well trained and it is banks' responsibility to ensure that these agents are capacitated well.

Business Planning and Marketing

While banks have prepared plans for financial inclusion at head office and regional office level, these are yet to be broken down into branch-level targets and integrated into a branch business plan. Business plans at bank/branch and agent levels are required to target break-even revenues within a period of time. Without such plans the business case will be weak.

Moreover, performance under FI plans of the branch manager and other branch staff should be measured. Unless FI is treated as a key responsibility area of the branch manager and adequate weightage is assigned in performance appraisal and periodic monitoring, the desired results and responsible treatment of the agents and clients will not be achieved.

Marketing support from banks for the BC channel has been minimal. Most common marketing support offered

TABLE 2.1 Design of Training for BCs by ISMW

Module	Stage of Training Delivery	Contents
Module 1: Functioning of the Business Correspondent and the Enrolment Process	Pre-enrolment module to be delivered while handing over the enrolment kit to the CSPs	**Introduction** – BC model, stakeholders, BC roles and responsibilities **Pre-enrolment** – promotion and awareness building **Enrolment Process** – account opening and data entry in laptop, maintenance of registers
Module 2: Financial Transactions, Smart Cards, and PoS Machine	Pre-transaction (Post-enrolment) module to be delivered while handing over the smart cards to the CSPs for distribution Also the identified SHG women members are trained to use the Point of Service (PoS) devices for financial transactions at community level	**Post-enrolment** – verification and distribution of smart cards **PoS machine** – use and maintenance **Conducting transactions** – financial and non-financial **Records to maintain** **Cash management**
Module 3: Other Financial Products and Services	Banks/BCs/CSPs are ready to offer other extended financial products and services	**Other financial products and services** – FD, RD, credit, insurance, and pension

by banks is in form of posters, name boards, introductory village meetings by branch staff. Since banks have better reputations and larger image than their BCs do, they have a key role to play in marketing BC services and creating trust among potential customers to do banking transactions at non-bank retail outlets, with which they never had any kind of financial relationship.

Marketing efforts should aim at building customer trust in the new channel. Banks will have to persuade hesitant customers that this alternative is not only secure and trustworthy, but in fact a preferable option for them. Banks need to refer customers to the bank's BC agents. They must also inform customers that these agents are monitored by the banks. This should be made mandatory.

Products on offer through BCs

The reason for the country's financial inclusion efforts to be bank led is that only banks will be able to offer entire suite of financial products at an affordable rate and hassle free manner. However, the experience so far shows that the branchless banking in India is largely mono or at best a dual product industry where most BCs offer a simple no-frills/BSBDA account to customers through which many process government payments. Remittance or money transfer is the second most commonly offered product by banks.

CGAP and CAB undertook a joint exercise to carry out a survey to assess the quantity and quality of services provided by CSPs, their finances and motivation. This survey of 2013 is a sequel to an earlier survey of 2012. In August and September 2013, customer service points of 1254 BCs in the country were surveyed in 15 states.[4] Most of the CSPs offered more than one product/service to the customers. The availability of products from CSPs had improved compared to the position in 2012. In MP 63 per cent CSPs offered three or more products, indicating that depth of services was higher. In Bihar 61 per cent and in Rajasthan 48 per cent CSPs offered only one product reflecting shallow services (see Table 2.2).

TABLE 2.2 Comparison of Products Offered by CSPs

Number of products offered	Percentage of CSPs in 2012	Percentage of CSPs in 2013
1	18	10
2 or more	82	90
3 or more	54	77

As can be seen from the table above, most of the CSPs offered more than one product/service to the customers. The availability of products from CSPs had improved compared to the position in 2012. The proportion of CSPs offering multiple products (3 or more increased from 54 per cent in 2012 to 77 per cent in 2013, indicating increasing capacity and maturity in the CSPs (see Figure 2.1).

Even where BC agents offer multiple products, they focus on higher commission services such as remittances. There are instances of some CSPs who are not satisfied with their remuneration referring the customers to bank branches rather than providing the services.

Savings Accounts and Services

The drive for opening of no-frills savings accounts since 2005 ensured that those excluded had a basic savings account with the bank. The 'no minimum balance' condition ensured that the savings service was made accessible for the poor. However, in 2012, the nomenclature was changed to BSBDAs to achieve a shift in mind set of bankers to operationalize the accounts. The characteristics of these accounts are customer friendly, as seen in the following points:

(a) No requirement of any minimum balance
(b) Deposit and withdrawal of cash at bank branch as well as ATMs; receipt/credit of money through electronic payment channels or by means of deposit/collection of cheques
(c) No limit on the number of deposits that can be made in a month; maximum of four withdrawals in a month, including ATM withdrawals
(d) Facility of ATM card or ATM-cum-Debit Card

All banks have given operational targets to BCs to open BSBDAs and pay commissions for opening of these accounts which has led to opening of large number of accounts. Governments have been keen to route their payments through bank accounts to avoid leakages—NREGA wages, social security pensions, and the direct cash benefit transfers are increasingly routed through bank accounts. These two measures have seen a growth of BSBDA accounts by banks. As of 31 March 2013, total number of BSBDA accounts is 182 million worth Rs 182 billion with an average balance of Rs 1,000 per account.

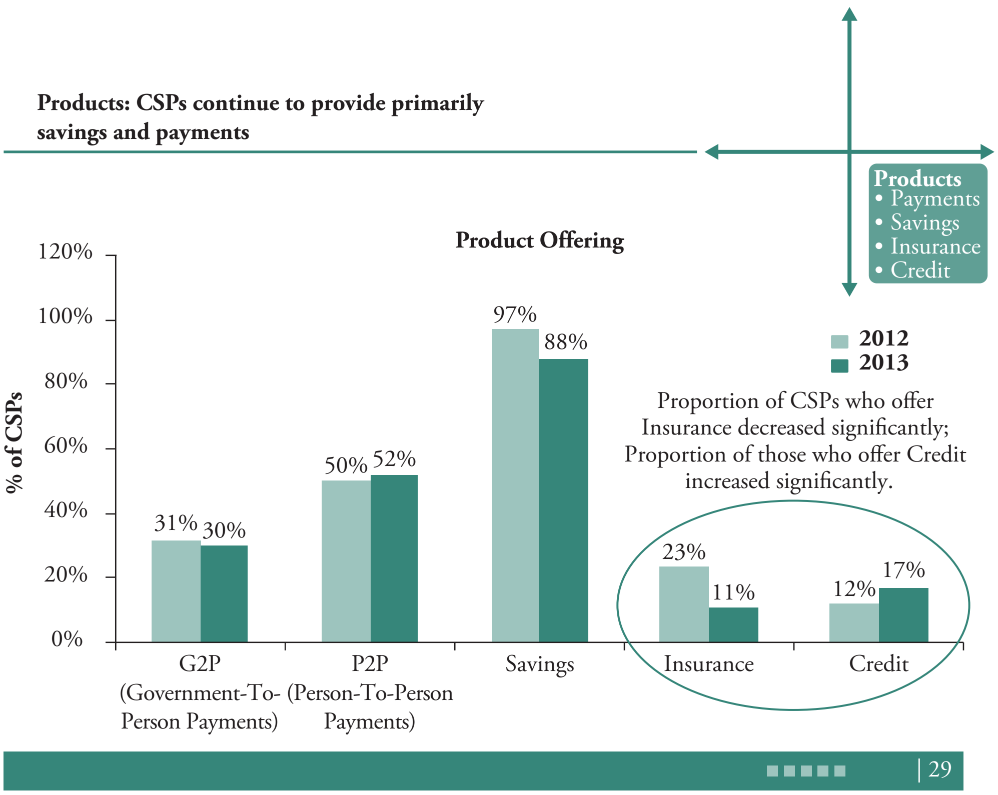


FIGURE 2.1 Products Offered by CSPs

The growth in number of accounts has been impressive but 60 per cent of the accounts are reportedly dormant (SBI 2014).[5] The following issues result in customer discomfort in savings services leading to dormancy (see Box 2.3).

a) There is an inordinate delay in opening of accounts after the documentation is done by CSPs. In some states branch managers are not cooperating to open the accounts.[6] Delay in opening of accounts seeds doubts in customers about ease of operations in future (see Box 2.4).

b) Agent remuneration incentivized opening accounts rather than mobilizing savings. Many of the agents did not actively solicit transactions and deposits.

c) The requirement of different accounts for direct benefit transfer programmes and for the financial inclusion programme has resulted in multiple accounts. An example is the need to use MGNREGS accounts as conduits for withdrawals rather than as a place where recipients can also store their savings. This causes duplication of efforts; confusion amongst banks, service providers, and consumers; raises costs; and makes administration difficult (Chopra and Hamza 2013).

d) Clients would like to have facilities such as ATM card, which will give them the flexibility and convenience to operate and not depend entirely on BC. However, some banks actively discourage issue of ATM cards by making unaware clients declare at the time of enrolment that they do not want such facilities.

e) Very little trust-building and marketing efforts are carried out by base branches. Clients hesitate to part with their hard-earned funds with CSPs who are mobile and do not operate from a fixed location. Their concerns are whether their funds will be safe and whether they will be in a position to access these funds in case of need.

f) Many banks are yet to make the accounts operable from the branches as well. In case of technological glitches, cessation of services of BC/CSP, customers are not able to transact in their accounts.

g) Products like recurring deposits and fixed deposits which are available at branches are not offered at present through BCs.

Box 2.3 Going Beyond Numbers

'A big challenge lies in moving beyond (business correspondent agent and enrolment) numbers and looking at how we actually make a difference. Unless banks are convinced that reaching out to the common man is not just a forced regulatory imperative but a potential business opportunity, the numbers will remain without life'.

Dr D. Subbarao, Governor, Reserve Bank of India, 4 July 2012 (MicroSave 2012a).

Box 2.4 Delay in Activation of Savings Accounts

'BCs open accounts with all documents but uploading is to be done by the technology provider at a central location. This process takes time; more than 350 accounts are pending activation for 6 months.'

CSP Network Manager of a BC firm, Rajasthan.

Credit Products

Most of the banks do not offer credit products through the BC network (see Box 2.5). RBI guidelines on FI specify that overdraft facility of Rs 5,000 should be offered as part of BSBDAs. As per RBI, up to March 2014, 5.9 million basic banking accounts availed overdraft facility of Rs 2 billion. However, considering that 243 million BSBDAs were opened by March, 2014, the overdraft facility has been availed in a very small fraction of these accounts. There is resistance from branch managers to offer this facility for fear of default. Senior managers of banks also mention that wherever these are opened, branches and CSPs have not adequately educated clients of the operation of these accounts, so that the limits sanctioned are not used.

A few banks are sourcing loan applications for Kisan Credit Cards and General Credit Cards through the BCs with loan appraisal and sanctions carried out by the branch staff. However, even for sourcing loans the CSPs require training so that they are able to interact with the customers adequately.

Box 2.5 Credit Product is Not Offered Through BCs

Credit was not usually offered through CSPs. Banks had reservations in entrusting loan origination to agents. While 16 per cent CSPs offered credit across the country, Uttar Pradesh, Rajasthan, and Bihar had a very low proportion of CSPs providing credit. In Madhya Pradesh 37 per cent of CSPs offered credit, which was impressive.

CGAP-CAB Survey report on CSPs, 2013.

Some banks are utilizing the CSPs for recovery of NPA loans and offer them commission based on recoveries. However, the CSPs have not been trained adequately on ethical recovery practices.

One of the major stumbling blocks in the growth of the BC model is the unwillingness of most banks to provide credit through BCs.

Micro-insurance and Pension

While the potential for distributing these products is high, many of the products are complex and involve higher risk of miss selling. At present banks are distributing some of the social sector insurance schemes such as Aam Aadmi Bima Yojana through BCs. Very few banks offer insurance in tie up with private sector and pension products. BC channel can be used to sell simpler insurance products. Some of the insurance companies are contemplating appointment of exclusive micro-insurance agents; these companies can leverage the existing BC infrastructure which will boost the viability for all stakeholders.

Remittances

This is the most sought-after product by both urban customers and CSPs. A large segment of urban customers are able to effectively use BC services through CSPs. They would be able to transact better if greater integration and interoperability with main-stream banking is established. The migrant workers residing in the urban areas remit money to their homes in the villages. They have to ensure that they use a CSP that is linked to a bank in which their relative back home has an account in order to transfer the money from account to account. Many CSPs offer National Electronic Funds Transfer, or NEFT-based remittance facilities through which customers can remit money to any bank account connected to NEFT, but they have to pay a remittance charge. The remittance facilities are cost effective for the customers, compared to the alternative remittance channels.

Self-help Groups' Financial Transactions

With exponential growth in SHGs, both branch staff and SHGs complain about the excessive workload and delays in transactions to deposit and with draw cash from SHG accounts. BCs have still not been authorized to deal with SHGs; the usual explanation has been that the technology does not allow bio metrics of both leaders to be read and accepted. A few BCs have been given tasks of group formation, overdue loan recovery from SHGs but not regular transactions.

Making available BC services for SHGs will improve responsible finance practices within groups. The SHG bank transactions have become leader centric since members were reluctant to assume responsibility to visit the bank branch. Allowing regular transactions through BCs will save time for both SHGs and banks.

Government Payments

The central government and a number of state governments have actively supported using the banking network, especially the BC agents, to pay out the MGNREGS wages through bank accounts. In 2013, the government expanded the scope of making government payments directly to the accounts of people and several state governments also routed their payments through bank accounts. Beginning with gas subsidies, the list of direct benefits paid to people through their banks accounts consists of old age pension, disability pension, scholarship for students, and others. Customers are benefiting from such direct transfers in terms of convenient withdrawal, full amount being reached to them with no leakages. The linking of unique customer identification provided by UIDAI (Aadhar) with bank accounts ensured that leakages through errors of omission and commission are avoided savings millions of rupees for the government.

However, the experience so far shows that electronic payments do not promote financial inclusion. Government instructions to the agents are to make the payments in full and the untrained agents do not promote small savings in the accounts. Since no other products are marketed through the channel and hence the payments, especially through direct benefit transfer (DBT) does not presently promote financial inclusion (see Box 2.6).

Box 2.6 Efficient Payments Vehicle but no Financial Inclusion

From April to September 2013, CGAP[7] directed a research study to better understand how the electronic payment of social benefits in Andhra Pradesh impacted the lives of poor beneficiaries, the agents who complete the transactions, and the banks who are disbursing funds. The research showed that while there are no banking regulations that prevent the electronic payments from being used to promote financial inclusion, there are design elements in the program that act as barriers and prevent electronic payments from linking beneficiaries with additional financial services.

Key Findings

1. Electronic benefit transfers run on technological platforms that could easily be applied to other services, but so far these government-to-person (G2P) transactions are isolated from other financial services.
2. Even though beneficiaries use a variety of formal and informal financial tools, they use the electronic channel only to collect payments from the government. Even though technically these accounts are basic savings accounts, none of them are being used for savings by recipients. Since agents act as intermediaries, beneficiaries remain only passive users of the technology used to make payments and leaves customers unaware of potential linkages with other financial services that could make their lives easier. It also prevents them from knowing account-specific information, such as whether payments have been credited to their accounts or the reasons why a payment might be delayed.

Continued

3. Agents, who help execute the disbursements, are neither trained nor incentivized to treat the electronic payments as a banking channel. Additionally, since all of the disbursements occur within a 10-day window each month, an agent must do over 100 transactions per day, so their time with each beneficiary is extremely limited.
4. Moreover, agents would need to be available on most days of the month, and on predictable days, for customers to trust this channel as one that offers financial services. The agent needs to be trained to offer financial services, and remunerated adequately, for this channel to offer quality financial services.
5. After studying five business models for electronic benefit payments, CGAP found that the business case for both banks and agents is weak. Banks are paid a fee by the governments to deliver payments, but it does not cover the bank's costs. Agents working to administer the program make less than the minimum wage.
6. Customer service standards for agents working should also be listed and accepted, which should dictate the costs and process finalization.

In order to overcome these challenges, the following recommendations are made:

- Improve the business case for banks by increasing their commission from 2 per cent to 3 per cent (up to 3.5 per cent in tribal areas).
- Improve the business case for agents by giving them a 1 per cent commission on transactions, allow them to carry out other kinds of transactions, and stagger payments throughout the month to make the agent's role less stressful.
- Improve the user experience by removing the full disbursement mandate so that recipients can leave small value deposits in their accounts and by allowing customers to access diverse financial services at agent transaction points.
- Focus on clear and consistent communication with recipients so that they better understand what the account is and the functionality it offers.

The study concludes that despite the challenges that exist in making electronic government payments in Andhra Pradesh, the state has made impressive progress over the years and is an important leader in improving the payment delivery mechanism for the very poor and opening the possibility for financial inclusion.

Box 2.7 International Experience in Payments and Financial Inclusion

With more than 400,000 agents as of December 2013 according to the Central Bank, Brazil has one of the largest agent networks in the world. To examine the impact of agents on financial inclusion in Brazil, a national representative survey was conducted in 2013, which finds that agent impact on financial inclusion in Brazil is mixed.

The study finds that nearly 70 per cent of respondents visit agents regularly to pay at least one bill through this channel. However, only a very small proportion of respondents use agents for transacting through a bank account or accessing new financial products: just 12 per cent of banked respondents usually make their withdrawals at an agent, and 9 per cent usually deposit at an agent. Even fewer have opened a bank account (4 per cent of banked individuals) or accessed credit (6 per cent) through the agent channel. This regular interaction represents a missed an opportunity to bring new clients into the formal financial system through the agent channel.

Although the percentage of Brazilian respondents who use agents for financial services beyond bill pay is small, the agents have reduced exclusion by serving traditionally underserved populations. Those who use the channel are more likely to be poor, less educated, female, and to live in small towns, rural areas, and the North-east, Brazil's poorest region. Few Brazilians use the channel for transformative access to financial services besides paying bills, but agents have succeeded in reaching poorer and more remote populations.

Source: Sanford 2014.

Continuity of CSPs and Services

An important factor that will give the customers the trust to use their savings accounts and deposit their hard earned money is the continued and reliable service from BC/CSP. A trust worthy and courteous person, available at a fixed place and fixed time, with uninterrupted service quality and with full knowledge of the products can only build the confidence of the customers in the channel.

However, the experience so far has not been encouraging as far as the continuity of CSP/BC at village level. Some estimates show that in spite of the large numbers of banking outlets reported to have been established, the attrition rates have been high and the closure rates of BC outlets can vary between 25 and 80 per cent in different states.[8]

There are four aspects that are contributing to the high attrition rates which are leading to customer discomfort: (a) adequate remuneration is not offered to the BC/CSP and often payments are delayed; (b) a connected issue has been that enough products are not distributed through the BC channel resulting in very low transactions and usage; (c) technology-related issues disrupt services affecting the business as well as customer trust in the mechanism; and (d) CSPs continue to be treated as outsiders and not agents of banks by the bank staff. Unless the bank staff treats BCs/CSPs responsibly, they cannot ensure that the clients get uninterrupted services. These aspects are discussed as follows:

(1) Adequate remuneration: Inadequate remuneration has been the most important reason for the attrition of the CSPs. Two factors for the inadequate remuneration have been:

(a) Many banks have been following only business/transactions based payments to the BCs/CSPs. Minimum fixed salary has not been offered by most of the banks to BCs and in turn by BCs to CSPs. Without adequate transactions and not enough products to ensure adequate number of transactions, CSPs have not earned adequate remuneration to keep them interested in the job.

(b) The practices followed by the corporate BCs in payment to CSPs also vary. While some retain 30 per cent of the bank commissions to cover their overheads and pay 70 per cent to CSPs, there have been cases where the CSPs are offered less than 50 per cent of the commission received from the bank.

There are also instances that though the banks have been paying the BCs the agreed transaction-based fees, BCs have not been paying CSPs adequately. Timely payment of remuneration has been an issue.

CSP Revenue expectation and realization: The CGAP–CAB survey of CSPs, 2013 found that the median revenue was about Rs 2,700 per month which was lower than the minimum wages for manual labour. The revenue expectations of the CSPs were high when they started off as agents. The gap between expectations

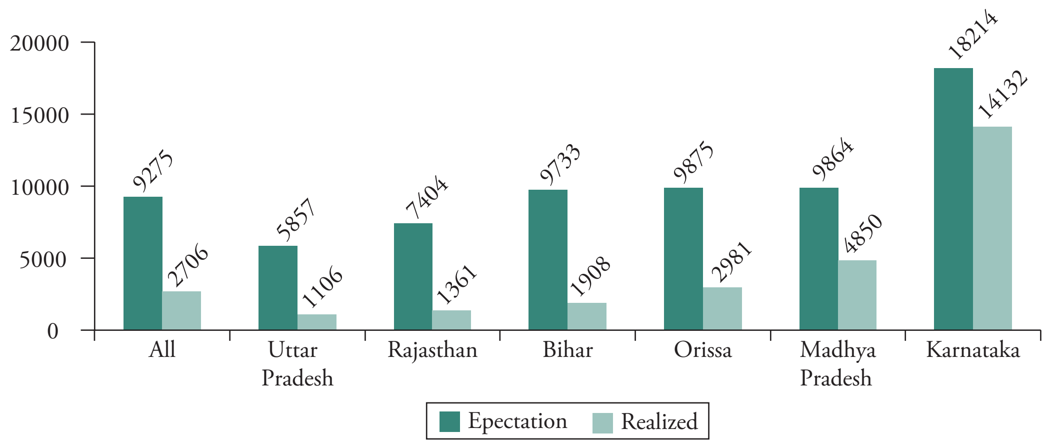


FIGURE 2.2 CSP Remuneration: Expectation and Realization

and realized remuneration is large. As per the survey, 53 per cent of CSPs depended solely on the income from their work as agent of bank. The minimum wages for clerical work in rural areas is set at about Rs 200 per day and Rs 5,000 for a month of 25 working days. The CSPs get about 55 per cent of the minimum wages fixed and if they are fully dependent on being a CSP, it would be difficult for them to support their livelihood needs (see Figure 2.2).

The study finds that the result of the low remuneration level is dissatisfaction among CSPs.

- Their earnings from CSP work are less than one third of what they expect in most cases.
- The disparity between expected median revenue and actual revenue increased from what was reported in 2012 survey.
- 180 CSPs that were surveyed in 2012, were again surveyed in 2013. Their income levels had remained static and cast doubts on their continuing in service as CSP.
- CSPs in Madhya Pradesh, despite realizing a large proportion of revenues against expectations, were surprisingly dissatisfied to the extent of 60 per cent.
- Enhanced reputation and goodwill of the community continue to be the major reason behind the CSPs continuing in the job. 53 per cent of CSPS cited this as the reason.

The Poorest States Inclusive Growth (PSIG) Programme supported by UKAid through DFID, UK, has commissioned a 'Drill-down BC study in Bihar' with the key objective to improve the current body of knowledge around the effectiveness of the model and provide recommendations to improve its effectiveness and to strengthen its policy advocacy initiatives. During the field visits in Bihar, MicroSave (2014) observed situations on the field where CSP had received no remuneration for six months or more. This has resulted in high levels of dissatisfaction and is likely to lead to attrition in the future. Another observation was that many CSPs often had limited or no understanding of the fixed and variable commission component they receive monthly. They do not currently receive any information on the commission structure and break-ups of the same. However, there are exceptions like Sanjivani Vikas Foundation (SVF), BC for SBI, communicates the details of monthly commission earned by each CSP as per the commission structure provided by the banks.

There is a huge gap between commission of least performing (Rs 2,000 per month) and best performing (Rs 75,000 per month). SVF faces challenges to optimize the level of business for each CSP agent associated with organization.

Learning from the experience of FIP 2010–13, the banks mention that under FIP 2013–16, they are now planning to pay a fixed threshold payment to CSPs apart from travel allowance; a few of them are also planning to directly credit this amount into the accounts of CSPs to ensure transparency and stop any malpractice.

Investment with low returns: BC banking business requires upfront investment with a long investment horizon and BCs and their investors find that this business is a high cost and low profit margin model. High level of requirement of working capital and inadequate support from banks are the other major reasons cited for lack of viability.

There are other practices that have increased the costs for the BCs/CSPs. RBI has also expressed concerns that the insistence by banks on BCs to fully prefund their accounts even after considerably long business relationship has become a major impediment in scaling up operations of BCs and also places a limit on the transactions that can be carried out. Often CSPs complain of having to wait long in the bank branch for cash withdrawals/payments at the cost of disrupting their transactions with customers.

Many BCs are not able to find investors who will invest further in the business primarily because of lack of confidence in the business model and predictability of revenues from the operations.

(2) Low level of transactions: As per the CGAP–CAB study, CSPs were not making adequate number of transactions across the country. The average transactions per day were 9; marginally less than the position prevailing in 2012. Bihar, Rajasthan, and Madhya Pradesh CSPs reported much lesser transactions per day. The number of transactions is linked to revenues and viability of CSP (see Figure 2.3).

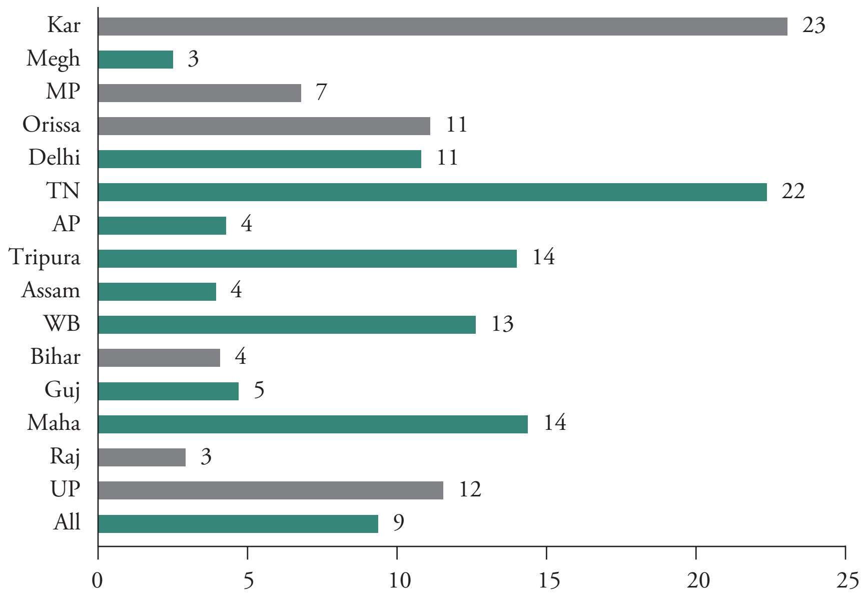


FIGURE 2.3 No. of Transactions per Day, State-wise

Source: CGAP and CAB study on CSPs, 2013.

(3) Technology-related issues: FI measures heavily depend on technology. In the field technology failures have plagued the smooth operation of customer enrolment and transactions. Hardware failure—in the form of PoS machines, computers, printers, cards, biometric scanners and other equipment—is common. Usually spare standby machines are not available immediately and services to customers get disrupted for several weeks due to failure of machines. The capacity to service the equipment is very low in the districts. Technical manpower is scarce and available personnel are unable to cope up with demands from the field. Learning by the past experience, the banks are including uninterrupted service through standby spare PoS machines in the MOUs with the service provider.

Software-related glitches have also been reported during the discussions with BCs and banks. Automatic credits and debits in certain accounts and types of transactions, denial of access to some set of accounts after software upgrades, etc., were reported in the field. Software glitches took much longer to rectify, as the original designers and source code have to be consulted to remove software infirmities.

Network connectivity problems reduce efficacy of CSPs and causes disruption of customer service. Delayed or denied transactions result from connectivity failures. These problems are much severe in underdeveloped states on account of lower levels of connectivity (see Box 2.8).

BOX 2.8 Weak Rural Connectivity adds to Woes

'Connectivity has been a major issue in the village since mobile/internet signals are very weak. Often transaction takes 30 to 40 minutes to be put through. Smart cards are often not readable. There is heavy demand for opening accounts from customers but I am going slowly due to technological glitches. Customers get impatient and also some look at me with suspicion as to why I am delaying the transaction.'

Source: CSP, Sundargarh District, Odisha.

The CGAP–CAB survey of CSPs found that 72 per cent of all CSPs faced constraints from technology of operations, such as connectivity failure, equipment failure, card failure, and biometric authentication issues.

States like Bihar have additional issues related to infrastructure. The study by MicroSave (2014) finds that limited road connectivity makes the monitoring of the agents, grievance handling and technical handholding very difficult as the operations and sales team of the BCs and banks are unable to reach the agents easily. This also has an adverse impact on customer service and trust levels. Another challenge that cuts across all BCs is the delay (of up to a year in some cases) in the printing of the smart cards which have to be provided to customers. This delay further reduces the confidence of customers and affects transactional volumes.

Many banks have still not introduced interoperability of BC systems with their banks. When CSP leaves or BC itself is terminated, lack of inter-operability leads to a challenging situation to the clients who severely limited access to their accounts till such time a replacement is made operational. But operationalizing a new BC and the CSPs can be a lengthy process on account of the technology issues and limited interoperability

(4) Treatment of agents by branches: With increasing number of CSPs placed in different parts of the country, banks should ensure that service quality is satisfactory. If good and timely training, adequate backstopping, timely payment of salary and other issues are not dealt with well, the service quality will deteriorate.

MicroSave, in their study of BCs in Bihar (2014b), found that the agents complain about not acknowledged in bank branches, about delays in account opening and passbook issuance, and finally, having to stand in long queues for depositing and withdrawing cash instead of having the process fast-tracked for them. However, bankers complain that their branches are understaffed when compared to the huge work load that they have in rural areas. The rural bank branches have two or in some cases, three people managing the entire bank branch and thus they do not have time for managing the FI operations.

Branch managers and their attitudes towards BC/CSP need to be more positive. CSPs have not been provided with the contact numbers of bank officials in charge of FI in most banks. The CSPs find it difficult to report directly on technological glitches which are not getting solved for considerable time.

Banks have to realize that the well-being of their agents is key for sustaining a relationship with the unbanked. This message has to go through to the lowest rung of bank staff so that they treat the CSPs as extended arms of the banks. RBI's recent instructions that the boards of the banks should review the engagement and performance of BC, ensure adequate remuneration to BC, and review the products handled by BC hopefully will ensure better working conditions and retention rates of CSPs. This can only provide customer comfort.

Customer Protection and Satisfaction

(1) Protection of consumer assets against fraud and misuse: Banks should protect consumers' deposits and other similar financial assets against fraud and misappropriation whether it is through their branch network or through their agents.

The consumer data and transaction information between the client and the agent needs to be secured

BOX 2.9 RBI Guidelines on BC Model[9]

With the objective of ensuring greater financial inclusion and increasing the outreach of the banking sector, the Reserve Bank permitted banks to utilise the services of intermediaries in providing financial and banking services through the use of business correspondents (BCs).

As reported by the banks under their financial inclusion plans nearly 2,48,000 BC agents has been deployed by banks as on March 31, 2014 which are providing services through more than 3,33,000 BC outlets. Nearly 117 million basic saving bank deposit accounts (BSBDs) opened through BCs remained outstanding as on March 31, 2014. Though the number of BC-ICT transactions showed considerable increase, it was observed that the increase in the volume of transactions was not commensurate with the increase in the number of BCs engaged and the accounts opened through them. A review of the BC model highlighted that the cash management system followed by the banks for BC operations was one of the major impediments in the scaling up of the BC model.

In order to facilitate the scaling up of the BC model, the Reserve Bank recently issued the guidelines asking bank boards to (i) review the operations of BCs at least once every six months with a view to ensuring that the requirement of pre-funding of corporate BCs and BC agents should progressively taper down; and (ii) review the remunerations of BCs and lay down a system of monitoring by the top management of the bank. it also directed that the cans handled by BCs be treated as the bank's cash and the responsibility for insuring this cash should rest with the bank.

adequately. This appears to be the weakest area with the highest risk for the banks where the BC and bank systems are not integrated.

The customer information flows through and gets stored in technical service providers (and BCs) servers. Transactions in respect of clients between BCs and the bank also need protection. RBI's regulation requires banks to link FI servers and Core Banking Solution (CBS) servers seamlessly for real-time operations.

Since the operations are based on the biometric identification, the chances for fraud are minimal according to banks. Very few frauds have been reported so far. But authentication failures have led to overriding security features in many places, compromising protection available to customers. Banks are also stepping up vigilance to ensure that customers are not duped. The PoS device shave different security features to protect customer interests. Some PoS devices require two cards—one of the CSP and the other of the customer. Some devices are provided with a voice confirmation of transactions so that customers that are unable to read screens can hear the confirmations. The PoS will not work if there is no paper placed in the printer slot. These control mechanisms can ensure reduced incidence of frauds through BC.

There are several risks arising from use of agents that can compromise consumer protection has to be built. Table 2.3 discusses possible risks and mitigation methods at bank and customer levels.

MicroSave (2012a), commenting on customer-level risk mitigation states that:

> The risks arising out of some of these can be mitigated through better integration and interoperability. For instance, if the customers can even check balance details or last few transactions at a linked branch, they can reconcile with the information received from agents servicing them. This would enable consumers have greater trust in the system and deter agents from attempting fraudulent activities. Discouraging manual receipts and following a practice of system generated receipts is a deterrent for errant agents and a major comfort factor for customers.

TABLE 2.3 Risks from use of Agents in Banking and Mitigation

Type of risk	Mitigation at bank level	Mitigation at customer level
Strategic risk: Agents conduct activities on own account that might conflict with strategic goals of the bank	Provision of information to customers through different media and literacy programs to the needy customers. Dissemination of the roles of agents and what they are authorized to do on behalf of banks. Regular, periodic monitoring of agents activities by bank.	Bank fully apprises customers of roles and tasks of banking correspondents. Customers should know what to expect from banking correspondents. Systems should be in place so customers can check with the bank on whether agents' actions are authorized. When the customers approach the bank, banks should make full disclosure.
Reputation risk: Agents render poor quality of service, agents do not meet service standards, harming the bank's reputation and alienating customer	Introduce system for seeking cusomer feedback. Train banking correspondents to ensure their skills are current. Set up service standards for banking correspondents. Contracts with banking correspondents, should ensure that agents provide quality service to customers.	Bank gives customers a statement of service quality when they open an account. Banks should put in place system of recording complaints and redress regarding quality issues. Signs detailing how complaints and grievances are handled should be prominently displayed in branches.
Compliance risk: Prudential guidance and regulations are ignored by agents, resulting in service disruption or loss of customer confidentiality Systems are inadequate and do not ensure banking correspondent compliance	Establish key prudential requirements to be fulfilled by the bank staff to customer satisfaction. Banks to ensure compliance systems and controls are in place to sustain uninterrupted service. Establish a system of penalties for wilful non-compliance. Remove and blacklist those who breach customer confidentiality.	Bank implements a policy of indemnifying customers for any breach of regulations that adversly affect customer interest.

Continued

Type of risk	Mitigation at bank level	Mitigation at customer level
Contractual risk: There is limited capacity to deliver what was agreed to under the contract, and the bank is unable to enforce the same.	Ensure due diligence of agents is thorough and comprehensive. Enforce through adequate financial securities or performance guarantees.	Not a significant concern
Access risk: It is difficult to generate data from agents in a timely manner for reporting to regulator	Introduce appropriate level of technology; train banking correspondents, provide for standby systems and build redundancies to handle system failure	Not a significant concern
Concentration risk: Banks lack control over the growing business and influence of agents in the local area of operation. Agents cross-sell and mis-selling products to maximize incentives. Large operations through a single entry (especially an individual banking agent) make the agent indispensable	Set up monitoring and supervision systems and establish rapport with customers. Set prudential limits for business through agents consistent with exposure and service quality (like credit exposure limits.) Create agent incentives that do not promote cross-selling and miss-selling	Bank periodically informs customers that services offered by agents are on behalf of the bank and that, even without specific agents, the bank will maintain service volume and quality.

Source: Srinivasan 2010a.

Mainstream banking adopts good practices and measures for areas like data protection, business continuity and disaster recovery. The BC channel is not adequately robust from risk control, fraud management and client protection perspectives. Once the BC channel is better integrated with mainstream banking channels, consumer security, fraud prevention and overall consumer protection will be better enhanced (MicroSave 2012a).

Customer grievance: Banks have set up dedicated phone lines for receiving customer grievances. These numbers are displayed in branches as well as in the documents given to customers, which the customers can use for grievance redressal. Banks engaging individual BCs have made the branch managers as the focal point for customer grievance redressal. However, the banks admit client education to make use of this mechanism is limited. CSPs are not adequately informed and educated about client grievance redressal mechanism and hence they are not able to guide the customers.

Customer satisfaction: Customer satisfaction surveys are not so regularly carried out and demand-side expectations in financial inclusion are not fully understood. Urban and rural consumers of BC services want greater convenience, flexibility and choice of financial services; as opposed to the limited offerings they receive currently. CGAP–CAB survey of CSPs 2013 shows large gap between customer demand for products and what is on offer (see Box 2.10).

The rural poor with access to BCs want banking facilities and features at par with mainstream savings account holders. Due to lack of adequate integration and interoperability of BC channels, they are unable to have access to many of the services they need or aspire for. See Box 2.11 for the factors that affect client satisfaction and trust.

BOX 2.10 Customer Expectations as per CGAP–CAB Survey of CSPs 2013

The customer expectations relating to products and services are being partially met. The role perceptions of CSPs in a number of services do not reflect customer demands at all. While 51 per cent of customers expected CSPs to handle loan products, no CSP thought of loans as a main role; only 16 per cent of CSPs reported offering loan related services. Similarly in case of insurance and pension, 41 per cent and 35 per cent of surveyed customers had expectations from CSPs. But only 11 per cent CSPs provided insurance and 12 per cent CSPs provided pension services. The customer expectations reflect a well-rounded services suite from CSPs, whereas service availability from CSPs is limited to savings and remittances and in rural areas some government payments. This mismatch between demand for services and actual supply has to be remedied if the BC arrangements are to provide effective access to financial services for excluded people.

Box 2.11 Factors that affect Client Satisfaction and Trust

For clients, satisfaction and ultimately trust can be shattered by experiences like:

- Delays of months in receiving account opening clearance from banks;
- Similar delays in receiving smart cards from technology companies;
- Inability to withdraw funds;
- Difficulty in understanding point of sale materials due to low literacy, leading to unrealistic expectations;
- Inability to check or confirm balances; and
- Expecting account statements but not receiving them.

Source: MicroSave 2012a.

Financial Literacy and Education

Financial literacy and customer-awareness-building measures are carried out by different sets of institutions. Financial literacy centres (FLCs) and rural self-employment training institutes (RSETIs) set up by banks and other training institutions and entities such as ISMW, Accion, etc., provide financial literacy training and also conduct campaigns.

FLCs have been established in each district and are usually manned by retired bankers. FLCs carry out financial literacy largely through camps and outreach programmes such as meetings in Gram Panchayats, schools and colleges. These centres are also expected to offer counselling in financial management for walk in customers. Branch managers conduct village-level financial literacy awareness meetings. Banks reportedly have spent Rs 100 crore on the financial literacy measures in the last three years. There has been no effort in measuring outreach and outcomes of financial literacy initiatives.

Stakeholders point out three weaknesses which have to be set right. First of all, the FLCs have to be manned by competent and trained persons. There is little training available for the FLC counsellors cum managers. Some of these retired bankers are neither qualified nor oriented to offer training or counselling. These counsellors need to be trained in standard procedures and processes of delivery of financial literacy and counselling.

Second, each technical agency is producing tools and materials for financial literacy, which is a duplication of efforts entailing avoidable expenditure. RBI should facilitate discussions among the tool developers, the funders and also users to standardize the training modules and tools (see Box 2.12).

Box 2.12 Suitability of FI Training Aspects

If you read any of the material, they seem to assume that people do not know anything about money. Even rural households in remote areas have had vibrant financial lives; they invested surplus money in gold, silver, and land. Most of the financial literacy modules do not talk about such wealth management. Highly complicated products like mutual fund, insurance, pension are being covered now which may or may not be suitable.

Source: A senior bank official, Development Financial Institution (DFI).

Third, there is large disconnect between the information provided on products and availability of the products (see Box 2.13). While the financial literacy topics cover savings, credit, pension, insurance, remittance etc., apart from savings and remittance other products are largely not available after training.

Financial literacy is important to improve financial behaviours of the clients and improve off-take of financial services. However, there should be differentiation between the needs of the poor and the low-income clients. The emerging needs of the low-income customers are product-specific advice, household financing planning, and how to manage their wealth. This involves one to one interaction with well-trained persons which at present is largely not available. Financial literacy efforts should enable the customers to utilize banking services well and choose appropriate

BOX 2.13 Too Many FI Trainings with Little Outcomes

Last two years has seen an explosion in organization of FLCs, training, awareness programmes; the efforts included organizing camps, radio telecasts, and training programmes to printing of calendars and diaries with financial inclusion messages. Those who conduct training are totally disconnected with ground-level realities on what works; products like savings, insurance, and pension are not available. Another message given is 'go to BC' but BC is non-existent. For next one year there should be a total holiday on financial literacy. We need to get the products and services right.

Source: A senior bank official, Karnataka.

products and services. Literacy efforts should go well beyond creating awareness and increase capability of customers in using banking services well. The present mode of dealing with financial literacy under FIP through rural branch managers once in a month is not a satisfactory one. Branches fall short of the targeted number of events and the branch managers are not well equipped to improve capabilities of rural people. Some of the other efforts are sporadic, theoretical and far removed from the ground realities of institutional presence and product availability. Fresh thinking on the design and delivery of financial literacy is needed; one in which institutions with experience of influencing people through multi-modal communication are involved along with financial services providers of the local area. The customers should feel confident that the training can be put to use in a nearby financial institution.

Gender Concerns in Financial Inclusion: Findings of FINDEX

As in the rest of South Asia, in India too, there is a large gender gap in the ownership of formal accounts. Women are 41 per cent less likely than men to have a formal account: while 44 per cent of men report having an account, only 26 per cent of women do so. By comparison, in the rest of the developing world women are 22 per cent less likely than men to have an account. The gender gap is even greater in Maharashtra, Rajasthan, and Uttar Pradesh, where more than 50 per cent women are less likely than men to have an account. Interestingly, across India the gender gap is smallest among the poorest: in the bottom fifth of the income distribution, account penetration is 23 per cent among men, 19 per cent among women. In 102 of 110 developing economies surveyed, lack of enough money is the most commonly reported barrier to account ownership. More unusual is the reason cited second most often in India: a family member already having an account. This was cited by 41 per cent of unbanked respondents—and by 46 per cent of unbanked female respondents. This result suggests that indirect account use is widespread among women, a concern because of the impact that lack of asset ownership may have on empowerment and self-employment opportunities. As with account penetration, Global Findex data reveals a large and statistically significant gender gap in formal savings behaviour. While 16 per cent of men in India report having saved formally in the past year, only 7 per cent of women reported to do so.

***The National Rural Livelihood Mission* (*NRLM*)**: NRLM is being rolled out in the country, has a core agenda of financial inclusion. States like Maharashtra are encouraging opening of accounts for individual SHG members. A few initiatives are harnessing the potential of women both in enrolment of women as CSPs and also targeting women in the financial inclusion drive.

Rural Financial Institutions Programme, India* (*RFPI*) *of GIZ: NABARD is working with Aryavrat Grameen Bank where SHG women are trained and enrolled as CSPs in about 50 Gram panchayats. The early results show that SHG women are willing to act as CSPs. More than 60 per cent of the accounts opened through SHG member CSPs are active with two transactions per month. 52 per cent of the account holders are women and not necessarily SHG members. Women realize that they can confide in a woman they already know and trust them enough to save money. Muslim women are willing to get photographed because it is a woman agent who is taking the photo for opening savings accounts. Men customers reportedly had initial resistance to operate their accounts through a woman. Caste barriers had to be overcome. The remuneration for the women currently is low nowwith an average of Rs 1,200 per month; with rolling out of credit products through CSPs, the earnings are expected to increase.

MFIs as BCs

Reserve bank of India has now permitted Non-deposit-taking NBFCs to act as business correspondents of the banks. This augurs well for the NBFC-MFIs who have been lobbying for such a facility. The present guidelines provide minimal guidance and rules on the engagement, products, precautions to be taken, etc., Small NBFC-MFIs whose viability has been questioned and who have faced mammoth tasks of raising loans from the banks, will benefit from this development and will be in a position to meet their client loan needs.

Compared to other types of BCs, NBFC-MFIs will have several advantages to offer to banks. Many NBFC-MFIs have managed to win the trust of the consumers. MFIs can help to leverage their existing engagement with the customers. In this way, MFIs' core competence of customer engagement and management can be more fully exploited.

Banks would get access to the brick and mortar infrastructure of the NBFCs; relatively well qualified/trained staff and better financial and operational risk management culture than the current BCs; deep knowledge of the low-income market segment; and familiarity with the use of technology.

Since NBFCs are largely providing credit, this is the service that may gain immediate acceptance. The precautions to be taken while offering credit products through NBFC-MFIs has not been specified by RBI which has left this issue to be sorted out by individual banks as part of their business strategy. There are concerns that the credit market will heat up further and competition will become intensive if this channel is used for credit dispensation in already crowded markets.

The experience so far in credit-led BC model has not been very encouraging as far as appropriate pricing is concerned. Banks have not ensured that this model can provide loans to the clients at lower rates than what the MFI does in its own books. Since cost of funds for the bank is lower (6 to 7 per cent), the risk is borne by MFIs in the form of first loan default guarantees (5 to 10 per cent), with the margin of 10 per cent to MFIs, the loans can be priced to end clients at 20 per cent per annum. However, the pricing on these loans is usually 26 per cent—the maximum limit prescribed by the regulator for MFI loans.

The policy change by RBI has been to improve financial inclusion measures and enabling the customers of NBFCs to access wider range of products. Savings is often considered as the most demanded service. However, past experiences of non-NBFC-MFIs in offering savings services have not been very encouraging. There are very few MFI BCs who offer savings products. Except Cashpor not many other MFIs are offering savings products on a large scale.

Axis Bank and Janalakshmi Social Services (Section 25 Company), a group organization of Janalakshmi Financial Services had entered into partnership for offering savings services to the urban customers of Janalakshmi (see Box 2.14). The no-frills savings product had unique features—the customers get an instant kit immediately after opening the account consisting of debit card and the personal identification number (PIN). The account gets activated within 2 working days. The customers can access bank ATMs. All the transactions like cash deposits and buying of insurance products happen at the doorsteps of the customers. Though both the institutions had best of intentions, translating this into action has been full of challenges due to limited products, small ticket size, low level of transactions and the resultant unviability at the bank and BC levels.

Box 2.14 BCs to Offer Other Products; not Just Opening of a No-frills Account

'If MFIs can offer relevant products as a package, then the entire financial inclusion concept can become a success. Today, we are only looking at BCs to source no-frills accounts and once done, nobody is bothered about the activation of these customers and drive customer behaviour towards transactions and balance build up'.

Janalakshmi Financial Services in MFIN GIZ survey on MFIs as BCs.[10]

GIZ-MFIN survey on MFI experience as BCs in 2013 shows some interesting trend. Out of 70 MFIs that responded to the survey, only 14 (8 NBFC-MFIs, 5 NGO-MFIs and one cooperative) has had previous experience as BCs. 6 out of 8 NBFCs, 2 out of 5 NGO-MFIs and the sole cooperative had closed down BC operations. Only 5 out of 14 are continuing with BC though many others who participated in the survey showed interest in becoming BCs. Lack of cooperation by bankers has been cited by six of the nine MFIs as the reason for closing. The other reasons have been unviability, lack of a clear business plan and difficulties in managing BC function along with core lending function. While reasons for taking BC agency of the bank can be many, the closure of the agency is a development that impacts customers.

When the excluded sections of population are brought in to financial services with great effort, their confidence in the financial institutions will be shattered if the service delivery is truncated. If a promise of doorstep service is replaced by a request to visit the branch for even small transactions (when BCs withdraw), then the customers might choose to let the accounts remain dormant.

FINANCIAL INCLUSION: SOME SUCCESSES IN THE MAKING

There have been successful initiatives in the BC sector. Cashpor has been a BC agent for ICICI Bank and IndusInd Bank. The arrangement has been found useful by the customers and effective by the banks but not cost effective for Cashpor, which is cross subsidizing the service. More than 200,000 customers have been enrolled by Cashpor with savings of Rs 246 million. A case study of the arrangement is carried as Appendix A2.2 to the chapter. The Government of Madhya Pradesh has embarked on streamlining and improving access to financial services through a program named Samruddhi. The government has partnered the banks in identifying banking shadow villages (those without a banking presence within a 5-km radius) and prioritized establishing a point of presence of banks within 5 km from these villages. To incentivize setting up the points of presence the government has provides space for CSPs or ultra-small branches to operate and routed government business through such arrangements. A detailed note on the MP experience is carried as Appendix A2.3 at the end of this chapter.

Pallavan Grama Bank, based in Tamil Nadu, has found that appointing SHG members as CSPs can be effective, for both the bank and the agent. 120 such CSPs are in place with more 100,000 savings accounts opened through their effort. Nearly 60,000 overdrafts have been sanctioned. The bank ensures that all business in the location of the CSPs is routed through them so that their viability is established besides reducing costs for the bank. The average remuneration per month per CSP in 2013–14 was reported to be Rs 4,000, which is a reasonable compensation for a few hours of work on a supplementary livelihood activity for the SHG members. A detailed account of this arrangement is carried as Appendix A2.4 at the end of this chapter. The cases demonstrate that the BC arrangement can be designed to be effective in meaningful financial inclusion.

CONCLUSION

Financial inclusion initiative, while providing benefits to hitherto excluded people through access to finance, is not an unmixed blessing. To ensure that customers benefit fully from financial inclusion, the banking institutions should ensure that there is certainty, continuity and quality in the offered services. Banks have a perception that for the most part financial inclusion is a low margin, high risk business and erodes profitability. The small and poor are not first choice customers of high street banks. The low cost intermediation through agents has not still been found viable by banks on account of supply and demand-side constraints. The agents' viability has not been satisfactorily established and the high attrition levels in CSPs are indicative of the weak 'effort to remuneration' relationship. On account of the risk perceptions, the BCs are mostly used to market a limited savings product, which does not fully address customer requirements. While banks are able to report having expanded access, in reality financial inclusion is not being achieved as seen from high level of dormancy of such accounts. As responsible finance initiative banks have to ensure that within a reasonable time of putting in place CSPs, basic banking products relating to savings, credit, remittance and payments are offered. If there is no confidence in the CSP to offer a suite of products, then the banks should not enter in to CSP arrangements, which offer false promises to the local population.

The certainty of services should be ensured through better monitoring and continuity of services in the determined locations even if the CSPs do not continue. Banks must invest in systems and processes that keep CSP attrition rates low, and have fall back arrangements to handle customers in their locations in case of specific

CSPs becoming non-operational for any reason. If the service continuity is disrupted, confidence of customers in the banking services will be eroded and savings mobilization will be impacted.

The quality of services need to considerably improve as the field observations depict a poor picture of CSP availability, readiness to transact, technology reliability, transaction completion and liquidity adequacy. The present problems and difficulties are not insurmountable, but expensive compared to the current level of business. If banks take an investment view of upgrading service quality through appropriate investments in both technology and CSP training, the banks will be able to distribute their entire suite of products through CSP channel thereby accelerating breakeven.

At best, the current state of affairs in agent banking is a partially satisfactory solution to the excluded people in that it brings a point of presence nearer the customers and a promise of comprehensive future services. As a responsible finance initiative, for the most part the agent banking model does not stand scrutiny as found in many studies—at policy, operations, and levels of customer comfort. The recent guidelines of RBI on improving the BC arrangement are timely and appropriate. Banks have to examine the BC arrangements in the light of their fair practices code and remedy shortfalls so that the standards of customer service, customer protection and customer satisfaction are improved to reasonable levels.

APPENDIX A2.1 FINANCIAL INCLUSION: SOME NUMBERS

Particulars	Year ended March 2010	Year ended March 2013	Year ended March 2014	Progress April 2013 to March 2014
1	2	3	4	5
Banking Outlets in Villages - Branches	33,378	40,837	46,126	5,289
Banking Outlets in Villages - Branchless Mode	34,316	227,617	337,678	110,061
Banking Outlets in villages - Total	67,694	268,454	383,804	115,350
Urban Locations covered through BCs	447	27,143	60,730	33,587
Basic Saving Bank Deposit A/c through branches (No. in million)	60.2	100.8	126.00	25.2
Basic Savings Bank Deposit A/c through branches (Amt. in Rs Billion)	44.3	164.7	273.3	108.6
Basic Savings Bank Deposit A/c through BCs (Nos. in million)	13.3	81.3	116.9	35.7
Basic Savings Bank Deposit A/c through BCs (Amt. in Rs Billion)	10.7	18.2	39	20.7
BSBDAs Total (No. in million)	73.5	182.1	243	60.9
BSBDAs Total (Amt. in Rs Billion)	55	182.9	312.3	129.3
OD facility availed in BSBDAs (No. in million)	0.2	4.00	5.9	2.00
OD facility availed in BSBDAs (Amt. in Rs Billion)	0.1	1.6	16	14.5
KCCs - (No. in million)	24.3	33.8	39.9	6.2
OD facility - (Amt. in Rs Billion)	1,240.1	2,623	3,684.5	1,061.5
GCC - (No. in million)	1.4	3.6	7.4	3.8
GCC - (Amt. in Rs Billion)	35.1	76.3	1,096.9	1,020.6
ICT A/Cs-BC - Transaction - (No. in million) (During the year)	26.5	250.5	328.6	328.6
ICT A/Cs-BC - Transaction - (Amt. in Rs billion) (During the year)	6.9	233.9	524.4	524.4

Source: Annual Report, RBI 2013–14.

APPENDIX A2.2 CASE STUDY 1: SAVINGS SERVICES BY CASHPOR MFI BC

Cashpor which is a section 25 company has a vision and mission of offering savings services to the households. The MFI believes that the indebtedness of the households has to reduce through building the assets and savings of the poor clients. This is the key motivational message that is delivered to clients while promoting savings.

Cashpor is acting as BC for savings and credit products for ICICI Bank and IndusInd Bank. While the credit product feature is similar to that of Cashpor, the innovation has been in the offering of withdrawable savings products for the clients. Specific branches are earmarked for the banks for BC arrangement for IndusInd Bank and hence co-mingling of funds of Cashpor and the bank are avoided. ICICI Bank lends to clients only from the second cycle; in these branches Cashpor ensures that co-mingling of funds are avoided.

All products on offer by Cashpor (savings, credit, insurance and pension) are handled by the field staff. Cashpor follows weekly meetings and each field staff manages 28 centres with average membership of 22. Cashpor has invested in financial literacy of clients, which is conducted as part of centre meetings.

Doorstep delivery of services: Each field officer has a float of Rs 2,000 and also carries cash of Rs 2,000 every day for the meetings; both of them have to tally at the end of the day in center meetings, first cash withdrawal from savings accounts is carried out so that allow members desirous of withdrawing funds to make loan repayments. There after loan repayments are recorded. Center leaders remit the repayments to Cashpor branch and thus cash related to repayments are handled separately. Then savings is mobilized. Though minimum savings amount is prescribed as Rs 20, field officers accept smaller amounts of even Rs 5 if the client has brought the savings to the meeting. Maximum amount for both deposit and withdrawal is Rs 500 beyond which the client has to visit the branch for the transaction. Thus the clients get doorstep services.

Safe and secure technology: Eko has provided mobile based technology and has enabled a three layer system for secure transactions. While deposits can be made through the mobile of the field officer, for withdrawal the mobile of the client, a unique pin number and key book are needed.

When customer opens an account they are issued an okekey which contain specific serial number. This booklet serial number requires registering with the account number to complete the accounting opening process. Every booklet contains 50 okekey's and each okekey pin consists of 10 digits, out of which six are randomly distributed and four are blank. It is a 4-digit personal identification number chosen by the saver. This is filled in the blanks provided in the okekey before a transaction. Unless all three authentication factors, that is, okekey booklet, customer pin, and mobile number match, the transaction cannot takes place and this procedure make account secure.

Monitoring for safeguarding customer savings: Field officer maintains a transaction register on deposits and withdrawals. Branch managers, Area managers and Regional managers visit each center and cross check the savings passbooks with the transaction register of the field officer. So far three cases of frauds were detected and the services of the officers were terminated.

Clients have preferred IndusInd Bank's product; the balance maintained has reached the level of ICICI Bank though the product was introduced only 8 months ago to IndusInd Bank clients. Clients have liked the features—there is no charge for the opening of the accounts and free limits of transactions. Cashpor plans to re-negotiate the terms of the savings product with ICICI Bank on the basis of total business generated out of credit and savings. Recurring deposit and fixed deposit are for a year and have been recently introduced. Cashpor's staff is marketing these products.

Viability: Cashpor like many other BCs find that the fees paid for the transactions does not cover the costs of offering savings. Cashpor at present cross-subsidizes the cost of offering savings from the overall income for the MFI.

TABLE A2.2.1 Savings Report of Cashpor

Particulars	As of 30 May 2014	
	ICICI	IndusInd Bank
Savings commenced from	2010	2013 (Nov)
Credit commenced from	Jan 2011	2011
Charges for enrolment	Rs 100	nil
Charges for transactions	2 options a) Rs 50 unlimited transactions b) Rs 2 per transaction	Monthly 10 transactions free; above this Rs 2 per transaction
Minimum savings	Rs 20 but field officers accept smaller amounts as well	Rs 20 but field officers accept smaller amounts as well
Eligibility	Open to all including those who are not borrowing from Cashpor.	Only for clients with credit
Enrolled savers since beginning	167,531	42,024
Deposit Mobilized since beginning	229,257,747	17,699,110
Withdrawal facilitated since beginning	188,949,241	4,596,805
Saving float	40,308,506	13,100,555
Percentage of active savers (Transactions within 90 days)	38.47 per cent	87.92 per cent
Percentage of savers with account balance greater than Rs 0	77 per cent	93 per cent
Average saving balance per saver (number of saving account with balance greater than 0)	312	335
Number of Recurring Deposit Accounts	3,362	
Number of Fixed Deposit Accounts	746	

APPENDIX A2.3 CASE STUDY 2: SAMRUDDHI – FINANCIAL INCLUSION BY MADHYA PRADESH GOVERNMENT

Customer at the core: In the Madhya Pradesh model the term Financial Inclusion has been defined as gaining access to all financial products within a reasonable distance, 5 km. In all its attempts in the Samruddhi model the beneficiary was kept centre stage. It was the ease of beneficiary that was the pushing factor for all the changes in the policy, mechanism and execution.

Access point based on distance: A massive exercise was under taken by each District-level Coordination committee to map the banks (commercial banks, RRBs, cooperative banks), post offices and identify villages that do not have such access points within 5 km (the distance of 5 km is considered walkable and hence ensures access and it will ensure sustainable business for BC). Thus the shift adopted by Madhya Pradesh was from population basis (more than 2,000 population) to access point from ease of access.

Identifying shadow areas: After the exercise, it was found that out of 53,009 villages, 14,767 villages did not have any of the financial institutions within 5-km radius and were termed as shadow area. SLBC decided to open ultra small branches (USBs)/customer service points to ensure these shadow area villages are catered. One of the unique features of Madhya Pradesh initiative is to consider post offices and cooperatives as well financial access points since (a) post offices were more in number than bank branches and were offering all products except credit and 65 per cent of the population had accounts in post office (b) cooperative banks have all the financial products except insurance and had large number of accounts.

Viable business for bank and BC: For opening USBs/ BC outlets the viable business model for the bank was explored; a single BC-operated centre to be visited by regular bank official at least once in a fortnight should have a turnover of at least Rs 45 lakh per annum. State offered 100 sq. feet area in the e-Panchayat room with facilities to set up this USB/CSC. The Panchayat accounts in the catchment area were also transferred to this USB/ CSP. There are 2024 locations has CSP/USB and banks have done business of Rs 1,500 crore in 2013–14 from these CSPs. The coverage of households in 5-km radius with no competition can make the business of BC viable and therefore provide continued and sustainable services to the customers.

Government payments and Direct benefit transfers: Co-operative banks and post offices that had maximum penetration were not in core banking platform but the government had to ensure devolution of funds to all the cooperative banks and post office that are not in core banking solution. Forcing households and individual beneficiaries to open accounts with commercial banks would have created hard ship for them. The state along with NABARD ensured core-banking systems in cooperative banks and, by the end of December 2013, all RRBs and cooperative banks had core banking solutions. Since CBS in Post Office is taking longer time, the State worked out intermediate mechanisms when the state shifted 100 per cent e-FMS payment in MGNREGA, all types of pensions and scholarships for the financial year 2013–14. Sanchay Post was used for the devolution to the post office.[11] It took 20 days to remit the funds but that was acceptable. Another challenge was making the no-frills MGNREGA account especially in post office as the multi-product account since MGNREGA account cannot be used for any other transaction except payment of wages. The MGNREGA account was converted into a savings account by putting Rs 50 as a basic balance so that clients do not have to deal with more than one account.

Common database: The government has developed a common database—Samagra—a customer information software that can help in identifying customers and authenticating their transactions for multiple purposes such as government schemes, welfare payments, and bank accounts. The bank/post office account details have also been collected and as a next step de duplication of multiple accounts will also be carried out.

Increasing usage of deposit, credit, insurance services: Financial literacy camps have been conducted through the bank managers of USB/CSP by RBI and NABARD. The USBs are offering three types of savings—withdrawable savings, recurring deposits and fixed deposits. It is proposed that over and above overdraft, based on savings pattern and household needs, USBs will enable other credit products. Since General Insurance companies are opening micro branches, it is proposed to converge with them to offer micro-insurance. Data on the demand and usage of these financial products in terms of opening of accounts, volumes of transactions, increase in bank balance and saving schemes are not separately available.

Key features: The state government has been a key driver and atypically it has been conscious of the viability considerations at every level. It has provided incentives such as space, internet connectivity and also provided a business base to generate revenues to the CSP through deposits of Panchayat and government payments through the BC. It has prioritized customer comfort by ensuring a CSP is available within a 5-km distance from each village. It has recognized the potential of post offices and cooperative branches and reckoned their presence while persuading banks to set up points of presence. Its on-going work at providing unique numbers to each customer and de-duplicating the multiple accounts by each person with the banking system will go a long way in streamlining payments and avoidance of leakages. This state initiative has the best chance of success in ensuring viability at all levels while ensuring facile access to banks by customers.

APPENDIX A2.4 CASE STUDY 3: PALLAVAN GRAMA BANK

Pallavan Grama Bank is functioning in 15 districts of Tamil Nadu with 171 branches. The bank was allotted 219 villages (68 villages with above 2000 population and the rest below 2000) in five districts for financial inclusion measures where in BCs have been appointed.

Engagement of BCs: Tata Consultancy Services is the Technology Service Provider at present after Bartronics failed to deliver satisfactory services. Instead of handing over the job of CSP appointment and management to a corporate BC, the bank engaged individual BCs. Individuals and members of SHGs are at present engaged as BCs. Since the bank has had very good customer base among the SHGs, selection of members of SHG as BC is a preferred option for the bank. BCs are identified by the Branch Manager on the basis of the reference given by regular customers of the bank. Personal details such as income, KYC proof and police verifications documents are submitted by the branch manager to head office for approval of appointments. Since in villages below the population of 2,000 a single BC is not found viable, nearby villages are clubbed. While engaging the BCs they are informed that being BC need not be primary engagement but can be an additional income for the household and more importantly they will be providing service to the villagers.

Initiating the BCs to their work: Before the BCs are placed in the field, they undergo 3 days of induction training. BCs are intensively trained by the banks' own trainers following a fixed curriculum. Since BCs are extended arms of the bank, on the first day they are informed of the genesis of the bank, its mission and broad activities. BCs are informed of their responsibilities of acting as representative of the bank. There after the need for financial inclusion, need for BC, their roles and responsibilities are covered and the various products they would be dealing with are explained. Dos and don'ts while interacting with customers are explained. There after technology-related aspects, operating the PoS machine, usage of cards are explained.

On completion of the training, the branch manager along with the financial literacy centre in charge conducts village meeting to introduce the BC and create awareness among the customers about the appointment of BC and services they avail.

Investment by BC: All the BCs are provided with PoS devices, operator cards, and a printer by the bank, worth Rs 40,000 approximately; these kits are given at bank's expense and BCs are not expected to invest. Stationery is provided by the branch. Cost of SIM and GPRS charges are also reimbursed to the BCs. No security deposit is taken from the BCs.

Products and services: Bank has a board approved business targets for financial inclusion for the period 2013–16. These are being disaggregated to branches.

The initial tasks of BC are related to savings accounts (a) Mapping the village households for holders of savings bank accounts and enrolment of new customers with biometrics, (b) Capturing biometric and photo image of the existing customers, and (c) Doing online transactions using the operator card and customer cards in the PoS machines. After three months of functioning, they are introduced to credit products and insurance.

Savings accounts: BSBD accounts, Current account, regular Savings Bank account, Recurring Deposit, Variable RD are the different types of savings accounts that the customers can open and operate through BCs.

Credit: Overdraft of Rs 5000 is inbuilt in the BSBDAs and is informed to the customers. Overdraft account is opened at the time of opening savings accounts and mapped with the PoS devices to do online transactions. Customers are provided details of operations of the overdraft facility in the financial literacy classes. Overdraft of Rs 500 to Rs 5000 can be drawn from the BSBD account which helps the customers in managing their cash flows and not resort to borrowings from local money lenders.

BCs also identify eligible rural customers who are in need of loans for their KCC and GCC activities. The loan scrutiny and sanctions are carried out by the branch manager as per usual norms.

Micro-insurance: Aam Aadmi Bima Yojana, of LIC and life insurance of Bajaj Alliance are being distributed through BCs. The bank believes that when bank outsources the insurance claims settlement, there can be issues. Enrolment and collection of premium is carried out by the BCs, whereas servicing of claims is the responsibility of the branch manager. Claims settlement processes have been well defined; instances of death are informed by BC to the branch manager who then contacts the heirs and guides the claims settlement. Corporate office centrally monitors the claims settlement.

Remittance: from one account of the bank to another of the bank is facilitated.

Government Payments:

Pensions: State Government Pension and Old age pensions are routed through BCs.

NREGS: Payment of wages to the NREGA workers through the PoS devices is under process.

Direct benefit transfer: Amount directly credited to the beneficiary account based on the Aadhar number. Payment from these accounts is done through the BC using the smartcards issued to the customer.

Direct, electronic payment of benefits through BCs increase convenience for beneficiaries, since the distance beneficiaries must travel to collect payments decreases by nearly half and also waiting time is far less.

Remuneration structure of the BC: The bank has fixed a minimum monthly amount of Rs 1500 to be paid to each BC and also transaction based incentives.

TABLE A2.4.1 Progress under Financial Inclusion (Amount in Crores)

		2013–14		2014–15	
		No.	Amount	No.	Amount
Individual BCs	Male	30		64	
	Female	31		56	
	Dropouts	10		4	
Number of savings accounts and balance outstanding in different categories	No Frills	29,672	0.64	86,650	0.44
	BSBDA	16,612	6.63	173,632	7.73
	RD	—	—	50	0.01
Overdraft accounts	Sanctioned/ Limit sanctioned	32,929	3.29	58,992	5.90
	A/c used/ Amount O/s	32,000	1.58	57,000	2.16
KCC		43,505	211.66	69,518	522.86
Insurance policies		140	0.03	1446	0.29
Any other business-related Electronic Benefit Transfer		4,533	0.40	237,274	15.83
Cost incurred on BC system			0.38		0.09
Average payment received by BC			Rs 3,500		Rs 4,000

TABLE A2.4.2 Transaction-based Incentive

Fixed monthly remuneration	Rs 1,500
Incentive for:	
Account opening (Basic SB/Current)	Rs 10 per account
Cash transactions	Rs 2 per transaction
Opening of SHG-SB account	Rs 5 per account
Opening of SB account	Rs 5 per account
Opening of small value deposit up to Rs 5,000	Rs 15 per account up to Rs 5,000 opened for 1 year and above
Pre-sanction stage	0.25 per cent of limit sanctioned subject to a minimum of Rs 25 and maximum of Rs 125
Post-sanction stage (documentation/follow-up ending in recovery	1. If the loan is less than Rs 10,000 then Rs 25 to be paid at the time of closure of loan only 2. If the loan sanctioned is greater than Rs 10,000, then remuneration will be @0.25 per cent of the amount recovered subject to maximum of Rs 125 per loan account at the time of loan repayment.
Recovery of principal/collection of interest in loan accounts up to Rs 25,000 per borrower other than those canvassed by BC	Service charges of 0.50 per cent of the amount recovered in all accounts subject to maximum of Rs 100
Recovery of principal/collection of interest in NPA account up to Rs 25,000	NPA (SS) – 2.50 per cent of the amount recovered NPA (D1 and D2) – 5 per cent of the amount recovered NPA (D3 and above) – 10 per cent of the amount recovered
Sale of micro-insurance/mutual fund products/pension products/ other third party products	50 per cent of the commission received by the Bank

Key Learnings from Pallavan Grama Bank

At Bank Level:

1. All the transactions in the FI village should be routed through the BC to ensure that BC is earning more incentive and the model is viable.
2. To conduct more awareness camps to impart confidence among the villagers that the BC represent Bank and transactions done are safe and genuine.
3. At Head Office level the performance of the BC is to be reviewed and monitored at regular intervals.
4. Orientation training on the importance of FI and awareness programme on the products of the Bank.

At BC Level:

1. Extending courteous service to customers is key to be accepted by the villagers.
2. BC has to have full details of the products to explain and serve the customers.
3. BC should be available at the specified place and time so that the trust of the customers improve and customers believe that this is an extended arm of the bank.

NOTES

1. Committee on Comprehensive Financial Services chaired by Nachiket Mor, Director RBI Central Board, 2013.
2. Taken from a speech by Dr Deepali Pant Joshi, Executive Director, Reserve Bank of India at the 5th Dun & Bradstreet Conclave on Financial Inclusion, Kolkata, 28 October 2013. Available at http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?Id=853, last accessed on 15 October 2014.
3. This section is based on RBI Annual Report 2013–14. Please see Appendix A2.1 at the end of the chapter for the full table on financial inclusion achievements.
4. The CSPs surveyed were agents of 15 different banks in public sector, private sector as also regional rural banks (RRBs).
5. Mor Committee also observed that 'Field research by College of Agricultural Banking, CGAP, and MicroSave suggest that over 75 per cent of accounts opened and over 25 per cent of BCs are dormant'.
6. See a narration of the difficulties in persuading branch managers to open no-frills accounts in Mason (2013).
7. http://www.cgap.org/news/linking-electronic-payments-and-social-cash-transfers-india.
8. MicroSave's surveys estimate a 37 per cent effective dormancy rate. CGAP–CAB survey estimated 34 per cent attrition rate in 2013.
9. Excerpt from RBI Annual Report 2013–14.
10. http://mfinindia.org/wp-content/uploads/2014/06/GIZ-MFIN_MFI_as_BC_online_survey_22042014.pdf.
11. The Sanchay Post enables transactions to ride on CBS platform of SBI and further transmits the data in the electronic form to head post offices, thus considerably curtailing the time.

3

Measuring and Reporting Social Performance[1]

Microfinance Institutions (MFIs) have been active in responsible finance and socially relevant activities. The quality and extent of their activities have not been well known and very little data had been in public domain. Over the last three years some efforts in measuring social performance and reporting data have been undertaken. Measurement and reporting of performance is a critical requirement to inform institutions and stakeholders and improve state of practice. In this context, while measurement and reporting of social performance is as critical as financial performance, collection, standardization and consolidation of social performance data continues to be work in progress at the global level. Microfinance Information Exchange (MIX) had introduced a reporting system for collecting information on social performance. This chapter analyses and draws from data submitted by MFIs to Equifax Credit Information Bureau, analysis carried out by MIX and study of ACCESS ASSIST on key social metrics.

The MIX has been and continues to be the most comprehensive data reporting platform covering outreach, and financial and social performance data across the microfinance sector. However, over the years, the quantum of regular reporting of specific SP data by MFIs to MIX has been lagging behind the overall reporting; albeit gradually improving (see Appendix A3.1 on the profile of MFIs reporting to MIX). Table 3.1 shows a comparison of number of MFIs reporting SP data with an encouraging trend.

Table 3.1 Number of MFIs Reporting to MIX

Fiscal year	Number of MFIs	
	Reporting to MIX – Total	Reporting SP Data^
2010-11	127	60
2011-12	122	43
2012-13	93	68
2013-14*	70	64

Notes: ^ MFIs are counted as having reported quantitative SP data if they report the following indicators (preferably more than one): borrower retention, staff turnover, nonfinancial services outreach (non-zero), complete client poverty (tool, poverty line, clients below poverty, sample size), complete enterprises financed (enterprises financed, sample size), or complete employment creation (jobs created, sample size). In this case, to estimate SP data reporting, Borrower retention ratio and Staff turnover ratio has been taken as a proxy.

* Data collection in progress.

OUTREACH

The growth of the microfinance sector picked up significantly in 2013–14 with over 100 MFIs providing credit information to Equifax reporting reaching out to 32 million clients as on 31 March 2014 with a total loan outstanding portfolio of Rs 350 billion, a historical high for the industry.

TABLE 3.2 Unique Clients

MFIs	Total Number of Unique Clients
Tier 1	26,664,014
Tier 2	3,827,019
Tier 3	1,530,027
Total	32,021,060

Source: Equifax.

The total also includes 6,094,110 clients of Andhra who have long been inactive clients of MFIs. Most Andhra MFIs continue reporting on the number of clients though they may have written off the portfolio from their books.

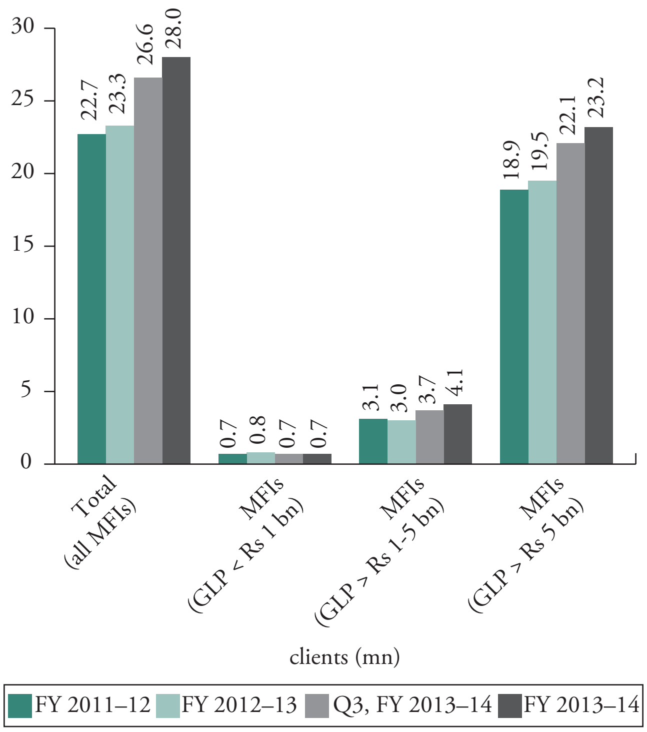


FIGURE 3.1 Number of Clients Served by NBFC-MFIs

Source: MFIN 2014.
Note: FY: Financial Year

MFIN reports a gross loan portfolio of Rs 279.31 billion (an increase of 35 per cent over previous year) lent to over 28 million clients (an increase of 20 per cent) by its 46 member NBFC-MFIs (MFIN 2014). Non-CDR MFIs grew their GLP by 51 per cent. Medium-size NBFC-MFIs (GLP>Rs 1.5 bn) registered highest growth of 37 per cent over FY 2012–13. The client base of small-size NBFC-MFIs (GLP< 1 bn) registered a decline.

MFIN members reported life insurance coverage of 30 million clients with sum assured of Rs 508.2 billion and coverage through pension services extended to over 1.2 million clients.

A small sample survey of MFIs conducted by ASSIST[2] indicates that the percentage of active women clients has declined over the last three years from 99.5 per cent in 2013 to 97 per cent in 2014. Rural clients constitute 54 per cent of the total client outreach in the sample MFIs. However, 33 out of 36 reporting MFIs indicate women as their target market segment and 21 reported targeting rural clients. Table 3.3 shows that there has not been any significant increase in number of MFIs targeting specific excluded and underserved segments such as indigenous and ethnic minorities and the youth, etc.

TABLE 3.3 Target Market

Target Category	2014 n = 39	2013 n = 36	2012 n = 46
Women	36	33	44
Adolescents and Youth	3	2	4
Indigenous people and ethnic minorities	5	4	10
Clients living in rural areas	24	21	35
Clients living in urban/semi-urban areas	22	20	32
Others (please specify)	1	2	-

Source: Small sample study by ASSIST, conducted in 2012, 2013, and 2014.

Geographical Outreach

It is encouraging that during the period of the last two years, MFIs have demonstrated outreach to many of the hitherto underserved states. While a few MFIs were driven by their mission to deliver services in the unserved and underserved regions, others were led into new states and areas due to regulatory stipulations on risk concentration and multiple lending. State-wise status of microfinance loans as of March 2014 is provided in Appendix A3.3.[3] Figure 3.2 shows the top 10 states in terms of number of unique clients. While clients in Andhra Pradesh are largely inactive, West Bengal and Tamil Nadu continue the last year's trend of accounting for largest number of clients followed by Maharashtra and Karnataka. The regional skew of MFI outreach towards southern (55 per cent) and eastern (22.5 per cent) areas in 2009–10 (Srinivasan 2010) has been rationalized to a large extent with MFIN reporting regional GLP distribution of 31 per cent in south, 28 per cent in east, 23 per cent in west and 18 per cent in north. Amount of loan disbursed in last one year (financial year 2013–14) is a good indicator for assessing recent trend of geographical penetration of MFIs. While inclusion of the North-eastern state of Assam in the top 10 states (see Figure 3.3) is a positive sign, it is a matter of concern in view of regional penetration that the top 10 states account for 86 per cent of the total loan amount disbursed by MFIs during the year. To become responsible towards excluded geographies, the GLP distribution across states should be more even and balanced. Equifax data reports no MFI presence in Nagaland, while the other bottom five states (Mizoram, Arunachal Pradesh, Jammu and Kashmir, Himachal Pradesh, and Sikkim, in that order from bottom up) account for only 0.04 per cent of the total loan amount disbursed during the year.

Outreach in Districts

The next level of assessment of the depth of outreach of MFIs has been done based on their penetration at district level and further into poor and backward districts of different states. The SPM report has been using a list of 154[4] backward districts and districts affected by left wing extremism (LWE) of the country, as identified by the Government of India. These serve as a proxy for regions that have highest concentration of poverty in the country and lack access to services including financial services in general.

Appendix A3.4 provides state-level comparison of outreach of over 100 MFIs reporting to Equifax across 32 states and union territories (UTs)[5] covering their 667 districts. 512 districts (77 per cent of total districts) in these states and UTs have active MFIs clients indicating that 155 districts still do not have any MFI lending. Of the 154 backward and LWE-affected districts, MFIs are currently operational in 120 (down from 124 districts reported in 2013), covering 78 per cent of the total backward districts, marginally better than the overall percentage of coverage of districts.

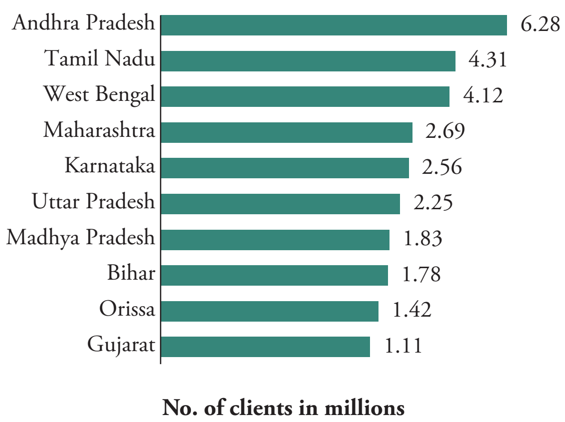


FIGURE 3.2 Top 10 States by Number of Clients: March 2014

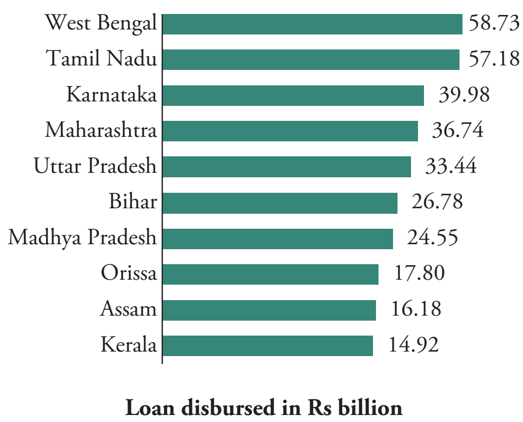


FIGURE 3.3 Top 10 States by Amount of Loan Disbursed in FY 2014

TABLE 3.4 Top 5 and Bottom 5 States/UTs in Loan Disbursement to Backward Districts

Top 5 states	Bottom 5 states
Bihar	Dadra and Nagar Haveli
West Bengal	Himachal Pradesh
Maharashtra	Assam
Karnataka	Sikkim
Madhya Pradesh	Rajasthan

Source: Data from Equifax.

Overall, all the North-eastern states as well as difficult states of Jammu and Kashmir, Himachal Pradesh, and Rajasthan have lower penetration in backward districts. Issues of lack of basic infrastructure, physical access, law and order, and social dynamics affect the penetration of MFIs in these areas, despite pressure on MFIs to diversify into new geographies.

Poverty Outreach

According to the data reported to the MIX, poverty reduction continues to be the most frequently cited development goals by MFIs (93 per cent of reporting MFIs), with 25 per cent of these also reporting outcomes against this goal. The (proxy) outcome indicator used by the MIX for reporting on poverty reduction goal is 'number of clients below a certain poverty line at entry or at a given point in time'.

Collection and standardization of poverty data is an intensive exercise for MFIs. While Progress out of Poverty Index (PPI) tool has been used by many MFIs, assessing the household income is still a more popular mechanism. Table 3.5 indicates an increase in number of MFIs collecting poverty data for all clients at entry level for two years. This is an important trend for measuring and reporting poverty outcomes across the sector.

Opportunity International (Dia Vikas Capital), with its partners in India, initiated a series of SPM pilots in 2009 which included PPI assessment of all new clients.[6] Figure 3.4 shows the percentage of new clients, who, by PPI estimates, live below the USD 2.50 poverty line. Poverty rates among partners' clients are compared alongside average poverty rates for the population in those states, separately for rural and urban areas. Based on this data, Opportunity SPM report 2013 observes that their partners have been successful in reaching out to people living in poverty. In urban areas, new clients' poverty rates are above the state poverty rates for all seven partners. The three partners who are not outperforming the state poverty rate in rural areas are focused on urban outreach.

TABLE 3.5 Tools and Frequency of Client Poverty Data Collection

Tool	No. of MFIs	
	2014 (n = 39)	2013 (n = 36)
PPI	13	11
Household Income	26	21
Means test	1	0
Housing Index	4	5
Other tool / index	8	5
Data collection for all clients at entry	35	25
Data collection for Sample	1	1

Source: Small sample study conducted by ASSIST 2014.

Measuring poverty levels requires technical support. Though tools like PPI are simple, integrating this tool into the systems of MFI requires adaptation of MIS apart from staff training in collection and analysis. Grameen Foundation reports that there are currently 46 countries that have PPI score cards and 142 MFIs are using PPI worldwide (Grameen Foundation 2014); out of which 12 are from India. The experience of technical support agencies like EDA Rural Systems show that more than the data collection through the tool, integrating additional indicators that the MFIs wish to collect, integration of data into existing MIS and building analytical capacity to interpret the data require tremendous efforts which only few institutions like Cashpor and Grameen Financial Services are able to do. The others are in different stages of integration.

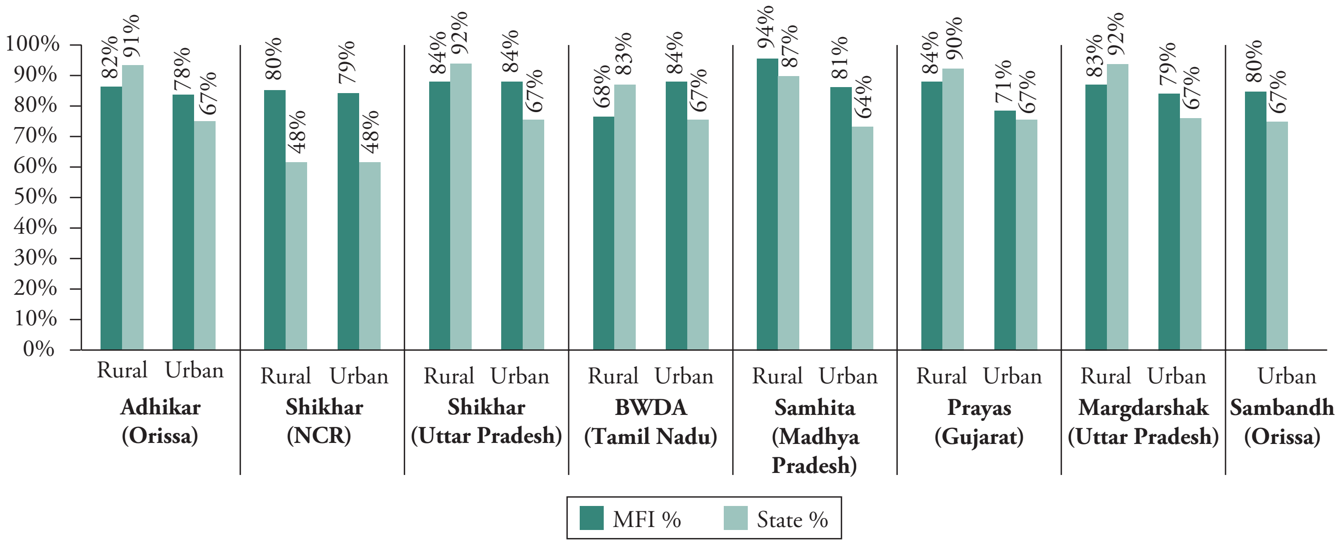


FIGURE 3.4 Percentage of New Clients Living Below USD 2.50 per Day

Source: Opportunity SPM Report 2013.

PRODUCTS

Increased access to financial services is a popular development goal across Indian MFIs: 90 per cent reporting MFIs cite it as an explicit social objective with 58 per cent citing as the most important social objective. One way to examine the alignment of operations with this particular objective is to look at an MFI's range of financial products, both within credit products and other financial services.

The product and service diversification of MFIs is improving—Table 3.6 shows that only about 13 per cent in the MIX sample offer only micro credit loans (approximately Rs 22,800 million in microcredit loans to 2 million clients, representing 12.3 per cent of the GLP and 10.5 per cent of the total number of Indian borrowers respectively), without offering other financial services whatsoever. The others offer other types of services. Three MFIs, which are cooperatives, offer savings services. MFIs in other forms cannot directly offer savings services. Voluntary insurance offered is mostly in life.

The small sample survey shows an encouraging trend in offering of other financial services such as savings,

TABLE 3.6 Financial Product and Service Profile of Indian and South Asian MFIs[7]

Indicator	India (n = 43)*	South Asia (n = 108)*
MFIs offering only microcredit loan for microenterprises	13%	10%
MFIs offering voluntary savings products of any sort	13%	48%
MFIs offering voluntary insurance	45%	33%
MFIs offering savings facilitation services	15%	17%
MFIs offering other financial services of any sort[8]	25%	40%

Source: MIX.
*Number of observations is balanced by indicator.

insurance, and pension (see Table 3.7). More MFIs report of offering these products during 2014 as compared to 2013.

TABLE 3.7 Other Financial Services Offered

Service type	2013	2014		
	Aggregate	Aggregate	Tier 1	Tier 2	Tier 3
Savings	1%	15%	25%	11%	15%
Insurance	30%	51%	63%	56%	50%
Pension	2%	32%	50%	44%	23%

Source: Small sample study by ACCESS ASSIST.

Loan Products

Data analysis from this year's ASSIST survey indicates 83 per cent loans are for livelihoods, with social loans and housing loans comprising 6 per cent and 7 per cent respectively (increased from 4 per cent each in 2013 survey results) (see Table 3.8 and Figure 3.5). Investment needs and consumption continue to be as low as 3 per cent of the portfolio. While the trend of gradual increase in number of MFIs offering need based loans such as education, water and sanitation, and health continues, in view of the size of the market, this needs improvement. The generic enterprise and IGA loans also need further granularity in differentiating product features for different types of enterprises.

Two developments in product space are cited by MFIs: (a) Individual products are being tested and fine-tuned by many of them, and (b) Many MFIs are also piloting and scaling up housing improvement, and water and sanitation loans. Some of the urban MFIs are increasingly moving towards individual loans since they realize the group loan product is nearing its shelf life, clients have larger credit needs and clients do not have time for group meetings.

Housing loan for repairs and construction of additional rooms is in great demand from clients. With improving incomes and also aspiration levels women especially are demanding house improvement loans. MFIs report that there has been an increase in demand for sanitation and water loans. As per Sa-Dhan's Microfinance report of 2013, during the financial year of 2013, MFIs distributed Rs 377 crore for water and sanitation (Sa-Dhan 2014a). MFIs like CDOT, RGVN, Sambandh, and Shikhar, which work in some of the most underdeveloped regions of Bihar, Assam, Orissa, and Uttar Pradesh respectively, have seen an increased demand for sanitation loans from their existing women microfinance clients. Dia Vikas and its partners have carried client need assessment which shows that access to sanitation is a significant issue (Opportunity International 2014). Adhikar, Samhita, and BWDA found 75 per cent, 85 per cent and 55 per cent of clients, respectively, do not own or have access to toilets (Opportunity International 2014). Even in relatively well-developed states like Tamil Nadu,

TABLE 3.8 Loan Purpose

Loan Products	No. of MFIs offering	Number of clients (Mn)	Loan outstanding (Rs Mn)	Average loan size (Rs)
Agricultural and Allied loan	8	1.6	18,441	11,189
Enterprise / IGA	39	12.1	72,312	5,958
Water/Sanitation Loan	10	0.2	1,120	4,546
Education Loan	11	0.1	1,064	9,465
Health Loan	3	0.01	74	7,067
Housing Loan	10	0.2	7,828	38,439
Social Loan*	9	0.5	7,019	13,017
Emergency / Misc. Loan	13	1.1	1,366	1,272
	n=39	**16.0**	**109,226**	**6,838**

Source: Small Sample study by ACCESS ASSIST 2014.

* Includes loans for jewellery purchase, marriage, festival, cook stoves.

** Includes welfare, gold loans, and combo loans.

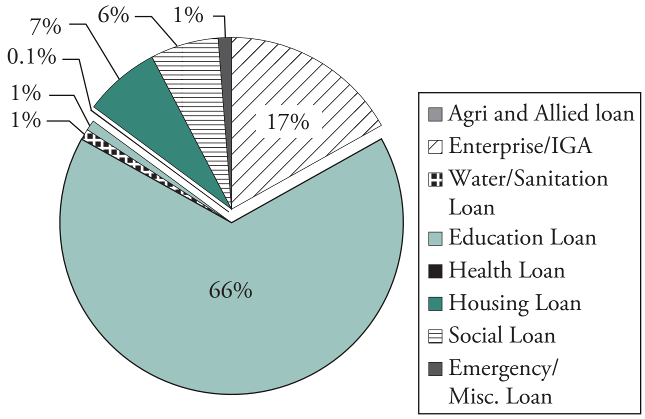


FIGURE 3.5 Portfolio Distribution of Loan Outstanding (n = 39; Fiscal Year 2014)

Source: ACCESS ASSIST survey.

SHG members are demanding special loan products for sanitation. Women are willing to borrow for construction of toilets and not depend on state subsidies alone, the reasons being safety, convenience and dignity of women. MFIs in southern states, such as Grameen Koota, ESAF, Sanghamitra, and Hand in Hand, have developed special loan product for construction of toilets which are now scaled up based on a good repayment experience. Some of them have invested in training of staff, developed blue prints for suitable designs, imparted mason training and over all ensured quality control. Most of the MFIs are at present pricing these loans as high as income generation loans. These loans have to be priced differentially. There are opportunities to develop suitably priced WASH products along with banks especially under the BC model.

Loan Size and Tenure

Apart from the purpose of loans, two critical aspects that define and differentiate loan products are the loan sizes and loan tenures. Sizes of loans to clients are also a proxy to understand the diversity of loans being offered by MFIs. While the average loan size on loan portfolio outstanding in the limited ACCESS ASSIST survey of 39 MFIs (Table 3.6) is low at Rs 6,838, the MFIN Micrometer reports an average outstanding loan per client of Rs 9,961. The average loan amount disbursed per client for FY 2013–14 was Rs 14,343, an increase of 12 per cent over the previous fiscal year, across all Tiers.

Equifax data (which has a larger sample of over 100 MFIs) indicates average ticket size of loans based on gross loans disbursed ever at Rs 11,874, average loan size of the loans disbursed in FY 2013–14 at Rs 14,405 (comparable to MFIN), while the average loan size of total loans outstanding as on March 2014 is Rs 9,057.

Figure 3.6 shows the distribution of loans disbursed ever by loan sizes; predictably 70 per cent of loans disbursed are between Rs 10,000–25,000 and higher size loans over Rs 25,000 account for 4 per cent of the pie. The state-wise analysis of data broadly indicates similar proportion of loan sizes with loans between Rs 10,000–25,000 occupying more than 60 per cent of the loans disbursed. Only Karnataka and Manipur deviate from this trend; with Karnataka having 53 per cent loans in this size category and 43 per cent loans disbursed of

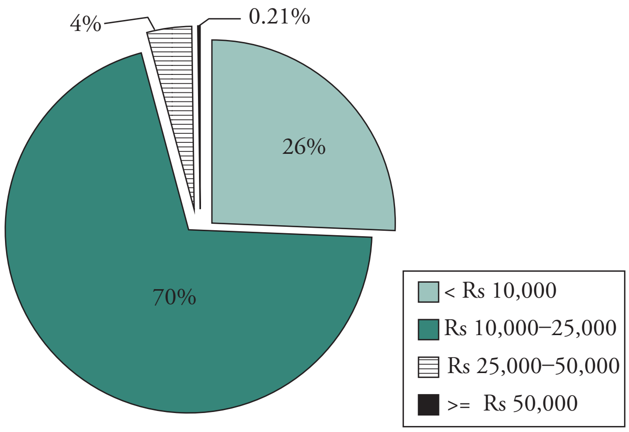


FIGURE 3.6 Loans Distributed Ever by Loan Sizes

Source: Data from Equifax.

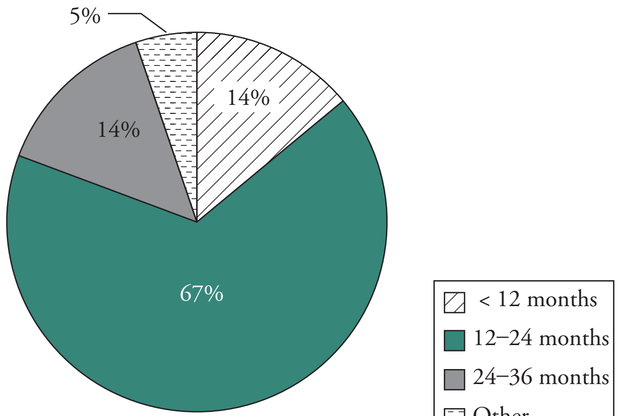


FIGURE 3.7 Active Loans by Loan Tenure

Source: Data from Equifax.

sizes up to Rs 10,000 and Manipur having an even more diversified portfolio with 42 per cent loans of up to Rs 10,000, only 32 per cent between Rs 10,000–25,000, and as high as 26 per cent loans over Rs 25,000.

The RBI guidelines for NBFC-MFIs limit total indebtedness level of clients to Rs 50,000 which has implications for loan amount that MFIs can offer to clients, considering clients avail loans from multiple MFIs. Also, RBI stipulates minimum loan tenure of 24 months for loans above Rs 15,000. Figure 3.7 shows 67 per cent of active loans with tenure between 12 and 24 months and 14 per cent over 24 months, which aligns both with the distribution of loans according to sizes and with the regulatory considerations.

Portfolio at Risk

Overall portfolio quality is good as per Equifax data, portfolio at risk of more than 30 days is given in Appendix A3.5. Andhra Pradesh understandably has the worst portfolio. While some of the states like Meghalaya, Sikkim, and Himachal Pradesh report more than 10 per cent to 30 per cent of active loan accounts/amount are delinquent as per PAR >30 days, these states have small portfolio. A cause for concern is West Bengal which tops the country in both loan accounts and amount where about 10 per cent of the loan accounts are delinquent as per PAR > 30 days. Tier-wise analysis of MFIs show that tier 3 MFIs are faring poor in many states including Kerala, Madhya Pradesh, Maharashtra, and Rajasthan. One of the reasons can be inadequate fund flow to these MFIs causing concern among the clients about availability of repeat loans leading to their holding on to the cash.

Retaining Clients and Measures of Client Feedback

Client retention rate is a good indicator of client satisfaction especially in markets where clients have a choice of service provider. Industry wide there is concern about client dropout rate which is reported to be more than 20 per cent. In some pockets the dropout rate is reportedly as high as 40 per cent. As per the sample study of ACCESS ASSIST, number of MFIs that track this indicator has increased year on year (see Table 3.9).

Large institutions like Ujjivan are taking several measures to improve client retention rates (see Box 3.1).

Client grievance redressal has been receiving lot of attention to provide timely resolution of issues faced by clients. The small sample survey of ACCESS ASSIST shows that different systems are used by the MFIs.

TABLE 3.9 MFIs Tracking Client Retention

Indicator	Units	2013	2014			
		Aggregate	Aggregate	Tier 1	Tier 2	Tier 3
Number of MFIs in sample		36	41	8	7	26
Number of MFIs tracking client exit rate		28	39			

Source: ACCESS ASSIST survey of 2013 and 2014.

BOX 3.1 Client Retention Measures by Ujjivan

Customer retention campaigns and increased proportion of pre-approved loans and ever reducing turnaround time for loans were key drivers for greater retention. Online credit underwriting through Document Management System has substantially increased approver productivity by nearly 60 per cent, reducing the turnaround time for credit decisions. During last one year, more than 96,000 centers were visited by Ujjivan's supervisory team from all departments to seek client feedback directly from the field. Ujjivan also calls for special reports on drop out customers to understand whether they are borrowing from elsewhere; the customer call center speaks to these clients to understand the issues with Ujjivan's services so that the processes and products can be made more customer friendly and also to bring clients back into Ujjivan.

Table 3.10 Client Grievance Redressal Measures

System Used	Number of MFIs				
	2013	2014			
	Aggregate	Aggregate	Tier 1	Tier 2	Tier 3
	36	41	8	7	26
Free helpline	12	19	7	6	6
Payable helpline	11	12	1	1	10
Staff phone numbers	24	30	6	5	19
Suggestions box at branch	20	24	6	4	14
Client service staff	14	12	4	2	6
Others	7				

Source: ACCESS ASSIST survey of 2013 and 2014.

MFIs find that free helpline is the most popular among clients and the complaint box in the branch is the least used. The data above shows that tier 1 MFIs are able to incur the costs in setting up free help lines; tier 3 MFIs largely depend on staff phone numbers and complaint box mechanism for grievance redressal. With MFIN setting up SRO, grievance redressal mechanism for clients of tier 3 MFIs also should improve with availability toll free phone mechanisms. MFIs are adopting more measures in soliciting client feedback on products, systems and processes (Table 3.11).

Table 3.11 Client Feedback Mechanisms

Mechanism Type	2013	2014
Client feedback/satisfaction surveys	56%	61%
Focus Group Discussions	31%	27%
Regional meetings of client representatives	36%	32%
Staff interaction	50%	68%
Client Exit Interviews	28%	41%

Source: ACCESS ASSIST survey of 2013 and 2014.
Note: Number of MFIs responding are 36 for 2013 and 41 for 2014.

Social Performance Desk Review by MIX

MIX reports that in all 70 institutions report social performance data to its database and thus, at a country level, Indian MFIs form the largest reporting group. MIX has commenced desk review to validate the existence of SP indicators that MFIs reported. Till July 2014, 13 Indian MFIs submitted supporting documentation for the desk review. The review by MIX can be seen in Appendix A3.6.

Supporting Documentation: The level of supporting documentation for each of the indicator made available to MIX has varied from institution. Grameen Financial Services ranks high on the documentation of SP indicators it has been tracking; it tracks the highest number of SP indicators among the MFIs, 35 in all and also has 100 per cent documentation of the same. The others scoring 100 per cent on documentation are Ujjivan and Utkarsh. Cashpor and ESAF also have high level of documentation.

Universal Standards for Social Performance Management (USSPM)

USSPM 1: Monitoring social goals 9 MFIs reported that they track the poverty level of their clients. Grameen Foundation's PPI tool is adopted by most of them. The poverty lines adopted by these MFIs vary from national poverty line, USD 1.25 to USD 2.5 per person per day. However, the percentage of the clients living below the chosen poverty line varied between 3 per cent and 86 per cent. This desk review will enable MFIs to evaluate their stated and actual practices on poverty measurement.

USSPM 2: Ensure board, management, and employee commitment to social goals Almost 80 per cent of the thirteen MFIs report that the members on their boards received some form of orientation on social performance management (SPM), whereas around 60 per cent could document this. Likewise, nearly 50 per cent report that a formal SP committee exists within the Board, but only 30 per cent could document what they had reported.

USSPM 3: Design products, services, delivery models and channels that meet clients' needs and preferences While all thirteen MFIs reported and documented offering microenterprise loans,[9] they had significantly over-reported other types of credit products. When reporting to MIX, MFIs tend to categorize their product offerings based on how clients use them rather than on the purpose for which they were designed (MIX's criterion for distinguishing one product from another). MFIs were, by and large, able to document the nonfinancial services they report offering. However, they are less capable of tracking the number of clients taking part in them.

USSPM 4: Treat clients responsibly MFIs report to MIX on nine client protection indicators—65 per cent of reporting Indian MFIs and 70 per cent for the global sample of 182 desk-reviewed MFIs have not documented any CPP indicator through external evaluations.

USSPM 5: Treat employees responsibly MFIs usually have little difficulty in submitting their human resources (HR) manual which, together with their credit catalogue, is one of the documents the vast majority of MFIs already have on hand. Most of the MFIs have most of these policies in place and successfully documented 70 per cent of all HR policy data points.

Social responsibility towards the environment: The majority of desk-reviewed Indian MFIs do not have any environmental products, services, or policies in place and, more generally, 41 per cent of all 70 Indian MFIs reporting SP profile information report no 'green microfinance practices'. The triple bottom line is a relatively less-used approach in the global microfinance sector.

MEASURING AND REPORTING OUTCOMES

While the most-cited goal of Indian MFIs is 'financial inclusion', MIX and Social Performance Task Force (SPTF) are yet to create outcome indicators related to financial inclusion and there is no satisfying proxy among MIX's suite of SP indicators. The outcome indicators for other commonly cited development goals are provided in Table 3.12.

The trends for measuring and reporting on outcomes is however not encouraging for India and for the rest of the world, with percentage of MFIs reporting outcomes (of those reporting the goal) ranging from 17 per cent to 35 per cent for the different goals. Reporting is better for 'Poverty Reduction' goal (35 per cent) (see Figure 3.8).

Measuring outcomes has remained a weak area for many of the MFIs; though most of the MFIs collect individual and household-level data at the time of entry, management of this data—verifying its accuracy, inputting in a database, analysis of the data, periodic update of this data to measure changes—has remained a challenge.

TABLE 3.12 Development Goals and their Associated Outcome Indicators (or Proxies)

Development goal	Outcome indicator
Poverty reduction	Percentage of clients below a certain poverty line at entry or at a given point in time (proxy)
Employment generation	Number of jobs created and number of microenterprises sampled
Start-up development	Number of start-ups financed and number of clients sampled
Growth of existing businesses	Number of existing microenterprises financed and number of clients sampled
Gender equality and women's empowerment	Number of clients served by non-financial women's empowerment services (proxy)

Source: MIX.

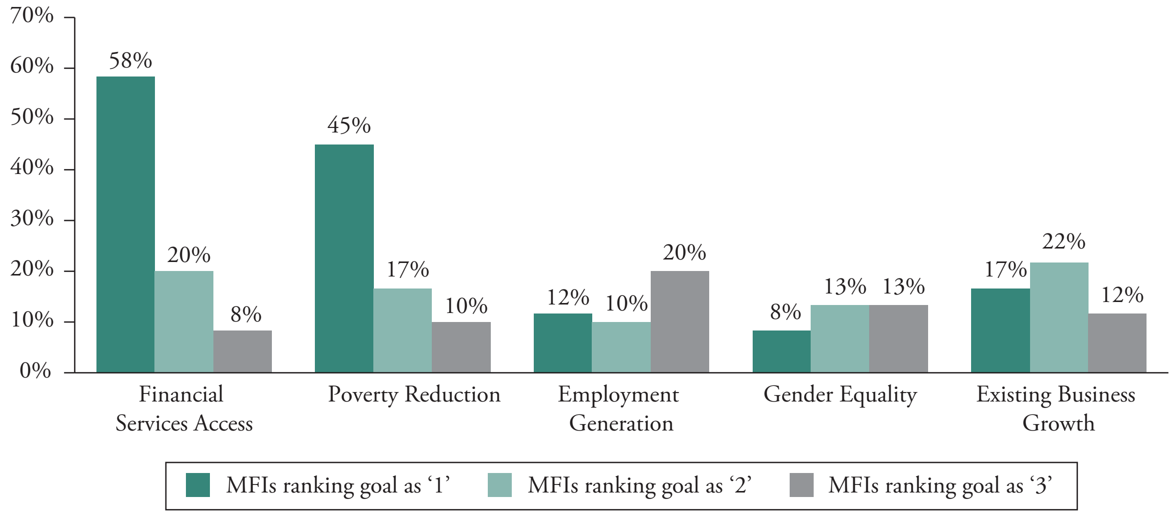


FIGURE 3.8 Relative Importance Assigned to Most Common Development Goals (n = 60)

Dia Vikas has been supporting its partners through technical assistance on measuring outcomes. EDA Rural Systems, the technical assistance (TA) provider, is adopting a systems approach to data management and providing support to these MFIs in integrating social data into the regular MIS, improving analytical ability to generate useful reports which not only guide operations but also support the Board of Directors in goal setting and monitoring. This is a work in progress.

However, tracking social outcomes has been an issue globally as a recent research by MIX market shows.

To conclude, the sector has a number of positive developments in the quantification, measurement and reporting of both outreach to targeted client base and social performance aspects. The data sets from Equifax, survey by ACCESS ASSIST and the desk review of documentation by the MIX show that MFIs are taking the measurement, reporting and tracking issues seriously. While the objectives of the MFIs and the sector in social performance management and reporting have not yet been fully met, the MIS and inferences there from so far show that there have been positive developments

BOX 3.2 MIX Research Analysis on Tracking Social Outcomes

What distinguishes an impact investor from a commercial one is the combination of social intention with a commitment to measure the social outcomes of an investment alongside financial ones. In reality, however, while impact investors are usually guided by a social mission, tracking social outcomes related to this mission is not yet common practice either for the investors themselves or for the microfinance institutions (MFIs) in which they are investing.

In order to examine the relationship between social funding and MFI operations, correlations between impact investments and various types of MFI performance indicators by comparing data from 658 microfinance institutions reporting social performance (SP), financial performance, and funding liability information to MIX was analysed.

The underlying hypothesis of this research is that MFIs funded by impact investors should demonstrate (a) better capacity to report social performance outcome indicators and (b) goals and product/service offerings with a social focus distinct from that of institutions funded by more commercial investors.

From the analysis, no evidence emerges that impact investors tend to invest more in MFIs with an inclusive social agenda than do their commercial peers. This is because most MFIs report financial inclusion, poverty reduction, and/or employment creation as their main development goals independent of funding structure. When it comes to outcome measurement, the vast majority of MFIs do not report indicators associated with their mission, illustrating the gap between intention and outcome measurement in microfinance.

and confirm that MFIs are concerned about the quality of outcomes from their business operations on vulnerable people and the social impacts. The challenge is in capturing information systematically and using the same to track progress on a variety of relevant aspects. The type of work that is being done by EDA Rural Systems, especially with partner MFIs of Dia Vikas, is particularly useful for adaptation and adoption across MFIs. Integrating SPM aspects in to regular MIS of MFIs and on-going review and analysis of the same at all levels is the next concrete step in scaling up social performance reporting.

APPENDIX A3.1 PROFILE OF INDIAN MFIs REPORTING SP PROFILE TO MIX

As of mid-July 2014, over 1,000 microfinance institutions (MFIs) from 98 countries have reported social performance (SP) profile data[10] to MIX. ('SP profile reporting/data/etc.' refers to the qualitative portion of the MIX/Social Performance Task Force (SPTF) SP indicators and consists of information on MFIs' SPM objectives, policies, and procedures. This is in contrast to 'SP results data', which is quantitative annual data on MFI operations: borrower retention and turnover rates, client poverty levels, gender composition of clients, staff, and board, etc. Unlike SP results data, which is updated annually, SP profile data is reported only once to MIX and then updated by MFIs as their institutional situation evolves. Profile data comprises the majority of the SP data available on MIX Market.) Within this data set, 70 of the MFIs are Indian, representing more than six per cent of all SP profile reporting (and ten times the number of MFIs reporting from the median country). Furthermore, these 70 MFIs comprise 75 per cent of all Indian MFIs that have reported basic financial data to MIX Market for fiscal year 2012.[11]

Furthermore, 60 MFIs that comprise the sample are fairly representative of the broader Indian microfinance landscape as captured by MIX data. The institutional diversity of the Indian microfinance sector becomes readily apparent when dividing these 60 institutions into MIX's various peer groups.[12] Table A3.1.1 shows that their outreach size and age run the gamut from small to large and new to mature respectively.[13] In addition, Figure A3.1.1 illustrates the variety of legal statuses of these institutions, with slightly more than three-quarters registered as non-banking financial institutions (NBFIs, usually called NBFCs in India) or non-governmental organizations (NGOs).

TABLE A3.1.1 Outreach and Age of Sample MFIs (n = 60)

	Small	Medium	Large	Unknown	Total
New			4	1	5
Young	2	3	10	2	17
Mature	9	3	17	5	34
Unknown			1	3	4
Total	11	6	32	11	60

From the sample, 43 MFIs reported basic financial information to MIX in fiscal year 2012. They served about 68 per cent of the Indian borrowers on MIX Market and had about 69 per cent of total Indian outstanding loans. In absolute terms, these 43 MFIs served approximately 19 million active borrowers and had an outstanding portfolio of around USD 3.1 billion at fiscal year-end 2012.[14] As the majority of MFIs in India currently are not permitted to accept and mobilize deposits in India, it should come as no surprise that only two MFIs in our sample held USD 42 million in voluntary deposits from approximately 717,000 clients at fiscal year-end 2012.

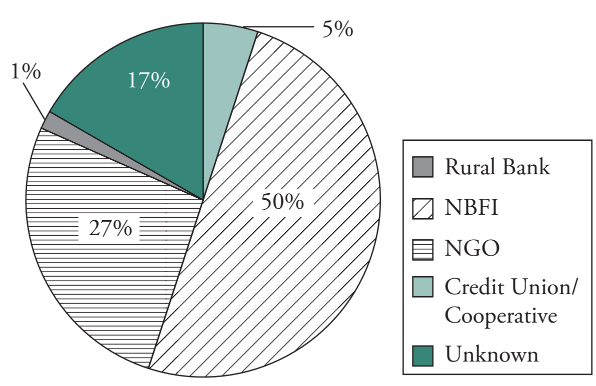


FIGURE A3.1.1 Legal Status of Sampling MFIs (n = 60)

APPENDIX A3.2 SUMMARY OF SOCIAL METRICS

Indicator	Units	2013	2014			
		Aggregate	Aggregate	Tier 1	Tier 2	Tier 3
Number of MFIs in sample		36	41	8	7	26
Number of MFIs acting as BCs		5	5			
Outreach						
No. of branches		4,185	5,924	4,537	677	710
Number of active clients (millions)	Nos.	12.41	18.25	15.63	1.33	1.29
Number of women clients	%	99.5%	97%	99%	96%	95%
New clients acquired		34%	26%	24%	47%	26%
Geographical outreach		**n = 34**	**n = 41**			
Urban/Semi-urban	%	48%	59%			
Rural	%	52%	63%			
Indigenous people and ethnic minorities	%	–	12%			
Portfolio at risk: 30 days	%	0.77%	0.93%	0.39%	1.45%	0.96%
Percentage of loan accounts with period > 2 years	%	23%	23.02%	27.29%	17.47%	23.80%
Active clients per loan officer		465	587	753	565	536
Active clients per staff		298	293	395	315	245
Operating cost ratio		13%	15%	10%	9%	19%
ROA		3%	4%	3%	2.6%	4%
ROE		14%	16%	17%	12%	16%
Other financial services offered: Client outreach						
Savings		1%	15%	25%	11%	15%
Insurance		30%	51%	63%	56%	50%
Pension		2%	32%	50%	44%	23%
Client Grievances						
Complaints received (No. of clients)	%	40.00%	33%	93%	5%	1%
Complaints resolved (No. of clients)	%	20.00%	56%	95%	4%	1%
Methods						
Free helpline		12	19	7	6	6
Payable Helpline		11	12	1	1	10
Staff phone numbers		24	30	6	5	19
Suggestions box at branch		20	24	6	4	14
Client service staff		14	12	4	2	6
Others		7				
Number of MFIs tracking client exit rate		28	39			
Client feedback mechanisms						
Client feedback/satisfaction surveys		56%	61%			
Focus Group Discussions		31%	27%			

Continued

Indicator	Units	2013	2014			
		Aggregate	Aggregate	Tier 1	Tier 2	Tier 3
Regional meetings of client representatives		36%	32%			
Staff interaction		50%	68%			
Client Exit Interviews		28%	41%			
Credit bureau reporting by MFIs						
No. of MFIs reporting to credit bureau		28	33	100%	100%	81%
No. of rejects	%	9%	10%	6%	8%	12%
CoCA						
No. of MFIs assessed		21	25	6	7	12
Number of MFIs scoring above 75% in COCA			14	6	4	4
CEO Remuneration: Loan officer		**n=21**	**n=27**			
Up to 20 times		12	11	2	1	8
Between 20 and 40 times		4	11	2	4	5
Between 40 and 60 times		5	5	1	1	3

Source: Sample study by ACCESS ASSIST for 2013 and 2014.

Appendix A3.3 STATE-WISE STATUS OF MFI LOANS—2014

State	No. of loans ever issued	Total ever amount disbursed Rs million	Average Ticket Size (Rs)	Total amount outstanding Rs million	No. of MFIs lending in FY 2013–14	No. of unique active clients (million)	Amount of loans disbursed in FY 2013–14 (Rs million)
Andhra Pradesh	17,416,974	194,426	11,207	65,138	5	6.28	689
Arunachal Pradesh	1,926	22	11,549	5	0	0.00	7
Assam	2,704,200	41,443	13,157	12,591	6	1.01	16,180
Bihar	6,452,488	80,338	13,201	18,563	19	1.78	26,780
Chandigarh	22,613	272	12,016	57	0	0.01	78
Chhattisgarh	1,664,887	20,832	11,696	3,535	7	0.38	4,898
Dadra & Nagar Haveli	6,614	118	17,954	58	0	0.00	71
Delhi	600,565	8,279	15,272	1,955	10	0.16	2,303
Goa	55,055	1,010	18,156	259	4	0.02	297
Gujarat	3,118,476	41,571	13,397	11,489	21	1.11	13,918
Haryana	621,593	8,459	13,592	2,235	9	0.19	3,003
Himachal Pradesh	14,853	180	13,474	38	0	0.00	24
Jammu & Kashmir	838	12	12,166	7	0	0.00	11
Jharkhand	1,750,338	19,511	11,134	3,591	7	0.40	5,161

Continued

State	No. of loans ever issued	Total ever amount disbursed Rs million	Average Ticket Size (Rs)	Total amount outstanding Rs million	No. of MFIs lending in FY 2013–14	No. of unique active clients (million)	Amount of loans disbursed in FY 2013–14 (Rs million)
Karnataka	18,940,045	184,688	13,235	30,636	24	2.56	39,980
Kerala	3,198,629	43,345	13,085	9,199	6	0.82	14,921
Madhya Pradesh	6,593,670	80,878	12,876	17,229	28	1.83	24,549
Maharashtra	10,571,513	131,444	13,530	29,556	25	2.69	36,740
Manipur	90,818	1,517	14,749	223	0	0.02	266
Meghalaya	77,976	1,445	18,754	418	0	0.03	424
Mizoram	259	3	11,788	3	0	0.00	2
Orissa	7,875,679	86,855	11,349	12,755	16	1.42	17,796
Other	8,937	93	10,355	0	0	0.00	0
Pondicherry	190,987	2,244	11,787	682	7	0.07	874
Punjab	390,027	5,002	12,142	1,943	5	0.19	2,712
Rajasthan	2,697,982	35,648	13,262	7,778	15	0.64	9,962
Sikkim	17,984	315	17,561	77	0	0.01	101
Tamil Nadu	16,158,451	187,821	13,067	44,060	27	4.31	57,177
Tripura	687,930	11,345	13,653	3,254	0	0.26	4,621
Uttar Pradesh	8,920,307	109,320	12,609	26,041	20	2.25	33,436
Uttarakhand	708,079	9,722	13,108	2,507	10	0.21	3,227
West Bengal	15,490,898	200,455	11,453	43,811	16	4.12	58,730
Total	**127,051,591**	**1,508,610**	**11,874**	**349,691**		**32.76**	**378,938**

Source: Data from Equifax.
Note: Active clients indicate unique borrowers across MFIs based on credit bureau roll-up of borrowers.

APPENDIX A3.4 STATE-LEVEL COMPARISON OF OUTREACH OF MFIs: ALL DISTRICTS VERSUS BACKWARD DISTRICTS

State	Total no. of districts	No. of districts with MFI ops	No. of MFIs currently operating	No. of active clients per district	No. of backward (B/W) districts	No. of B/W districts with MFI ops	Percentage of backward districts with MFI ops	No. of MFIs operating in B/W districts	No. of active clients per B/W district
Andhra Pradesh*	23	23	14	8,016	1	1	100%	7	11,960
Arunachal Pradesh	16	1	3	576	2	0	0%	-	0
Assam	27	21	9	47,864	4	2	50%	2	3,451
Bihar	38	38	23	46,101	27	25	93%	12	49,896
Chandigarh	1	1	3	5,200	0	0	0%	0	0
Chhattisgarh	27	15	12	23,839	4	4	100%	6	13,062

Continued

State	Total no. of districts	No. of districts with MFI ops	No. of MFIs currently operating	No. of active clients per district	No. of backward (B/W) districts	No. of B/W districts with MFI ops	Percentage of backward districts with MFI ops	No. of MFIs operating in B/W districts	No. of active clients per B/W district
Dadra & Nagar Haveli	1	1	3	3,993	1	1	100%	2	3,993
Delhi	11	7	13	22,282	0	0	0%	-	0
Goa	2	2	6	9,407	0	0	0%	-	0
Gujarat	33	22	27	45,955	2	1	50%	4	13,756
Haryana	21	18	13	10,499	3	2	67%	3	6,677
Himachal Pradesh	12	7	3	233	3	2	67%	2	491
Jammu & Kashmir	22	1	3	779	3	0	0%	-	0
Jharkhand	24	20	13	18,397	11	10	91%	9	15,636
Karnataka	30	28	29	87,378	3	3	100%	10	70,459
Kerala	14	14	9	56,522	2	2	100%	8	59,921
Madhya Pradesh	51	46	30	37,690	23	21	91%	18	32,817
Maharashtra	35	32	31	78,212	12	9	75%	13	48,129
Manipur	9	4	3	4,515	1	0	0%	-	0
Meghalaya	11	3	4	7,858	2	0	0%	-	0
Mizoram	8	1	3	259	2	0	0%	-	0
Nagaland	11	-	-	0	2	0	0%	-	0
Odisha	30	30	19	42,502	8	6	75%	7	16,679
Pondicherry	4	2	9	35,478	0	0	0%	-	0
Punjab	22	15	7	12,684	0	0	0%	-	0
Rajasthan	33	30	19	19,671	4	3	75%	4	2,648
Sikkim	4	2	3	2,862	4	2	50%	3	2,862
Tamil Nadu	32	32	35	127,527	2	1	50%	10	127,786
Tripura	8	4	3	63,760	2	2	100%	3	77,387
Uttar Pradesh	75	62	25	35,746	20	18	90%	8	12,669
Uttarakhand	13	11	14	18,320	1	1	100%	2	3,994
West Bengal	19	19	20	199,108	5	4	80%	9	170,889
Total	**667**	**512**			**154**	**120**	**78%**		

Source: Equifax.
Note: Clients indicate unique borrowers across MFIs based on credit bureau roll-up of borrowers.
*Data for Andhra Pradesh is inclusive of Telangana, since Equifax data does not report Andhra Pradesh and Telangana separately.

APPENDIX A3.5 PORTFOLIO QUALITY REPORT: STATE-WISE, AFTER WRITE-OFF

Name of the state	Average of Percentage 30+ Delq (Volume- number of accounts) (>31DPD)	Average of Percentage 30+ Delq (Value) (>31DPD)
Andhra Pradesh	98.3	97.8
Arunachal Pradesh	3.2	0.7
Assam	0.4	0.2
Bihar	1.6	0.8
Chandigarh	0.3	0.1
Chhattisgarh	7.1	4.0
Dadra & Nagar Haveli	0.3	0.1
Delhi	5.4	2.3
Goa	0.1	0.0
Gujarat	10.6	4.3
Haryana	2.9	1.0
Himachal Pradesh	38.7	27.6
Jammu & Kashmir	0.0	0.0
Jharkhand	7.3	4.8
Karnataka	4.1	2.6
Kerala	4.2	3.6
Madhya Pradesh	6.1	3.1
Maharashtra	6.9	3.9
Manipur	9.5	4.4
Meghalaya	16.1	19.1
Mizoram	0.0	0.0
Orissa	10.6	6.4
Pondicherry	0.1	0.0
Punjab	0.4	0.2
Rajasthan	8.4	3.3
Sikkim	12.7	8.9
Tamil Nadu	5.5	2.4
Tripura	0.4	0.2
Uttar Pradesh	1.5	0.6
Uttarakhand	1.9	0.8
West Bengal	10.4	5.4

APPENDIX A3.6 SOCIAL PERFORMANCE DATA QUALITY AT MFIs IN INDIA[15]

This Appendix is the summary of the second instalment of a two-part series focused on the performance of Indian MFIs reporting social data to MIX.[16]

This article focuses on select findings from desk reviewing thirteen Indian MFIs. It proceeds through the various social performance (SP) indicator areas, highlighting those that are easier for microfinance institutions (MFIs) to document and those where SP data points were most affected by the documentation process. The article concludes with some reflections on why certain SP indicator areas are easier to document than others, how the desk review has influenced MIX's understanding of the indicators it asks MFIs to report, and the value of the documents collected for sharing knowledge and spreading best practice in the industry as a whole.

Enhancing Social Performance Data Quality at Indian MFIs

With 70 institutions in total, India is the country with the highest number of MFIs reporting SP data to MIX. Of these 70, thirteen have submitted supporting documentation through the desk review to validate the existence of the SP indicators they reported.

The following paragraphs present desk-review findings organized by each Social Performance Task Force (SPTF)'s Universal Standards of Social Performance Management (USSPM) category.

TABLE A3.6.1 List of Indian MFIs that Participated to MIX's 2013 SP Document Desk Review Process (as of July 2014)[17]

Full Organization name[18]	Name as it appears on MIX Market	Legal status	SP indicators documented*	STAR recognition
Bandhan	Bandhan	NBFI	66% (19/29)	No
Belghoria Janakalyana Samity	BJS	NGO	29% (8/28)	No
Cashpor Microcredit	Cashpor MC	NGO	100% (22/22)	Yes
Chaitanya India Fin Credit Private Limited	Chaitanya	NBFI	45% (9/20)	No
ESAF Microfinance and Investments (P) Ltd	ESAF	NBFI	94% (32/34)	Yes
Grameen Financial Services Pvt Ltd	GFSPL	NBFI	100% (35/35)	Yes
Janalakshmi (formerly Sanghamithra Urban Program)	JFSPL	NBFI	31% (9/29)	No
Lok Biradari Trust, Indore	LBT	NGO	5% (1/22)	No
Muthoot Fincorp Ltd	Muthoot	NBFI	34% (11/32)	No
Samhita Community Development Services	SCDS	NGO	20% (4/20)	No
Satin Creditcare Network Limited	SCNL	NBFI	48% (10/21)	No
Ujjivan Financial Services Pvt. Ltd.	Ujjivan	NBFI	100% (28/28)	Yes
Utkarsh Microfinance Pvt. Ltd.	Utkarsh	NBFI	100% (19/19)	Yes

Note: * Refers to the number of indicators documented over the total number of indicators reported that are subject to desk review. For instance, 50 per cent (10/20) means that the MFI reported twenty SP indicators subject to desk review (including both qualitative and quantitative indicators) and submitted corroborating documents for ten of these twenty.

Social Performance Data Quality at Indian MFIs: an In-depth Examination

USSPM 1: Define and Monitor Social Goals

Table A3.6.2 below provides, along with its desk review status, the most recent client poverty measurements from the nine desk-reviewed Indian MFIs reporting client poverty measurements to MIX at least once since fiscal year 2010.

Overall, *institutions are willing and able to provide evidence of their poverty measurements*, even if one or more years have passed since the measurements in question. Additionally, the wide variety of documents submitted to document these figures illustrates both the differing ways in which MFIs are measuring client poverty and the flexibility of the desk review process to accommodate this heterogeneity. Last but not least, *the desk-review process has proven valuable* not only to document what MFIs had already reported but *also to update and correct the information published on MIX Market*. In the case of poverty tracking, for example, SP analysts added figures for four Indian MFIs and changed previously reported figures for two more.

USSPM 2: Ensure Board, Management, and Employee Commitment to Social Goals

Under this category, MIX desk reviews information on governance and social bases for staff incentives.

Almost 80 per cent of our thirteen Indian MFIs report that their BoD members received some form of orientation on social performance management (SPM), whereas around 60 per cent could document this. Likewise, nearly 50 per cent report that a formal SP committee exists within the Board, but only 30 per cent could document what they had reported.

In general, MFIs are capable of submitting documents corroborating the basis for their bonus system. However, *MIX often found a discrepancy between information reported and actual practice*. This implies (a) MIX's staff incentive indicator typology is not well understood by MFIs and/or (b) MIX's staff incentive indicator typology does not fit MFI operations very well.

USSPM 3: Design Products, Services, Delivery Models and Channels that Meet Clients' Needs and Preferences

While all thirteen desk-reviewed Indian MFIs reported and documented offering microenterprise loans,[19] they had significantly over-reported other types of credit products. Indeed, the SP desk review reveals that, when reporting to MIX, *MFIs tend to categorize their product offerings based on how clients use them rather than on the purpose for which they were designed* (MIX's criterion for distinguishing one product from another).

Our group of thirteen Indian MFIs was by and large able to document the nonfinancial services they report offering,

TABLE A3.6.2 Desk-reviewed Client Poverty Measurements at Nine Indian MFIs

Institution (FY)	Poverty tool used	Sample	Poverty line considered	Clients below poverty line	Desk review status
JFSPL (2010)	Grameen PPI	178,517	National poverty line	3%	Self-reported
Utkarsh (2012)	Grameen PPI	1,800	USD 2/day	86%	Documented
BJS (2012)	Grameen PPI	9,300	NPL	70%	Self-reported*
GFSPL (2011)	Grameen PPI	280,399	USD 2/day	73%	Documented
SCNL (2011)	Own tool	271,999	USD 2.5/day	39%	Documented
Chaitanya (2012)	Grameen PPI	5,007	USD 2/day	80%	Documented
ESAF (2011)	Grameen PPI	12,281	USD 1.25/day	27%	Documented
Ujjivan (2013)	Grameen PPI	1,301,808	USD 1.25/day	22%	Documented
Cashpor MC (2012)	Grameen PPI	1,503	USD 1.5/day	39%	Documented

Note: * MIX analysts did receive a copy of the loan application form BJS uses to collect poverty data, so this indicator is actually partially documented (the "poverty measurement tool" field has been documented).

successfully corroborating the existence of 93 per cent. However, they are less capable of tracking the number of clients taking part in them (Table A3.6.3).

USSPM 4: Treat Clients Responsibly

MFIs report to MIX on nine client protection indicators that are, in turn, based on the Smart Campaign's Client Protection Principles (CPPs).[20] This is the only section of the desk review where MIX does not accept internal MFI documents. Given that a large majority of institutions everywhere have not undertaken any sort of external client protection evaluation, *this is the category with the highest percentage of self-reported indicators*: 65 per cent for our sample of thirteen Indian MFIs and 70 per cent for the global sample of 182 desk-reviewed MFIs have not documented any CPP indicator.

USSPM 5: Treat Employees Responsibly

MFIs usually have little trouble submitting their human resources (HR) manual which, together with their credit catalogue, is one of the documents the vast majority of MFIs already have on hand. The majority of our thirteen institutions reported having most of these policies in place and successfully documented 70 per cent of all HR policy data points.

Social Responsibility Towards the Environment

The majority of desk-reviewed Indian MFIs do not have any environmental products, services, or policies in place and, more generally, 41 per cent of all 70 Indian MFIs reporting SP profile information report no green microfinance practices.

The triple bottom line is a relatively new approach in the global microfinance sector. While MIX has collected indicators on environmental policies since 2009, green microfinance is not part of the USSPM framework and CERISE has only recently introduced environmental components into its social audit tool, the SPI4.[21] As such, mainstream MFIs may require some time to incorporate green microfinance approaches into their operational strategies.

This section concludes that:

- MFIs appear to find it easiest documenting human resource policies in place, financial product/service offerings, and client poverty measurements.
- The desk review process has offered MIX an opportunity to revise the MIX/SPTF SP indicator typology to fit its own criterion that these indicators be easily verifiable: for example, the consistent confusion around documenting certain staff incentive bases has lead MIX to consider revising/removing certain elements of this indicator. In a similar vein, the nature of documentation MFIs provide for indicators on governance (in conjunction with the SPTF's revised USSPM indicator language)[22] will likely lead to a revision of the way MIX phrases these indicators.
- The many documents collected constitute a valuable source of information for understanding how individual MFIs are addressing the challenge of managing their social performance and identifying best practices in a wide variety of SPM areas.

TABLE A3.6.3 Non-financial Services Outreach (Fiscal Year 2012)

Non-financial services offered	Percentage of MFIs offering non-financial services that also reported number of clients participating in fiscal year 2012		
	Desk reviewed Indian MFIs (n = 13)	Indian MFIs (n = 60)	South Asian MFIs (n = 175)
Enterprise	30	30	25
Education	27	31	21
Women's empowerment	60	43	27

NOTES

1. With contribution from Radhika Agashe, Executive Director, ACCESS ASSIST.
2. This survey is undertaken to collect a more-granular data on outreach and other social metrics. The summary results can be seen in Appendix A3.2.
3. The number of active clients is more than tier-wise break-up provided in Table 3.2 because this data additionally includes microfinance reporting by some banks.
4. This includes list of 100 backward districts identified by the Planning Commission and list of LWE-affected districts notified by the Department of Financial Services for promotion of women SHG programme.
5. Of the 29 states and 7 UTs; Andhra Pradesh and Telangana are taken as AP; Union Territories of Andaman and Nicobar; Lakshadweep and Daman and Diu are not reported in Equifax data.
6. Opportunity International Social Performance Report 2013.
7. It should be noted that annual financial data for only 108 of the 175 South Asian MFIs (and as previously stated, 43 of the 60 Indian MFIs) were made available for FY 2012.
8. Other financial services include mobile banking services, micro leasing, remittance services, and debit/credit card services.
9. As is the case for 93 per cent of desk-reviewed MFIs globally.
10. More information on the MIX/SPTF SP indicators, is available at http://www.themix.org/social-performance/Indicators (16 July 2014). Unless otherwise stated, all data in this article comes from MIX Market (www.mixmarket.org).
11. As of mid-July 2014, this is the latest complete annual data set available on MIX Market, covering the Indian fiscal period of 1 April 2012 to 31 March 2013. While some fiscal year 2013 data is available for Indian MFIs, data collection for the period 1 April 2013 to 31 March 2014 is currently on-going.
12. Information on MIX's benchmarking peer groups (16 July 2014) is available at http://www.themix.org/sites/default/files/Methodology%20for%20Benchmarks%20and%20Trendlines.pdf.
13. Outreach peer groups are Small (number of borrowers < 10,000), Medium (number of borrowers 10,000–30,000), and Large (number of borrowers > 30,000). Age peer groups are New (one to four years old), Young (five to eight years old), and Mature (more than eight years old).
14. MIX considers the fiscal year of institutions with a fiscal year-end from 1 January to 30 June to be part of the previous fiscal year, while fiscal year-end from 1 July to 31 December are counted as part of the current fiscal year. For example, data from MFIs ending their fiscal year on 31 March 2013 are considered to be fiscal year 2012 because this fiscal year-end is before 30 June 2013.
15. Report prepared by Armonia Pierantozzi Social Performance Analyst, MIX, apierantozzi@themix.org, and Michael W. Krell, Analysis and Data Management Lead, Social Performance, MIX, mkrell@themix.org.
16. Full version of this article is available at http://www.themix.org/publications/mix-microfinance-world/2014/08/India-development-findings-2014-second.
17. Equitas Microfinance Private Limited completed the desk review process in August 2014.
18. The complete list of Indian MFIs reporting to MIX and the link to their respective MIX Market profile pages is available here: http://www.mixmarket.org/mfi/country/India, accessed 22 September 2014.
19. As is the case for 93 per cent of desk-reviewed MFIs globally.
20. These CPPs have been endorsed by 1,457 MFIs, 180 microfinance associations and networks, 174 investors and donors, 297 support organizations, and 2,044 individuals. Visit http://www.smartcampaign.org/about/campaign-endorsers, last accessed on 17 July 2014.
21. For more details, see http://sptf.info/sp-tools/audit-tools, last accessed on 25 August 2014.
22. The complete list of USSPM indicators is available at http://sptf.info/images/usspm_standards%20indicators_revised%2020140411_english1.xlsx, last accessed on 25 September 2014.

4

Governance for Responsible Finance

Governance is a key aspect of organizational performance and achievement of its mission. The board and senior management can determine the sharpness of focus and intensity of intent on responsible finance through appropriate goal setting and rigorous reviews. Boards have the mandate and capacity to set the policy, strategy and to influence operations and thus are in a unique position to secure social performance across the MFI. The Social Performance Report, 2012, discussed issues in governance of MFIs and the state of practice of governance in the sector. At that time the major concerns listed were: the need for separation of ownership from governance structures, composition of boards, need for more independent directors, trade-offs in balancing social goal achievement with financial performance, and board supervision over reporting and monitoring of responsible finance.

The sector has made significant overall progress including in governance aspects. The changes have not been necessitated just by expanding business and external compulsions but also by genuine internal motivation to improve governance. RBI has been progressively increasing the governance requirements for NBFCs of which MFIs are a subset.[1] The new Companies Act of 2013, has brought in significant changes to corporate governance requirements in case of public limited companies as also companies that have their shares listed in the stock exchanges. SEBI on its part has introduced regulations in the light of the new Companies Act, requiring changes in both structure and practice of governance. The changes made in the Companies Act and the SEBI regulations are being seriously examined by MFIs and a calibrated adoption plan has been prepared by most of the larger MFIs, which eventually plan to list their shares in a stock exchange.

The Microfinance Banana Skins 2014 (CSFI 2014) survey globally ranked governance risks as the fifth major risk. This is an improvement over the 2012 position when governance risks seemed to be very high, ranked second. Corporate governance risk was the third highest ranked risk in South Asia in 2012 in the Banana Skins survey. Reflecting the improving governance environment in South Asia in general and in India in particular governance risk is ranked thirteen in 2014.

The Poorest States Inclusive Growth (PSIG) programme, funded by DFID and implemented by SIDBI, had commissioned MicroSave (2014) to undertake a study on governance in MFIs. The study surveyed governance practices in 40 MFIs across India. The study findings confirm the improving situation in governance of MFIs. A large proportion of surveyed MFIs have constituted boards with directors of wide ranging expertise. More than 75 per cent of the MFIs had independent directors on their boards and 39 per cent of them had an independent director as Chairman. The independent directors chosen were persons with experience at senior levels in the financial sector or were professionals such as Chartered Accountants. 74 per cent of the MFIs had women directors on their boards.[2] MFIs had committees of the board dealing with subjects such as audit (89 per cent), risk (74 per cent), nomination and remuneration (58 per cent), Social Performance, governance and other matters. To a large extent independent directors chaired audit committees. Most boards had a well-organized process for scheduling meetings, determining agenda and discussions.

However, there were some persisting problems and challenges. The promoters were highly influential in boards with friends or family represented disproportionately. In most companies microfinance expertise was located in the promoter or the CEO (in 23 out of 28 MFIs that shared this information) and other directors did not have a good understanding. In 21 per cent of MFIs the promoter had family members on the board of directors. Investors had high representation in some boards and independent directors were too few. 21 per cent of MFIs in the survey did not have a single independent director. 32 per cent MFIs had less than 1/3 independent directors on the board. On account of too few independent directors being available, it was difficult to constitute the committees of the board required by the regulator—such as the nomination and remuneration committee. The findings of the study on how boards dealt with social performance and responsible finance are covered in later part of this chapter.

While there have been on-going improvements in governance, there are several persisting weaknesses. Governance has been seen in some companies as a compliance exercise where only external expectations and regulatory guidelines are fulfilled. Internal recognition of governance as an aspect that is central to a well-run organization is yet to take place in a number of MFIs. The weaknesses in governance impacted customers and responsible finance practices more as it was a relatively new aspect of oversight for MFI boards. Some of the common aspects in the practice of governance that require attention are listed in the following section.

'FIT AND PROPER' PERSONS IN BOARDS

In some MFIs, the board positions are filled with persons that the promoter can rely upon to support his/her interests. Either family or friends or independent directors that are amenable to the promoter's suggestions are placed in the boards. These types of board appointments serve neither the interests of the company nor that of the promoters in the long run. (See Box 4.1 for an example of an unsuitable board.) The phenomenon of cousin boards should be dealt with carefully by the Nomination and Remuneration Committees that are vested with the responsibility of establishing the 'fit and proper' criteria for board appointments.

A related issue is the nomination of directors by investors and lenders. At times, persons without necessary background in the business and lacking in experience are appointed to the board using contractual clauses in the shareholder agreement or loan agreement. Such directors, on account of an inadequate appreciation of the nuances of satisfying all stakeholders, may orient business strategies towards profit maximization. The regulator might have to issue a fit and proper criterion for nominee directors identified by financial institutions to represent their interests on MFI boards. Unsuitable persons can compromise

Box 4.1 Limited Exposure to Microfinance Restricts Oversight

In one of the MFIs in north India, none of the board members other than the CEO has an experience in microfinance sector. While there is little doubt that the board members of the MFI bring their knowledge and experience from their respective areas of expertise, they still have to depend on the CEO to understand the nuances of microfinance business. This will not only affect the quality of discussions but may also lead to over-dependence of the board on the management thereby affecting quality of supervision and oversight.

customers' interest by agreeing to all proposals made by the management either on account of their nearness to the promoter or for the want of required expertise.

ORIENTATION OF BOARD ON THE MFI'S SOCIAL MISSION AND GOALS

The MicroSave study finds that most of the MFIs do not have a formal mechanism or system to orient the new board member on the MFI's social mission and goals. This is mostly as there is a belief in the microfinance sector that board members are experts from the microfinance sector and therefore do not require a formal orientation programme at the time of induction. Some of the MFIs generally invite the prospective board members to one of the board meetings to acquaint him/her with the functioning of the board. One of the MFIs organizes a 3-day orientation programme for all its board members including the nominee directors. RGVN provides formal orientation programme to all its directors.

A few MFIs ensure that before a shareholder or board of director joins in he/she has alignment with the mission and goals of the organization and the condition for the investor to comply with the same is incorporated in the term sheet and the shareholders' agreement that is signed with the investors. As a result, board members bind themselves to these commitments.

HAVING INDEPENDENT MEMBERS ON BOARD

As indicated in the study report of MicroSave, a number of companies have very few independent directors. 21 per cent of MFIs had no independent directors. MFIs have difficulties in getting persons with requisite experience and expertise. A centralized database by the industry associations might be of great help to smaller MFIs in identifying suitable persons as independent directors. While the Companies Act, in case of companies with Rs 500 crore net worth; and SEBI regulations, in case of listed companies, mandate one-third of the directors to be independent, not all MFIs fall under this category. However, looking at the numerous vulnerable customers handled by these companies, they require a major proportion of their directors to be independent so that customer protection becomes effective. Barring a few MFIs others seem to be content with technical compliance with the regulations on having independent directors.

At times it is suggested that employee and customer representatives should be appointed to the board to ensure that all stakeholders in business have participation in governance (Box 4.2). This for many reasons has not been found to be practical. The independent directors should be in a position to represent interests of those stakeholders that are not part of the board. The directors should also keep themselves informed about customer concerns and their point of view.

PROVIDING ADEQUATE AND TIMELY INFORMATION TO BOARD

Matters taken to the board in some of the MFIs are routine and operational in nature. The strengths of the board in setting policy and strategy are not always harnessed. In fact there are divided views on the aspect of what is the board's role in developing business strategy. According to the MicroSave study report:

Box 4.2 Accommodating Employee and Customer Concerns

The customer perspective is important for effective governance, but having clients on the board has not proved to ensure that voice. Clients generally lack the requisite financial skills, and their participation is often little more than window dressing. The board should, however, make it a priority to get on-going input from clients through client visits, market research, and other means. Visits by board members to meet clients may be a good way for board members to understand how the MFI and its management are perceived by its clients.

Source: Excerpt from the *Practice of Governance in Microfinance Institutions*, Consensus Statement of Council of Microfinance Equity Funds, 2012.

[W]e encountered two views about the role and involvement of the board in defining the mission and strategic direction of the MFI. On the one hand, there are MFIs that believe while board may not provide a very clear direction to the MFI but it helps in defining the periphery for the management to confine their ideas and strategies. They raise flags if they perceive risks and guide the management team to avoid pitfalls. The board/business committee in such cases usually discusses the areas of impact if the business plan is approved—mostly around the compliances and statutory issues—and flag the same to the board and management for consideration.

On the other hand, there are MFIs that acknowledged that their board members play a more direct and central role in defining the strategic direction of the MFI. The board in such cases generally collaborates with the management during the strategy development process and actively provides inputs throughout the course of strategy formulation.

The study found during the survey that most MFIs referred certain matters more than others to their boards. Business strategy, capital mobilization, risk management, and internal controls rightly occupied the attention of almost all the boards. But key issues relating to customer protection, responsible finance, and social performance were not focused in a number of boards. Only 60 per cent of the boards seemed to consider issues relating to responsible finance, grievance redressal, and human resources (Figure 4.1). While the committees of the board consider specific areas in depth, the boards should spend adequate time on the minutes and reports of committee meetings.

BOARD PROCESSES

The conduct of meetings, placement of agenda items before the board, dealing with quorum requirements and ensuring that all directors are able to participate and contribute to decision making are some aspects under the board processes that should be carefully facilitated by the chairman of the board and the CEO/company secretary. The resort to resolution by circulation for important matters has been in practice. This should be avoided. Through advance consent of board members meetings can be timed to ensure maximum participation. The board should itself consider whether to retain on board the directors who miss many meetings. The board should look beyond the technicalities of asking for leave of absence and

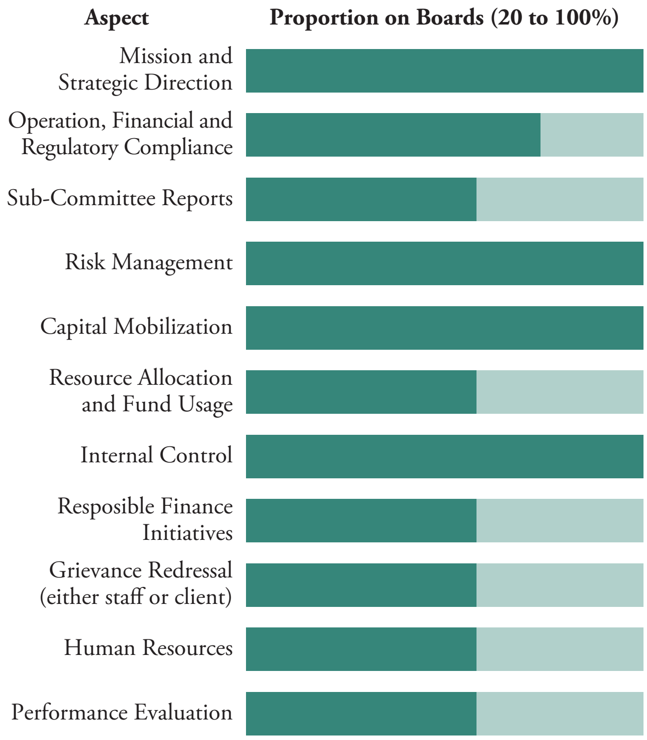


FIGURE 4.1 Matters Considered by the Boards of Surveyed MFIs

assess whether the director is interested in making a contribution to the company's objectives.

SETTING UP AND FACILITATION OF COMMITTEES

The MicroSave study found that most NBFC-MFIs complied with the requirement of setting up board committees on audit, risk management, and nomination and remuneration (see Figure 4.2). Some MFIs have, in addition, set up CSR, governance, and business committees as well. However some of the requirements relating to constitution of the committees such as an independent director chairing the audit committee or, having majority independent directors in the nomination and remuneration committee have been found difficult to fulfil in MFIs that had very few independent directors. The functionality of the committees has been reduced by not having adequate number of directors with necessary background. Apart from NBFC-MFIs, other MFIs rarely have effective sub-committee structures. Out of 11 MFIs, which are non-NBFCs, 27 per cent of MFIs do not have any sub-committees.

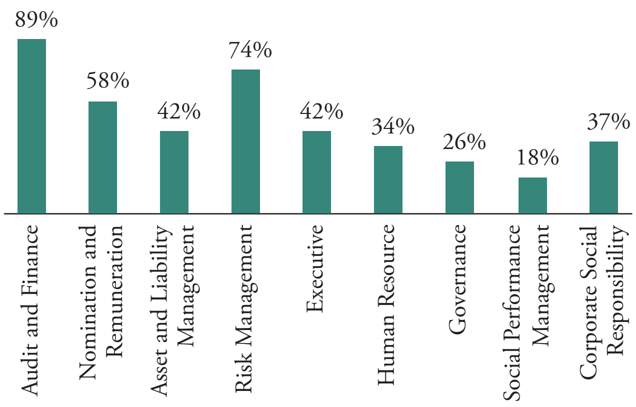


FIGURE 4.2 Board Sub-committees

Although the recent Company Law requirement on setting up CSR committees is a welcome development, it can cause confusion in MFIs. CSR committees may not necessarily deal with customer protection and responsible finance issues. MFIs have to carefully draw up the terms of reference of CSR committees and ensure that in the absence of other arrangements, customer protection and responsible finance matters are clearly listed in the roles of the committees.

COMPENSATION POLICY

The board should be adequately remunerated for its time and expertise spent on the company's affairs. The remuneration should be in such a form and extent that it does not influence the board towards the interests of one set of stakeholders—the promoters. The practice of remunerating the directors varies across the MFIs. About 22 per cent of the MFIs in the MicroSave survey said that they do not pay any fee to the board members. On the other hand as many as 73 per cent of the MFIs said that they do pay a fixed fee to the directors. In most of such cases, the remuneration is in the form of a sitting fee for attending the board meetings as well as sub-committee meetings. At least two MFIs in the survey said that in addition to the sitting fee, they also pay remuneration to independent directors if the company is in profit in the relevant year. Some MFIs said that they do not pay any fee to the nominee directors as such and the fee is taken care of by the lender/investors themselves.

If MFIs are expecting high-calibre and highly qualified senior people to commit a significant amount of time to their governance duties, sometimes with personal liability, often with extensive travel, then they need to be willing to compensate directors for their time and efforts. The role of a board director needs to be seen as a responsibility, not an honour, and remuneration underscores the importance of the role. (Excerpt from the *Practice of Governance in Microfinance Institutions*, Consensus Statement of Council of Microfinance Equity Funds, 2012)

While most MFIs have fixed reasonable sitting fees for attending meetings and also a remuneration, a few pay excessively. Some MFIs do not pay an adequate fee to the director to compensate for their time inputs. The remuneration should make it worthwhile for the directors to focus on the company's issues with enthusiasm. The CEO and senior executives' remuneration has to be within reasonable limits and not merely linked to commercial goals of the organization. In the past, some MFIs have reported the CEO's salary as at 100 multiples of the lowest paid staff in the organization. While there is no denying the fact that the remuneration should be relevant in a competitive market, it should not be high especially where the executive is the promoter or from the promoter group. Boards have to ensure this.

TRANSPARENCY AND DISCLOSURE

The requirement of transparency and disclosure is at two levels. One is to the customers and another is to the stakeholders at large. Regulation has stipulated the nature and quality of information that should be made available to customers from MFIs in an understandable form. The information to be made available to customers includes terms of loan, code of conduct, processes adopted by the MFI and the grievance handling procedure. NBFC-MFIs have to place in public domain information relating to their finances, profitability of operations and the annual report in the format prescribed by the Ministry of Corporate Affairs. For listed companies (both for equity and debt instruments), SEBI requires periodic disclosure of financial results. MFIs in company form comply with the regulatory requirements and many of them go far beyond the minimum disclosures prescribed. Some MFIs in non-profit form do not make adequate disclosures and the information that is made available in public domain is too little and opaque. Funding banks have a role to play in transforming MFIs in other forms to be more transparent and disclose adequate information in the public domain.

A connected issue in disclosure of information is that of ensuring privacy of customer data in the hands of MFIs. While most MFIs have a policy, the necessary operational procedures outlining the steps that should be taken to deal with demands for client data are not in place in most of the MFIs. MFI staff at different levels should be informed about the steps they should take to ensure that they do not part with customer information without their consent.

ACCESS TO SENIOR MANAGEMENT AND AUDIT STAFF FOR BOARD MEMBERS

Some well-governed MFIs provide space and time for board members to interact with senior management staff to better understand the link between board level strategies and implementation. The audit committees meet both internal and statutory auditors periodically to discuss audit observations. Boards finalize the MFIs' annual accounts only after discussion with statutory auditors. While NBFC-MFIs are required by law to meet auditors exclusively, the quality of interaction differs from MFI to MFI. While some boards have detailed discussions with the auditors, there are others in which the discussions are routine, fulfilling a requirement. A number of MFIs keep senior management staff away from the board. The CEO or select officials communicate with the board to the exclusion of other executives. The discussions with audit staff are crucial for boards in that the directors can get first-hand information on field observance of different customer protection measures initiated by the board. In these discussions, among other matters, the boards should seek information on code of conduct adherence by field staff and working of the grievance redressal mechanism.

INVESTOR CONTROL OVER GOVERNANCE

The entry of large ticket private equity also brought in shareholder agreements aimed at protecting the interests of equity investors from capricious conduct of promoters. But the shareholder agreements are not uniform in their contents and have in some cases taken the governance away from boards and placed it in the hands of investors. The shareholder agreements contain a list of 'reserved matters' under which the board cannot take binding decisions. These matters are referred to investors who are parties to the shareholder agreement and only with their consent the decisions of the board becomes binding on the company. Typically these matters relate to diversification of business, change of key managerial personnel, issue of additional equity, payment of dividends, related party transactions of the promoters or CEO, and actions that can impinge on the rights of the shareholders.

However a number of shareholder agreements have several additions to the list such as annual business plans, contracting long-term debt, appointment of independent directors, director remuneration, CSR activities, and appointment of staff of any kind. Loading a large number of items to the reserved matters list severely restricts the board in being effective. Removing critical aspects of oversight from the board and placing it in the investors' hands that are not answerable for their decisions is a clear miscarriage of governance. While equity investors require protection, it should be ensured through good governance and having appropriate persons appointed to the board. The board's role is to ensure that all stakeholders are protected, equitably rewarded and the company does well over the long-term. The independent directors of MFIs should ensure that interests of customers who do not have a strong voice are well represented and counteract any shareholder interests that might be disadvantageous to customers.

CAPACITY BUILDING OF THE BOARDS

Boards can be provided with improved capacities that will make them focus intensely on all aspects of the MFIs' working, such as financial soundness, operational efficiencies, responsible finance and social performance. At the board level, governance aspects of managing MFIs are more important than the technical aspects. The attention of investors, funders and regulators is on responsible finance, customer protection and social performance and these are the areas in which governance capacities should be strengthened. The management teams of most MFIs that were surveyed felt that considering the background, experience, and expertise of the board members there is hardly any need to build capacities of the board members. They acknowledged that the board members should be updated about the latest developments in the sector (see Box 4.3). However, these MFIs do not have a system for the capacity building of their board members.

EDA Rural Systems is facilitating implementation of Universal Standards for Social Performance Management (USSPM) in ten MFIs in the country. The work with MFIs entails examination of the agenda and minutes relating to social performance aspects, discussions with senior management and the board and a half-day's training for the board. Such on-location training, based on an examination of the actual oversight done by the boards, will be useful in improving the board capacities as also the quality of information reported and reviewed.

THE COMPANIES ACT, 2013

The new Companies Act has increased the content of quality of focus on governance by boards and the directors. The Act has described the role of independent directors as

> offering independent judgment on issues of strategy, performance and key appointments, and taking an objective view on performance evaluation of the board. Independent directors are additionally required to satisfy themselves on the integrity of financial information, to balance the conflicting interests of all stakeholders and, in particular, to protect the rights of the minority shareholders.

SEBI has imposed additional conditions on constitution of boards and the tenure of independent directors. The SEBI regulations stipulate the following:

- A separate meeting of independent directors to review performance of other directors, chairperson and assess the quantity, quality, and timeliness of information flow to the board
- Prohibition of stock options to independent directors
- Exclusion of nominee director from definition of independent director
- Enhanced role of audit committee and their prior approval for all material reports
- At least one woman director on board

On number of directorships and tenure of office, SEBI has placed more rigorous conditions on independent directors as compared to the Companies Act, as seen in Table 4.1.

The questions that arise in the context of the Companies Act, 2013, and the revised SEBI regulations are as follows:

- Are the directors aware of their roles, responsibilities and duties under the New Act? How would the companies help the directors in this process?
- Would the full board participate in setting out policies for corporate social responsibility, internal financial

BOX 4.3 Increasing Capacity of Boards

A handful of MFIs that were visited during the governance study pursued capacity building of board members seriously. One of the MFIs in southern India, despite having a high-profile board comprising experienced bureaucrats, investors, bankers, insurance specialists, microfinance sector experts, and chartered accountants, has a well-structured system of inviting external experts to deliver talks or sensitize the board members on emerging issues. At every board meeting, the MFI organizes a session on either technical or strategic issues. In the recent past the MFI had organized discussions with external experts on governance rating, securitization and its implications, new Companies Act, institution building, inclusive finance and its prospects, and governance and growth. Not only the management but also the board members of this MFI acknowledged the value that these speakers brought in enhancing and enlightening the board. Similarly, another MFI from southern India invited guest speakers to orient the board members on the provision of the Companies Act, 2013, the recent RBI draft policy on small banks and payment banks and regulations allowing NBFCs to act as business correspondents of banks. The management team of the MFIs felt that these were critical issues and could have ramifications on the strategy of the MFIs. Thus, it was imperative that the management as well as the board is kept abreast with these developments.

TABLE 4.1 Provisions of Companies Act versus SEBI Regulations

Companies Act	SEBI regulations
A person can hold 20 company directorships of which not more than 10 in public limited companies	A person can hold directorships in only 7 listed companies and not more than 3 as whole-time director.
An independent director can have two terms of five years each, prospectively, after excluding the current term. He/she can return to the board after a 3-year cooling-off period.	An independent director who has already served for 5 years or more in a listed company when the regulation becomes effective, he/she shall be eligible for appointment for one more term of 5 years only.

controls, regulatory compliance and risk oversight and in assessing the key risks and vulnerabilities, and would the board be involved in monitoring these policies?

- How will the board satisfy itself about the adequacy and effectiveness of the systems of internal financial controls, and regulatory compliance so that it could give affirmations in the Directors' Responsibility Statement?
- How should the board assure itself of the reliability of disclosures to be made on behalf of the board?
- How will the performance of the board and its directors be evaluated?
- What process should the board follow in evaluating the performance of the board and of the Independent Directors prior to reappointment?
- What process should the Independent Directors follow in reviewing the performance of the non-executive directors and the Chairperson, assessing the quality, quantity and timeliness of the information flow, scrutinizing the performance of the management?
- What process should the Independent Directors follow to satisfy themselves on the integrity of the financial information and that the systems of financial controls and risk management are robust and defensible?
- What process should the board follow to review and approve the related-party transactions?
- Do the boards have charters for the various committees of the board?
- Should the board and the Independent Directors document all processes related to board functioning and management oversight?

MFIs currently find it difficult to attract persons with expertise and experience to take office as independent directors. The stringent regulations on number of directorships and the capping of tenure of directors will reduce the availability of independent directors and increase the competition for such persons from all types of companies. The introduction of the concept of liability of independent directors for actions of the company—for which they were a party either actively or negligently—could dampen the enthusiasm of persons of repute to become independent directors. Some MFIs aspiring to list their shares in the stock exchange will have to work harder to get the right kind of people in their boards.

The Companies Act, 2013, and the SEBI regulations do not focus on responsible finance or customer protection, but more on equitable governance that protects minority shareholders' interests and social relevance of businesses. The emphasis on independent directors and CSR of the company, thus, do not automatically lead to responsible business practices towards customers. Businesses such as microfinance that have a large number of vulnerable customers have to introduce specific safeguards for customers in place and board oversight on implementation of the safeguards. The COCA and fair practices are examples of such safeguards introduced by the sector.

OVERSIGHT OF SOCIAL PERFORMANCE

One of the major issues in governance in MFIs is that the structures designed for for-profit forms may not be suitable to secure vulnerable customer interests. (See Appendix A4.1 for some alternative ideas on design of governance.)

From a corporate governance perspective, microfinance companies and their boards of directors are faced with the classic dilemma. On the one hand, the principal goal of microfinance is to reduce poverty; to that extent the interests of borrowers (or customers) as principal stakeholders becomes paramount. On the other hand, a shareholder-centric approach operates as a major countervailing factor by compelling microfinance companies to generate profits to service investors and maintain stock price. The current discourse in corporate governance does not appear to satisfactorily address the predicament of boards of microfinance companies, as investors and stock markets judge the companies against the same standards generally applicable in the corporate sector. Conventional concepts and doctrines in corporate governance to for-profit microfinance companies do not adequately address the issues specific to such companies. It calls for a paradigm shift that necessitates examination of corporate governance in microfinance companies through an altogether different lens. (Varottil 2014)

Gaining commitment of the directors to social goals of the MFIs, even at the time of induction, is a key element in securing good governance for customer protection. Boards should also develop a quality reporting system and sub-board-level structures such as a committee on Social Performance.

The survey of MFIs found that boards of almost all the MFIs have passed a resolution to adopt and implement Fair Practices Code. These codes, in most of the cases are an amalgamation of the MFIN and Sa-Dhan's code of conduct, fair practices guidelines from the Reserve Bank of India, Smart Campaign's client protection principles and MFIs' own code of conduct.

Boards of directors across many MFIs have relied on adoption of code of conduct to ensure compliance with RBI regulations. They seek a compliance report to the Code of Conduct at least once in a year. Some of the big and medium sized MFIs have included compliance to code of conduct as part of their internal audit and risk rating of branches; and the compliance report is submitted to their board every quarter. Some of the large MFIs submit reports on compliance to code of conduct every quarter to the board as part of their regulatory compliance report.

Around 60 MFIs in India have COCA done by external agencies to check their compliance level with Industry Code of Conduct and Fair Practices code of RBI. A few of them have also gone for second round of COCA by external agency to check the improvement in compliance. Though these assessments have been done in large numbers, the study team observed that this exercise too was intended as a compliance exercise to meet SIDBI's requirements.

Most of the MFIs have shared the reports of COCA with their board of directors. Boards of some MFIs have taken corrective action or made suggestions based on the findings in COCA. In case of an MFI in north India, board members have driven an alternate financial education programme for their clients to increase the financial literacy of clients, as in their COCA low financial awareness in clients was reported. Boards of almost all the MFIs have discussed and approved policies related to grievance redressal mechanism for clients.

While, grievance redressal policy for clients has got attention from majority of the MFIs, only few big and medium sized MFIs have a board approved formal staff grievance redressal mechanism. These MFIs present to the board a report on the staff grievances and the action taken by management to resolve them, every quarter.

Box 4.4 Highlights of Some Best Practices Adopted by MFIs

An MFI has adopted a 3-level client grievance redressal mechanism:

- Level 1: Customer care representative (CCR): 80 per cent of its branches have a dedicated CCR-based resolution within 3 working days
- Level 2: Toll free helpline: Resolution within three working days
- Level 3: Grievance Redressal Officer: Resolution within five working days

Another MFI has one of the most well-established call centres in microfinance sector in India, which acts as the service quality department. The call centre has people who know vernacular languages so that they are able to handle calls in seven languages—Hindi, Kannada, Marathi, Telugu, Malayalam, Bengali, and Oriya. 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. The MFI has recently introduced a system of tracking abandoned calls and establishing contact with such callers. There is a different number for Ombudsman and complaints should be resolved within 2 days.

Box 4.5 Customer Service: A Key Driver to Measure Financial Performance

In a large pan-India MFI, focus on customer service is given prime importance. The board monitors the customer retention, type of customer complaints and the turnaround time for the resolution of customer complaints. The focus on service quality in the MFI has enabled them to convert dropouts to active members. As per an exit survey done by the MFI, they were able to bring back about 40 per cent of dropouts back in the system. The retention rate also went up from 65 per cent to 80 per cent.

Board members provided guidance to the management on changes if required in the products and services of the MFIs. At least five MFIs, sampled in the study, provide detailed reports to the board around customer grievances. Additionally, they also present the action taken on the suggestions made by board members in the next board meeting. Some of the MFIs have also set up subcommittees of the board on grievance redressal. Box 4.4, given on the previous page, highlights some of the best practices adopted by MFIs.

Client protection initiatives, undertaken by an MFI, form part of the discussion in the board meetings of only few MFIs. Many board members, in spite of being aware of the importance of the need to be socially responsible, still equate social performance management with CSR activities. For example, customer retention, other than being an important driver to improve financial performance, is also an extremely important indicator to assess the MFIs, ability to service clients responsibly (as seen in Box 4.5 above). Whether, boards of majority of the MFIs see such operational indicators through the social performance lens is still a question that needs to be answered.

There is little thrust in understanding the impact that the MFI services have made on the lives of the clients. Discussion over client protection initiatives is more from the perspective of compliance with regulatory requirements. An MFI in north India conducts annual staff satisfaction and impact surveys and shares the reports with the board (see Box 4.6). Based on the report, the Board has driven a few non-credit programmes like health education, financial literacy, etc., for the clients. Board members of some MFIs also visit the branches/clients at the time of board meetings. Around 18 per cent of the sampled MFIs have SPM sub-committees at their boards and have included SPM as an agenda in the board. This committee is primarily responsible for driving the client protection initiatives in the institution. In case of one of leading MFIs in south India, the shareholders participate in the CSR activities undertaken by the MFI.

The fundamental reason for coverage of governance in this report is the need for mission-driven initiatives for customer protection, responsible finance, socially relevant actions by financial institutions especially when dealing with vulnerable customers. While regulatory prescriptions are followed, the larger question is whether boards push orgnizations to go beyond the minimum standards and ensure that customer interests are prioritized. The changes made to constitution of boards, improvement in board processes and capacity

Box 4.6 Client Protection Initiatives

An MFI in south India has an integrated financial literacy initiative for its clients. Though the service is voluntary, the program is tracked on a Core Banking Software which ensures close monitoring of the program and its progress, minimization of error, and non-duplication of entries. This software tracks attendance, certification, bank account details, stocks (such as diary, calculator, savings box, and certificates), and attrition rate.

The MFI conducted an impact evaluation of the programme through an external agency. It was found that the programme helped 90 per cent of its participants understand the need for financial planning; 84 per cent actually plan their household budget; and 76 per cent track their income and expenditure. 81 per cent of the respondents were even willing to pay some amount for the training. The programme has helped over 130,000 women save for health, education, and emergencies.

Box 4.7 Oversight of Social Performance

Commitment to social goals should be a requirement for board membership and should be taken into account during member vetting and orientation.

- A board may wish to form a social performance committee, or to assign individual board members to act as 'champions' for social performance, tasked with ensuring that mission fulfillment receives adequate weight and attention.
- Boards must invest time to develop a shared understanding about social goals and how to achieve them.
- Explicit social goals and targets should be set through the strategic planning process and approved by the board.
- MFIs should have, and the board should monitor (at each meeting), indicators demonstrating the achievement of social targets and goals.
- MFI boards should seek in-depth information about social performance from time to time, through market research, impact studies, and personal interaction with clients.
- Boards should advocate for the endorsement and implementation of client protection practices.

Measurement of social goals poses a particular challenge, as reliable indicators are still in development. 'Social scorecards' or 'balanced scorecards' are often used, but there is frustration about the value, consistency, and reliability of available indicators. Nevertheless, social outreach indicators, benchmarks, or scorecards should be reported and discussed as part of a board's information package as in the case of financial performance.

Source: Excerpt from the Practice of Governance in Microfinance Institutions, Consensus Statement of Council of Microfinance Equity Funds, 2012.

building of directors should lead to increased attention to customer issues and improved responsible finance practices. While there is evidence to indicate that boards systematically review customer protection, code of conduct in the field, and grievance handling processes, it is clear that more can be done to ensure that the business model and products are closely aligned to customer needs. Boards that keep the customer at the core of the business should drive new product development and process refinements to offer greater choices and greater satisfaction to people.

To conclude, boards and governance structures can do a power of good to vulnerable customers. The existing state of governance in India among MFIs is clearly improving and ensuring that responsible practices prevail. There is scope for improvement especially in monitoring last mile delivery of services. Further the socially relevant actions that positively impact customers are not an integral part of many MFIs operations. The few who have integrated social performance into their business models have made a lot of difference to their customers. The others must move beyond compliance with regulations and try to satisfy customers' needs. The trade-off between profit maximization and improving customer comfort should be managed well by the boards.

APPENDIX A4.1 A THREE-DIMENSIONAL APPROACH TO GOVERNANCE IN MFIs TO ACCOMMODATE CUSTOMER INTERESTS[3]

The microfinance sector merits a specific corporate governance framework when examined from a theoretical perspective. Traditional firms use corporate governance to mitigate agency costs through monitoring of agents by the principals or other third party reputational intermediaries. In view of the inability of the agency cost approach to address the relationship between financial sustainability and social goals, corporate governance issues in the microfinance industry must be subjected to a different set of parameters that effectively aim at the core of that relationship. Towards that end, I build upon a three-dimensional approach set out by Mersland and Stromin identifying problems that affect various constituencies within the microfinance sector from a corporate governance standpoint:

1. A *Vertical Dimension* between the MFI and its providers of capital, which include shareholders, financiers, and employees;
2. A *Horizontal Dimension* between the MFI and its customers and the communities that are affected by it; and
3. An *External Dimension* focusing on the market for product competition and the role of the state in regulating the sector.

(See Figure A4.1.1 for a diagrammatic representation of the concept.)

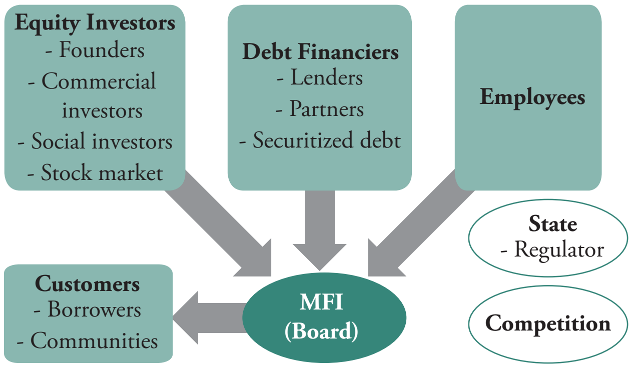


FIGURE A4.1.1 Relationship-Dimensions in MFIs

NOTES

1. Master circular on corporate governance in NBFCs - RBI/2013-14/44DNBS (PD) CC No.342/03.10.001/2013-14 dated 1 July 2013.
2. Companies Act, 2013, requires that all companies with a share capital of Rs 100 crore or more should have a woman director on the board within five years and in case of listed companies a woman director should be brought on board within one year.
3. Adapted from Varottil 2014.

5

Measuring and Monitoring Client (Over)-Indebtedness

Partial Answers Masking Larger Problems

Credit dominates both supply and demand sides of microfinance irrespective of the channel or methodology. MFIs, banks and even large poverty reduction programmes adopting SHG methodology like NRLM adopt a credit push approach. MFIs believe that credit will help their clients in reducing external high cost debts, manage the cash flows better, and improve their income. NRLM has hypothesized that repeat loan totalling Rs 100,000 over a ten year period can enable a family to come out of poverty and are setting up mechanisms to enable such credit flow to SHG members at subsidized rates. While regulator and banks insist on microfinance loans being used largely for income generation purpose, money is fungible and clients use the loans for a variety of purposes as per their need; this flexibility has also its perils especially if the clients are not able to manage credit well.

Client feedback and need assessments indicate there is persisting demand for larger loans in both urban and rural areas. Field research such as financial diaries indicates the financial acumen of the households. However, competition among providers to push credit, their lack of understanding of client capacity to repay, misspelling practices, and clients own miscalculations about their ability to repay can result in over borrowing. Banks and MFIs have to be conscious and responsible lenders to ensure that the clients are not over indebted. Credit is a risk for the unfamiliar and ill-informed clients as the households can plunge into distress and can be worse off if they are unable to handle credit well. In the last two decades, microfinance industry has travelled a long distance from having a surfeit of clients who did not have access to the present situation where clients have facile and excessive access.

MULTIPLE BORROWING AND OVER-INDEBTEDNESS

Some recent studies show that multiple borrowing is widely prevalent in the country (Centre for Microfinance 2013; Lahkar et al. 2012). Whether access to multiple loans leads to over indebtedness is a point often questioned. Global research on factors contributing to over-indebtedness (OID) has identified the following as contributory factors for client OID: (1) larger number of loans, (2) competition, and (3) lack of knowledge/discipline of borrowers. OID occurs when a borrower has more debt than he or she can reasonably repay. Debt repayments start to consume a disproportionate share of borrowers' available resources leading to arrears. OID poses a challenge for borrowers and lender alike. The consequences of OID can be devastating for individuals who are often vulnerable and also their families. Faced with such huge debts that they are unable to service, these households either borrow more to service the instalments or resort to selling off their meagre assets. Under group guarantees the pressure spreads to other members. If faced with heavy handed debt collection practices and pressure from peers some borrowers can turn to extreme coping strategies.

Most MFIs and banks operating in this segment are offering financial services with the primary intention of helping poor and low income clients. Any distress to clients can be demoralizing for mission driven institutions. For regulated institutions like MFIs and banks a deteriorating portfolio can strain their financials, trigger higher provisions towards reserves and in extreme cases, like the MFIs in Andhra Pradesh (AP), threaten their solvency. As seen from the AP crisis, this can also trigger other risks such as political interference and public anger (see Box 5.1).

Two significant measures have been taken in India to curb over indebtedness among microfinance clients:

(a) The regulator has prescribed the cap on number of loans and total debt levels for a household from all sources of loans. Unified code of conduct has also prescribed similar norms as per which:
- MFIs must conduct proper due diligence as per their internal credit policy to assess the need and repayment capacity of client before making a loan and must only make loans commensurate with the client's ability to repay.
- If a client has loans from two separate lenders, then irrespective of the source of the loans, a MFI shall not be the third lender to that client.
- MFIs must not, under any circumstance, breach the total debt limit for any client, as prescribed by RBI or central/state government(s).

(b) While these caps and limits are useful, MFIs need reliable information on the existing outstanding loans of potential borrowers. Credit bureaus have been established/made functional to provide borrower-specific debt-related information. Significant investments have been made by the industry, especially MFIN with IFC playing an advisory role in establishment of credit bureaus and streamlining the data flow from MFIs to credit bureaus. (See Appendix A5.1 for a chart on the evolution of Credit Bureaus in India.)

The Indian MF sector needs to be applauded for the tremendous efforts taken to operationalize the data sharing by MFIs with the credit bureaus. The credit bureaus have been rolled out and operationalized in a remarkably short period of time. High Mark Credit Information Services has the distinction of now holding the largest database of microfinance clients in the world.

FUNCTIONING OF CREDIT BUREAUS

At present, High Mark Credit Information Services (referred further as High Mark) and Equifax Credit Information Services (referred further as Equifax) collect and collate data from MFIs and banks, lending directly to this client segment. High mark and Equifax together have about 135 MFIs and banks as members out of which

BOX 5.1 Over-indebtedness of Clients Rated as the Top-most Risk for the Industry

Globally the industry ranked the risk of over indebtedness as the number one risk (same as year 2012 when the survey was last done). The report mentions that microfinance continues to be seriously dogged by the problem of over indebtedness and the sector is not giving adequate strategic thought to its evolution. While the actual incidence of OID can be smaller than the ranking suggests because this survey captures perceptions; however, several respondents mentioned that it was growing. Thus OID remains a dominant concern. It is significant that microfinance service providers, investors, raters and sectoral experts rated this as the top most risk. Only regulators perceived this risk as fifth most important. In South Asia political interference was ranked as first followed by OID.

Source: CFIS 2014.

105 contribute data. There are regulatory restraints on accepting data from MFIs registered as private trusts. Largely MFIs contribute data to both the bureaus since there are no charges for submission. However, some MFIs (non-MFIN members) contribute to only one of the Credit Bureaus.

While MFIN members (30 million records constituting 75 per cent of the data) contribute data on loan sanctions, repayments and defaults every week, the others upload data once in a month. About 20 million credit reference queries are made annually. High Mark, the older credit bureau, holds about 120 million loan account details (both current and closed). MFIs with individual lending portfolio subscribe data to Credit Information Bureau (India) Limited (CIBIL) as well. They use two reports for lending to individuals—a report from one of the MF credit bureaus apart from CIBIL.

There are two reasons for data sharing and credit checks by MFIs—the first is the requirement of compliance with regulatory guidance. These second and more important reason is the realization in MFIs that credit reference checks improve the quality of credit decisions and avoids certain types of risks. MFIs use credit bureau data for checking regulatory compliance with number of loans as well as level of debt. Some MFIs/banks are also using the data for assessment of credit needs of the borrower.

Accurate data is critical to establish identity of client and to establish credit history: A common data-reporting format for MFIs has been evolved by High Mark, catering largely to the information requirements of MFIs (RBI 2014b) through a consultative process. This format has since been standardized for use across MFIs. There are still issues in the adequacy and quality of data submitted. Credit bureaus require the following data to come up with unique identifiers for each borrower.

- Personal identifiable information: Complete name, Date of Birth / Age, Voter ID (identification) / Ration Card / UID (unique ID), Spouse name / other relationship name
- Location information: Address details including district, pin code, phone numbers
- Account information: Account number, status, balance amounts, overdue amounts, open date, repayment date, closed date, etc.

All these three segments should have a reasonable level of accuracy and completeness. Credit bureaus as well as conscientious MFIs agree that data quality is an area of concern which needs to be improved. Incomplete or inaccurate data can harm customer's interests and lead to denial of credit or let clients with multiple borrowing to slip through the check.

Establishing unique identity: India still does not have a national identification system. The recent initiative through issue of UID numbers is progressing slowly and marred by contradictory pronouncements on the status and validity of these numbers. Reliable means of uniquely identifying borrowers are necessary otherwise the quality of data is reduced and is of limited value. In the absence of one unique identity, MFIs collect different identification documents such as ration card, voter ID, and driving licence. Apart from ID, other data fields critical for establishing identity are also captured. A recent study commissioned by MFIN and International Finance Corporation (IFC) highlights the challenges in capturing and matching different data fields (Table 5.1).

Identity record matching is continuing to be a challenge since names, contact information are captured differently when clients apply for a loan in different MFIs. Inconsistent spelling, no fixed address and no birth certificate or even lack of knowledge of one's age pose significant challenges. If the identity document is different for different MFIs and also there is change in other fields, the client matching is difficult. Some of the clients learning about this loophole are at present providing different data to escape matching. Some of the field staff is also encouraging this practice since they have to meet disbursement targets and they believe that the clients have need for additional credit and capacity to repay. The task force on credit bureaus set up by MFIN has advised MFIN members to gather two identification documents, one of which can be Aadhar card or voter ID. If the policymakers' position on Aadhar card becomes encouraging, the industry has to move towards adopting a unique identity for each client.

Credit bureaus have been consistently improving the identity matching through improving the logic and validation processes involved and now report that the reject rates at submission has come down substantially. Average rejection rates at the time of data submission are

TABLE 5.1 Issues in Capturing Data for Credit Bureau

Name	Many MFIs capture data in physical forms in local language and this then gets transliterated into the system for data submission to Bureaus. Bureaus are handling the challenge well with phonetic matches and similar innovations. Key issues are: (a)The inclusion of special characters in the name field by MFI; (b) In case of short names (3 characters or less), not suffixing spouse or parent name to make it 'eligible' for Bureau processing.
Address	This poses one of the two most critical challenges in record matching. Given the profile of the borrowers, having a 'good quality' address would be wishful thinking. Bureaus have developed some solutions by maintaining branch and centre address masters and using the same to populate pin code for borrower addresses. Nevertheless, the quality of address continues to be an issue in the entire Credit Bureau process.
Identification Information	Key issues are: Non-availability of 'matchable' ID data. Accuracy of the available data No standard format of certain ID data and hence validation checks cannot be done. Cases where dummy data is captured just to show that data has been captured Quite a few instances noticed of borrowers giving different ID information to different MFIs.
Relationship Data	Is generally being captured and reported by all MFIs Though multiple relationships are being captured, the key relationships that can be consistently used for record matching are that of spouse, father, and mother.
Date of Birth / Age	Generally available in the data being submitted to Bureaus. Accuracy might be an issue, but can be considered to be approximately accurate.
Telephone number / Bank account details	Available in some cases, however, accuracy and usability is an issue. Mobile numbers—if consistently and accurately captured—can be a good parameter for matching records. Bank account numbers of CBS branches can also be a good parameter for matching provided IFSC code can be used for bank/branch identification.
Gender / Marital Status	Generally available and reliable
Account information	Generally available and reliable

Source: Balan 2013.

about 2 to 5 per cent as per the credit bureaus. Data-matching accuracy is termed as 98 per cent. One of the credit bureaus checks the data of customers within 20 km radius to improve matching (see Box 5.2).

MFIs and banks mention that data rejection experience for same set of data is different for both the credit bureaus because of differing norms on data quality and also technology used. This provides some arbitrage for MFIs and banks. Depending on their intent and seriousness in credit bureau checking, these institutions choose one over the other credit bureau. MFI staff can soften their enquiry by leaving out some of the data fields to ensure that the application goes through. Among the clients and branch staff there is an increasing tendency to change the identification document, name of spouse, address, etc.

RBI has appreciated the quality of data being submitted by MFIs to credit bureaus to be better than that of the banks. As per Dr K.C. Chakrabarty (2014), Deputy Governor, RBI:

> While, I understand that the quality of data held by microfinance institutions about their borrowers is comparatively better, the quality and consistency of data of the banking system is not very reliable and hence, poses significant challenges to the effectiveness of credit information system.

This view is endorsed by the credit bureaus as well. The depth of data that is captured for MF clients is

Box 5.2 Incentivizing Staff to Improve Data Quality

Some of the MFIs are consciously working on improving data quality. SKS has set up centralized systems to check the quality of data being submitted, fill in the required data fields in respect of all active accounts. A separate quality checking department which has been set up to improve quality of service to customers ensures quality of data submitted to credit bureaus. Strict KYC documentation is followed by SKS—submission of Aadhar card is being insisted upon apart from another identification document. The information captured in loan application form and the data submitted to credit bureau are being checked to ensure that complete and accurate data are submitted. De duping of loan applications is being carried out to identify clients who have changed their names slightly and joined another centre. Field officers and the branch manager are being incentivized to provide complete information – if more than 50 per cent of the clients have Aadhar card, special incentive is paid for the branch manager. Field officers who capture four essential fields date of birth, phone number, husband's name and Id accurately are also provided incentive.

Source: Personal interaction with senior management official, SKS.

higher as per credit bureaus. Banks are also not regular in updating data and credit checks are miniscule compared to the number of loans that are sanctioned by the banks. However, two sets of issues need to be addressed to further improve client matching. According to MFIs, queries on same data set from both the credit bureaus should have similar results, which is not the case as of now. While both the bureaus claim their data matching to be superior, MFIs still find that the results vary and are not sure as to which credit bureau's outputs are better. The second issue is taking measures to improve data quality since at present credit bureaus are accepting most data given by MFIs. Credit bureaus with the support of MFIs need to update the missing fields in a time bound manner. Credit bureaus need to make rejection reports simple and understandable, industry associations have to stipulate a time frame for rectification of rejections for MFIs.

Account-related data: As per credit bureaus, the account information—active loans, current balance, overdue if any, are generally available and reliable. There are still some issues with data quality. A credit bureau official states 'If MFI gives us loan record with the current status and with an overdue amount how should we categorise as overdue loan or current loan? We compromise and accept the data because user knows that something is wrong and will probe this further. We also write to concerned MFI to rectify the data'. The onus is on the Credit Bureaus to ensure that the data that they gather is error free. Thus the credit bureaus have to play the role of counselor to MFIs to provide accurate data.

Timely data: MFIN members update information every week. Considering that even the *Committee to recommend data format for furnishing of credit information to credit information companies* has advised monthly updating of data, weekly updating is a very good practice adopted by the MFIN members. However, there are other MFIs who have taken membership in the credit bureaus but share data monthly or infrequently. The credit bureaus are pursuing with such MFIs for periodic updating of data.

Completeness of Data

Many MFIs are yet to become members of credit bureaus: While MFIN has taken stringent measures to ensure data reporting to credit bureaus by its member NBFC-MFIs, there are other NBFC-MFIs and also large NGO-MFIs like SKDRDP that are not reporting data to credit bureaus. With a client outreach of 3 million and loan portfolio of Rs 3,300 crore, SKDRDP is one of the largest MFIs. MFIs in Karnataka mention that there can be up to 60 per cent overlap among their clients and that of SKDRDP in some of the districts. There is high likelihood of several clients breaching the regulatory norms. While MFIs should be persuaded to share data, it is the onus of the lenders to the MFIs to ensure that their client MFIs share and use credit bureau data. MFIs by not choosing to be part of the credit bureaus and credit referencing compromise their customers' interests and also weaken the operating environment of other MFIs. Refusal of MFIs to become part of the credit bureaus and avoidance of use of credit information are clearly not responsible business practices. Funding banks, by failing to discipline such MFIs, become party to the breach of RBI regulatory norms on other NBFC-MFIs. Banks and RBI should seriously take up the issue of non-participation and unwilling participation by some MFIs and ensure that orderly conduct ensues in the sector.

It is generally assumed that all MFIs have the capacity in terms of skilled man power and systems (MIS) to participate in credit bureaus. Experience shows that MFIs initially have to invest in improving their systems to be credit bureau ready. While larger MFIs with more sophisticated MIS have been able to contribute data with ease, for smaller MFIs technology and human capacity has been a challenge. Substantial overhaul of back end processing systems, software, hard ware and skills are needed to enable the capacity and processing speeds. Some of them require soft funds to build these systems. PSIG is supporting some of their medium and small NGO-MFI partners to improve their capacities to participate in credit bureaus. However, such funding is not easily available for other MFIs. Sa-Dhan will have to take concrete measures to enable their smaller MFI members to report to credit bureaus.

Member defaults within JLGs not captured: MFIs following Joint Liability Group (JLG) methodology also adopt group guarantee mechanism where in if a member defaults, other group/centre members make good the payments. From the standpoint of client protection, tracking the invoking of group guarantees is important; client repayment history can strengthen the loan assessment process in repayment capacity analysis. This will help to assess the over indebtedness of clients. MFI can have an early warning system and can also follow up with delinquent clients based on the situation. Since group members can be rough in handling defaulters, they will also need to be trained in appropriate behaviour in order to avoid further distress to defaulting clients.

At present most of the MFIs do not track individual defaults within the group, how often the group guarantee mechanism is invoked and also the quantum of such adjustments. This data is also not reported to credit bureaus. Grameen Foundation is working with Utkarsh on processes to track individual repayments through group liability—the centres are classified as immediate attention centres and defaulting clients are flagged. This data is consolidated at each level and risk management team also analyses the data by branch, division in terms of concentration of immediate attention centres and clients. Based on monthly trends, the management recommends revision of loan ceilings since clients have difficulties in repayment (CFI 2014).

Credit bureaus potential in improving credit decisions in MFIs is fully realized only when individual credit track record is fully captured and reported. Presently credit references provide information on number of loans taken by a borrower, the amount of outstanding loans and defaults at the group level relating to the customer. The repayment record relating to whether the borrower defaulted on loans necessitating the other group members to make payment is not available with the credit bureaus. Neither is this information captured by the MFIs nor reported. Credit bureaus are not proactively insisting on receiving such information as tracking the same entails extra workload as well as investment in new information and reporting systems. Tracking of individual repayment records is a critical piece in responsible finance. Since customers keep joining new groups and new MFIs, high risks of customers with tendency to default and burden other groups members are passively passed on to new unsuspecting customers elsewhere. To ensure that full benefit of credit information is available not just to MFIs but also to customers, tracking individual repayment record is necessary.

SHG member borrowing not reported: At present bank lending to SHGs and the members is not reported to credit bureaus. The SHGs have a client outreach twice as that of the MFIs. SHGs also have multiple sources of credit—their own savings as internal lending, loans from banks, loans from federations/MFIs, and loans from a self-help promoting agency. In mature groups, individual members are borrowing more than Rs 50,000 from the group, which is the ceiling set by RBI in case of MFI clients.

Many believe that SHG members cannot be over indebted. With limited savings and indifferent and inconsistent lending by banks, the resource pool is not expected to be high to inundate members with loans. SHGs being member owned institutions, its members are expected to know each other's capacity well and thus provide need based credit. However, the ground realities are different. In southern states some of the old SHGs have savings above Rs 5 lakh. Banks also lend large sums to groups. Lending through federations especially in Andhra Pradesh is high. With multiple sources the borrowing is high; SHG members view subsidized credit as their beneficial entitlement and hence there is a tendency to distribute loans equally. Need based lending is diminishing. Leaders are likely to be more indebted than others since they are more entrepreneurial and also see the loan as a reward for their free services to the group. MFIs also target SHG members; they do not exclude SHG members from joining their groups. The rising NPA level of banks is one indicator that there is high likelihood for SHG members being in debt trap.

The committee on credit bureaus (RBI 2014b) has suggested that banks need to provide credit information of individual borrowers of SHGs to the credit bureaus. Bankers who were members of the committee had opined that it was not feasible for banks to provide borrower-level information to bureaus since banks lend only to SHG and not to individuals in the groups, group decides on the quantum and loan term for each member and banks do not have information on outstanding and repayment by each member. However, the committee recommended that credit information on individual members of SHGs was critical to establish their credit history which would, in turn, foster growth of credit to the sector and banks should arrange for capturing the required data from SHGs for reporting to credit bureaus within a reasonable period of eighteen months.

At present, banks capture very limited data on SHGs; group details such as name, village name, pin code, and also 'know your customer' (KYC) details of the leaders of the group are collected. Loan and repayment performance of the group as a whole is captured. Some banks in the loan application have details of proposed disbursement to individual members but no post disbursement details are available with banks on actual loans taken by individual members. Several studies have observed that actual loans disbursed to individual members differed significantly from the loan application submitted to banks by the SHGs.

The KYC details of individual borrowers are captured and stored digitally by a few Self-help promoting agencies. Data on internal lending, borrowing from external sources including banks are first written in the books of accounts of groups. The quality of book keeping and thus accuracy of data varies. Large programmes by governments, such as Society for Elimination of Rural Poverty (SERP), International Fund for Agriculture Development (IFAD) funded Tejaswini programme run by Mahila Arthik Vikas Mahamandal (MAVIM), self-help promoting institutions (SHPIs) like Development of Humane Action Foundation (DHAN Foundation), and Professional Assistance for Development Action (Pradan), have developed computerized MIS and the resultant data provides accurate individual-wise information on all loans taken by SHG members. However, such initiatives may not cover more than 20 per cent of the groups in the country. Massive effort will have to be taken across the country to get accurate data on loans of SHG members.

Some banks feel that SHPIs should be made responsible for the data collection and reporting. However, they will need to act as business facilitators for banks. As in the case of BC operations, the individual-wise data can be maintained in separate software database which is taken into the core banking solutions periodically. This will also require regulatory clearance since at present credit bureaus cannot accept data from non-regulated entities.

The overlap between SHG members and MFI clients is expected to be a minimum of 30 per cent, going up to maximum of 70 per cent. In areas with high overdue under SHG bank linkage programme, there is likely to be higher rejection rate for fresh loans for both MFIs and also banks. This can lead to shrinkage of loan volumes in the short term. In states like Andhra Pradesh, with large numbers of SHG being defaulters to MFIs, this can cause considerable problems for existing borrowers though the SHGs. However, these institutions will benefit in the long run since the clients will have to repay the overdue amounts to be eligible for fresh loans. The past experience of MFIs show that older overdue get repaid since clients wish to have a clean record in order to borrow. In Andhra Pradesh, among MFI clients, Recovery of such loans will not only be good for MFIs but also for banks as the funding of MFIs has been mostly from banks. Clients will also benefit from better credit history.

One of the concerns of the banks has been multiple memberships in different SHGs resulting in over borrowing. By subscribing data to credit bureaus, banks will be able to get information on the overall exposure of individual members of the SHGs including multi-group membership, old groups, etc., SHPIs can benefit from better data for monitoring the loan repayments. Many NGO-SHPIs face fund constraints and unable to monitor the groups. Since banks expect SHPIs to monitor SHGs, this will provide legitimacy to the work they are expected to carry out and also earn fees.

Another concern for the MFIs and banks is that the debt level of customers that access loans from SHGs and MFIs might exceed the regulatory maximum of Rs 50,000 on account of the higher loan sizes in SHGs in some states. A minor issue will be that of involuntary breach of regulatory lending cap when the SHG loans are also reckoned. When SHG loans are reported, the MFIs and banks will require some time to reduce debt levels to conform to regulation. A larger issue is the need to review the regulatory cap on individual debt to raise it to a level that would be adequate to support income generating activities.

A further concern for the SHPIs in especially the government programmes like NRLM is the treatment of old overdue by banks; banks may refuse loans to SHGs in case a few members of a group have individual defaults to MFIs. The problems of SHGs in getting timely credit from banks will further be exacerbated.

Despite the concerns, there is no denying the fact that credit data of SHG members should be shared with credit bureaus to understand the indebtedness levels of clients. While initially bank loan data can be reported to credit bureaus, over a period of time SHPIs and banks can work out mechanism to capture and report on internal lending and federation lending data to members as well. This will vastly improve the credit discipline and curb excessive borrowing among SHG members, which has been cause of concern in the last few years.

Banks: Many banks, especially private sector banks, are establishing suitable network—BC channels/ small branches/ hubs to directly lend to microfinance clients. Their outreach and portfolio size is increasing. Some of the banks such as IndusInd Bank, Ratnakar Bank are very diligent in sharing and using data with credit bureaus. Most others are not sharing data even in their direct lending portfolio. This should be set right and Reserve bank needs to advise banks to follow similar norms as are applicable for MFIs since the clientele are the same. Some banks are seen as aggressive lenders lending large sums to existing clients of MFIs. Regulatory guidance on debt levels for vulnerable clients should be made applicable in the case of banks too to protect customers from excessive and unaffordable debt.

USAGE OF CREDIT BUREAU REPORTS

MFIs mention that in different regions between 5–25 per cent of the applications get rejected on grounds of default history, loans above regulatory limit or multiple loans. The credit bureaus have helped MFIs distinguish between good (low risk) and bad (high risk) borrowers by looking at their loan, and repayment histories. MFIs are increasingly integrating credit bureau query into loan originating software; normative credit decision is prompted in their IT systems and if any branch manager wants to override the decision, he has to give satisfactory reasons therefor.

There is greater awareness among banks and MFIs on the potential of credit bureau reports in planning forays in competitive markets or identifying hot spots. *Pin code portfolio reports are an innovation by IndusInd Bank and Equifax.* Pin code-wise credit portfolio reports indicate the concentration of MFIs operating in a geography and also portfolio quality of all the institutions in that area. IndusInd Bank, in its co-origination model, uses these reports to enable MFI partners to move into areas which are not adequately serviced to avoid issues of over indebtedness. Reportedly among the top 10 MFIs, 8 ask for such data in planning their branch expansion. Ujjivan for example does not open branches in areas of high competition or bad portfolio experience.

The PSIG project funded by DFID and implemented by SIDBI has commissioned studies for the four states they are operating in—Uttar Pradesh, Madhya Pradesh, Bihar, and Odisha. High Mark has carried out district-wise analysis of potential risks based on past trends, penetration levels, loan per borrower, number of poor clients, and recent lending activity to arrive at districts where SIDBI can intervene for improving outreach and better development results. A few MFIs and banks ask for customized reports on repayment performance of their clients in respect of all their outstanding loans even those of other MFIs and banks. In case the clients have any issues in repayment of other loans, they consider it as a pain point even if their own loans are getting promptly serviced. Any future loans to these clients go through rigorous repayment capacity assessment since over indebtedness can be an issue.

Ujjivan takes additional customized reports from the credit bureaus—reports on any time overdue of clients are taken for all the loans she has taken—that is, current loan may be up to date but she might have missed a few instalments in between. Fresh loans will be disbursed only on understanding her repayment issues and also indebtedness levels. Ujjivan also calls for special reports on drop out customers to understand whether they are borrowing from elsewhere. The customer call-centre speaks to these clients to understand the issues with Ujjivan's services so that the processes and products can be made more customer-friendly and also to bring them back into Ujjivan. MFIs have to move beyond mere regulatory check to usage of credit information for extending appropriate credit terms for clients. This data will also be useful to check loan-servicing capacity of clients.

There is tremendous potential to use the credit history of clients to deliver appropriate financial services. IndusInd Bank analyses the loan amounts and frequency of repayment in areas where its partners are operating and guides its partners on adjusting loan amounts and frequency based on trend analysis. When a few MFIs wanted to move from weekly to bi-monthly and monthly repayment mode, they were unsure of how regular the repayments would be. For aiding their pilots, they used the pin-code-level frequency-wise repayment reports (what percentage of the loans are in which frequency). If say 80 per cent of the loans in an area are already in bi-monthly repayment mode, MFIs gain confidence to offer similar product features, which is beneficial for both clients and MFI.

Graduation to be individual customers of banks/MFIs is made feasible by a good credit history report. For example, education of children is a priority for the clients of microfinance. SHG members borrow often at 24 per cent for educating their children. If a member has a sound credit history within a group, a bank can offer education loan for higher education. Thus graduation of clients within MFIs or to banks is more feasible if the credit history is available. MFIs can also differentiate borrowers based on their credit history. Client borrowing for a longer term with low/nil at e-payments can be offered differentiated rate of interest.

For Some Clients MFIs are Third Lenders

The available research on over-indebtedness shows there is direct correlation between number of loans and OID. RBI has capped the loans to two and MFIs have interpreted it as two MFI loans not counting other sources of loans.[1] As per Equifax data as of 31 March 2014, 2 per cent of the clients with outstanding loans had more than three loans (Table 5.2).

TABLE 5.2 Clients with more than One Loan

Number of MFI loans with clients	Total number of clients	Percentage to total
1 loan	29,282,111	89.37
2 loans	2,951,811	9.01
3 loans and above	530,172	1.62
	32,764,094	100%

Source: Equifax.

A heartening feature is that 89 per cent of clients had only one loan as of 31 March 2014. Some MFIs check the post-disbursement status of their clients on a sample basis—the number of loans and also loan outstanding. Even those MFIs who diligently share and use the credit bureau reports find that a certain percentage of their clients have more than two loans (Table 5.3). Equitas is very regular in checking portfolio status of their clients on sample basis (more than 5,000 clients across various locations). Their report for last five quarters is given below which shows a spurt in the incidence of clients with more than two loans.

Data of Equitas shows that there can be breaches of regulatory cap since other MFIs are not diligent enough. This might also be because there is time lag between credit query, loan disbursement and data reporting to credit bureau. There are MFIs that are not regular in submission of data; submit data only on a monthly basis. Last quarter lending by banks also put pressure on disbursement on MFIs to disburse quickly in the first quarter of a financial year. MFIs need to know whether there are already queries raised by other MFI/s which can potentially make them a third lender. Credit bureaus need to develop a red flag system of clients for whom multiple queries have been raised. Both the bureaus are also planning to bring out reports on number of enquiries raised in respect of the customers.

MFIN calls for exception reports to counsel member MFIs. Sa-Dhan also has to step up its efforts. Self-regulatory organizations (SROs) have to take action against repeat violators.

TABLE 5.3 Data on Clients with More than 2 Loans

No. of clients	Q1 (%)	Q2 (%)	Q3 (%)	Q4 (%)	Avg. loan outstanding for Q4 fiscal year 2014 (Rs)	Q1 fiscal year 2015 (%)	Avg. loan outstanding for Q1 fiscal year 2015 (Rs)
Clients with only loan with Equitas	60.27	64.95	63.98	54.86	12,374	55.57	12,165
Clients with 2 MFI loans	34.86	31.23	32.53	36.19	23,764	31.56	23,420
Clients with more than 2 MFI loans	4.87	3.82	3.49	5.18	38,870	12.87	32,304

However, for such value-added services MFIs should be willing to pay adequate fees to the credit bureaus. While few MFIs like Equitas are willing to go the extra mile to understand post disbursement status of their clients, and are willing to pay for value added services many others are not. With the present fee structure and remuneration levels, both the bureaus are running unsustainable operations. Unless the viability of Credit bureaus is ensured, this essential infrastructure that supports credit decisions might collapse. Pricing is an aspect of viability. Pricing of the services of credit bureaus needs to be reviewed from time to time. The increased reporting envisaged from SHG membership is likely to improve business volumes and thereby viability of the credit bureaus.

Customers Need to Know Their Credit History and Scores

At present the clients are not provided any information on their credit history or scores. If there are issues regarding number, quantum of loans or overdue, they are informed that their application is being rejected. Otherwise at present they are passive recipients of loans.

Clients need to be given copy of their credit information report / scores (as and when scores are computed). This will help create awareness about the need to have good repayment history, correct their behaviour if they have tendency to borrow excessively or tend to delay payments. Clients can also identify whether their identity has been stolen. They can also enable the credit bureaus to correct and validate their data base. More importantly, using the credit information reports, MFI clients can also access bank loans since the credit history can provide reputational collateral where borrowers have limited collateral to offer. Credit information should become a part of financial literacy curriculum. Customers should be advised on how to manage their loans in such a manner so as to retain high credit scores.

CLIENT GRIEVANCE REDRESSAL

The clients are denied credit if they have two outstanding loans or their outstanding loans along with proposed loan exceed Rs 50,000 or the client has a default. There can be errors in the above three parameters and also there can be mismatch in the identity resulting in a wrong credit report. In case of grievances arising from wrong reports, microfinance clients do not approach the bureau directly but have an interface with only the MFIs at present. Depending on the nature of error the rectification of data can take a day to a few weeks. In case of individual lending, the clients can directly approach CIBIL.

MFIs mention that about 1 per cent of their customers are not happy due to such wrong credit report that increases turnaround time for loans. The errors at times occur on account of delayed updating of data by MFIs. In cases where customers represent their case to the lending MFI, the earlier MFIs with which customer had loans are contacted and a no objection certificate is obtained. Association of Karnataka Microfinance Institutions (AKMI), Karnataka has standardized the no objection certificate (NOC) format. When MFIs close down branches, often some of the existing loans are not collected and these accounts are left pending. Clients may not know where and how to repay the loans in absence of field staff and this has resulted in non-wilful default in a few locations. Involuntary defaults that arise in such situations have to be resolved without inconveniencing the borrowers.

Customer grievance redressal in relation to update or alteration of credit information should be given priority. Clients need to be educated that the grievance redressal mechanism will address these aspects as well. Specific time periods need to be stipulated for update, alteration of credit information, resolving disputes, issue of NOCs, etc., as part of code of conduct stipulations for MFIs and fair practice code of banks. MFIs find it difficult to approach other MFIs on defaulter data confirmation which is disputed by clients. A specific officer needs to be designated in each MFI for resolving these complaints so that MFIs can contact this person in case of need.

Deviations should be reported to boards as is the case with other aspects of customer service. Importantly, mechanisms should be set up in due course where clients can access their credit history and correct their credit record/ credit scores.

Credit Bureau Check Is Just One Step

Effective credit bureaus can be an important tool for MFIs to gain information about the debt levels of their clients and can assist in making responsible lending decisions. However, they are not the sole answer to measuring the indebtedness of clients or repayment capacity of the households. Not all sources of credit are reported to credit bureaus, as we have seen in the earlier section. Apart from SHGs, there are other sources of informal credit like chits, day finance companies. These details are not readily available from any formal source but have to be diligently gathered by field staff. Moreover, ability to repay has to be assessed for larger loans through a careful analysis of cash flows.

Some of the MFIs are adopting additional measures to check the debt levels of clients especially from other sources. Cashpor measures indebtedness and repayment capacity of clients. As per M2i, which has carried out the COCA, the credit officers are well trained to collect information on debt levels through different questions, peer assessments etc. The loan application has details of different sources of debt, household-level income from various sources which are collected and analysed for repayment capacity.

One recent phenomenon has been the spurt of lending institutions (which are not MFIs) but managed by wealthy individuals or groups. They usually lend to MFI clients and even mimic MFIs' systems and pass books. According to Cashpor, there are some villages which have as many as 18 different loan access points. Cashpor finds it necessary to educate clients on perils of over borrowing and also step up its efforts in collection of data on clients. In a centre, and even within a group, members can borrow as per their need and repayment capacity. The credit officers carry out individual-wise analysis. Cashpor conducts weekly meetings that are attended by credit officers. As a result the caseload in Cashpor is limited as compared to many other MFIs but there is high-touch with clients. This also helps in better understanding of the client debt levels.

As per COCA reports, some MFIs like Arohan carry out detailed analysis of debts, cash flows as well as setting debt threshold limits. In Jagran, MFI household visits are carried out to ascertain credit from all sources followed by a detailed analysis of the repayment capacity of the clients. Annapurna Microfinance, Odisha lends to SHGs but still carries out individual debt and cash flow assessment. However, loan appraisal is the weakest area for many MFIs and except credit bureau check these MFIs neither ascertain other debts nor analyse the repayment capacity. Repayment capacity indicators such as income to instalment ratios are not applied by many of the MFIs. Staff training on measuring cash flows and assessing repayment capacity is a weak area for some of the MFIs as per COCA reports as well as SMART assessment (Bansal et al. 2013). The field staff requires training in tracking actual cash flows, arriving at per person expenditure based on norms and debt-servicing capacity assessment.

In group methodology, it is important to train all members in repayment assessment. MFIs largely follow JLG methodology where a group decides to recommend a members' loan and also stand guarantee to each other. MFIs need to train their group members to assess each other's repayment capacity and specify that the

MFI credit decision should be based on the opinion of all members within the group. By design, SHGs are supposed to assess loan applications of members, prioritize needs, assess their repayment capacity, and sanction loans. While in initial years these aspects were given adequate attention in trainings and periodic hand holding support, over the years training and capacity building of groups have fallen short. With availability of larger subsidized credit, equal distribution of loans is being practiced widely; some members get larger loans than what they need and can manage. With no regular follow up and monitoring the loan assessment and sanctioning process is largely left in the hands of one or two leaders who may not have adequate capacity; who can favour a few members with larger loans and in worst case scenario can also corner large loans plunging the groups into distress. Thus in both JLG and SHG, how to assess repayment capacity should be an aspect of members for intense training.

Equitas has done risk profiling of the branches and has fixed debt levels for branches based on: (a) rural and urban towns, (b) new branches, and (c) dry areas with low economic activities (Table 5.4). Equitas carries out cash flow and indebtedness analysis of households as well.

TABLE 5.4 Loan Cap for Branches

#	Loan Cap (Rs)	No. of Branches	Percentage
1	30,000	19	6
2	40,000	141	43
3	50,000	169	51
Total		329	100

Source: Equitas.

Ujjivan has also developed branch-wise credit policy on the basis of periodical analysis of industry performance; the pin code report enables the MFI to benchmark its performance against that of industry. Average industry ticket size is analysed loan-cycle-wise to adjust the loan amount. Moreover, Ujjivan also carries out occupation-wise study and sets credit limits occupation-wise for different branches. If in any branch, other MFIs operating in the area have issues with their portfolio quality, Ujjivan analyses the reasons for this and limits its exposure to the area with the objective of containing risks of the customers as also its portfolio.

From available secondary literature it is not clear how the boards are adequately challenging and guiding management to develop appropriate strategies and risk management framework to ensure that clients are not over indebted. MFIs need to develop risk management policy where client-level risks also need to be addressed. Board and senior management are responsible for developing benchmarks or internal limits for each indicator they track for client OID (Box 5.3). An internal committee should periodically review adoption of the policy through appropriate practices by field staff. Internal audit function has the responsibility of checking that field practices conform to policy.

While many MFIs conduct internal audit checks to monitor over-indebtedness, the depth of analysis varies across institutions. A few MFIs have included indebtedness aspects to be checked systematically as part of internal audit on a regular basis. For example, many MFIs such as Cashpor, Grameen Financial Services, Ujjivan, Equitas, and Arohan had their internal auditors interact with at least 10 per cent of their clients to

BOX 5.3 Management and Board Need to Monitor Indicators of Client OID

The Smart Campaign Standards requires that management and the board monitor the risk of client over-indebtedness. Senior managers should regularly track indicators such as the incidence of multiple borrowing and client *debt to income* ratios. They should also review the MFIs' market penetration rates, competition, and macroeconomic trends that could lead clients into debt stress like food price increases. These factors should be checked through audit, surveys, portfolio reports, feedback from the field, and competitor analysis. Any time that management identifies a potentially 'high risk' situation (for example, PAR is on the rise and competition has increased), they should take quick action to mitigate the problem.

Smart Campaign carried out client protection assessment of 18 MFIs in India over a period of two years and found that almost all MFIs met or surpassed adequate client protection standards with regard to avoiding OID of clients. However, the Campaign finds scope for improvements in board oversight. While MFI board minutes indicate that the issue of over-indebtedness is a concern and part of the discussions of most MFI board meetings, it is often discussed in general terms. There is scope for MFIs to better monitor markets at high-risk of over-indebtedness.

Box 5.4 Client Education on Perils of Over-indebtedness

Ujjivan has developed a video highlighting the risks of over indebtedness. The cases of two women who have taken larger loans due to pressure from husbands and relatives and find themselves unable to repay are portrayed. Since its development in 2011–12, the video has been shown to not only Ujjivan's clients (it is compulsory for the new clients) but to clients of other MFIs as well since Ujjivan freely makes this available for sectoral benefit. The video has been translated to 12 regional languages. The video covers functioning of credit bureau as well.

Source – Personal interaction with senior management of Ujjivan.

determine their eligibility to get a loan, and understand issues around the potential wrong selection of clients or multiple borrowing (Bansal et al. 2013). In order to instil comprehensive audit checks, it is necessary for the internal auditor to ensure that policies are adhered to at the field level, and that the internal audit team visits a representative sample of clients on a regular basis, including clients who have defaulted or whose loans have been rescheduled (Bansal et al. 2013).

Clients often have cash flow issues; MFIs build in 3 to 4 weeks' grace period for such emergencies. However, if there are prolonged lean seasons or sickness, clients borrow more to repay the instalments. If clients had recourse to savings to meet emergency needs, they would not have to take another loan which is usually larger in size than what they require. MFIs don't offer savings services, banks are considered unapproachable for small savings and few MFIs offer emergency loans to help clients tide over cash flows. In exceptional cases clients also need rescheduling of loans. While rescheduling was not a stated policy for most of the MFIs till 2010, as per the unified code of conduct for MFIs, they must have a Board approved debt restructuring product/program for providing relief to borrowers facing repayment stress. How this is effectively implemented is an area which requires deeper study. Equitas reports having a client-friendly repayment practice (CFRP) to help customers facing difficulties in meeting repayment obligations on account of reasons beyond their control. The Micro Credit Rating International Ltd. (M-CRIL), in its COCA report (M-CRIL 2014) observed:

> The CFRP details various scenarios in which the borrowers are eligible for reprieve (rescheduling and waiving off loans). It deals with common calamities like death in household (50-75% instalment waived off, 1–2 months holiday), destruction due to natural calamity like fire, (1-2 months interest free holiday) and illness (100% written-off). The decision is taken after BM's visit to the household and verification by the supervisory staff. Since inception, 2289 cases (as on June 2013) had been settled as per the CFRP.

Client Education and Behaviour

While lenders bear much responsibility for avoiding over-indebtedness, clients also have a responsibility to borrow prudently. However, some of them lack sufficient understanding to measure the quantum of debts they are taking up. Some do not exercise caution to avoid over indebtedness. Moreover research in behavioural economics suggests that over optimism about the future leading to risky borrowing is an inherently human trait (Microfinance CEO Working Group 2014b). Client education to make people aware of dangers of over-indebtedness is one approach to countering this tendency.

Customers also need education on functioning of credit bureau and how positive credit history can help the clients in the future, especially possibilities of obtaining larger loans from MFIs/banks. Overall most MFIs feel that customers are more diligent about repayments than before since they are aware that they have to get good credit history. Many of them have experienced 0.5 to 1.5 per cent improvement in loan recovery as compared to pre credit bureau days.

CONCLUSION

Financial institutions including MFIs have to concern themselves directly with how customers will use the funds they receive, the household circumstances and how the additional obligations will affect both their customers' short and long-term cash flow. Understanding the causes and potential remedies for over-indebtedness is critical to socially responsible lending. The fallout from over-indebtedness can be catastrophic, not only to the clients whose inability to repay loans can lead to social, economic, and personal problems with long-lasting repercussions. The measures taken by the sector at all levels have brought considerable discipline in ensuring that customer debt levels remain under scrutiny and are limited to safe levels. The regulator has played a significant role by prescribing absolute limits and persuaded the MFIs to subscribe data to credit bureaus and make use of credit reference reports. MFIs have seriously applied regulatory guidance in their operational processes to ensure that OID is avoided. The credit bureaus have rolled out their credit reference services within a remarkably short time.

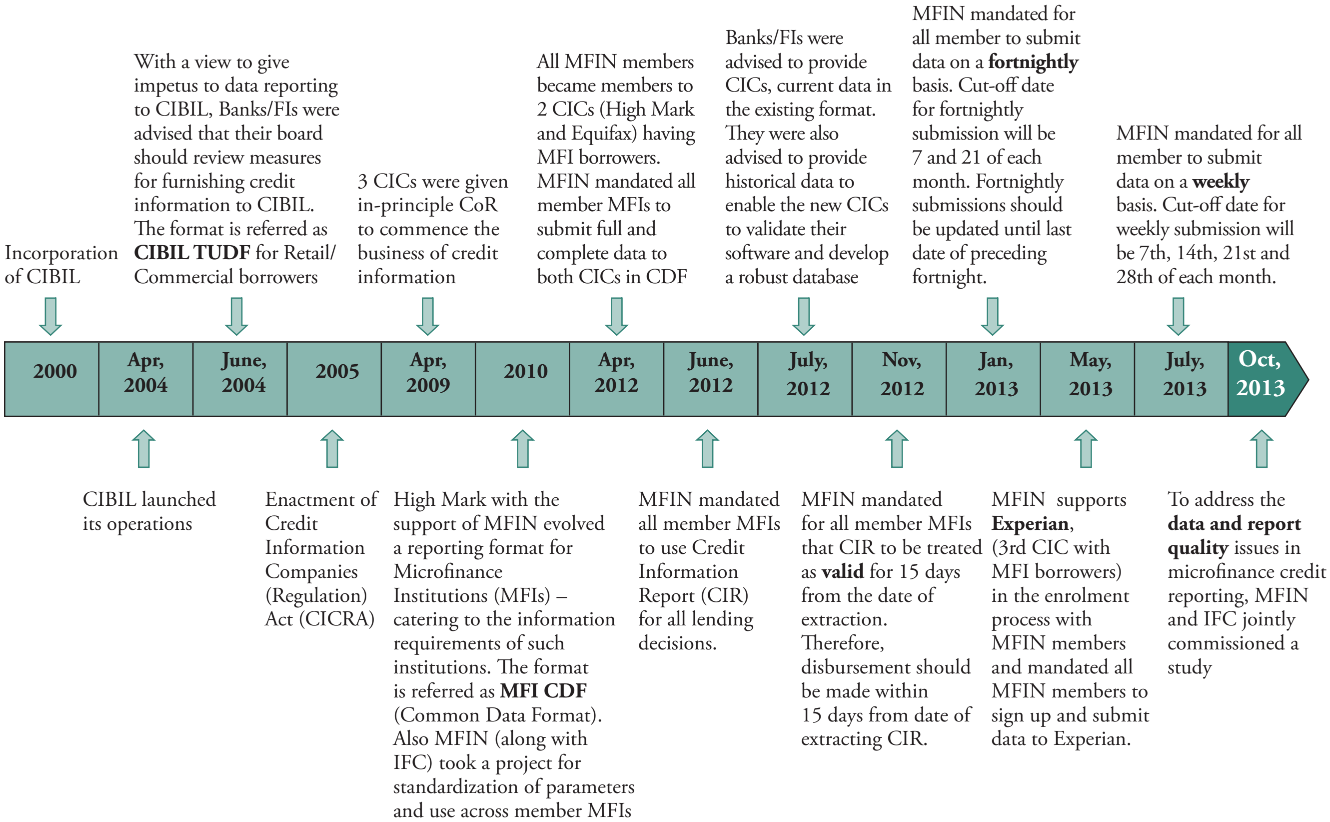
However the sector has continuing problems relating to multiple borrowing that should be attended to on an on-going basis. The current state of practice limits indebtedness analysis to compliance with regulatory guidelines. The regulatory limits on number of loans and amount of debt are at best thumb rules; these do not exclude the responsibility of MFIs to carry out a proper appraisal of customer situation with regard to credit need, credit absorption capacity, credit servicing capacity and risk mitigation arising from risks. Regulatory limits on debt might have brought about a sense of complacency among MFIs with regard to the rigour of client-level assessments on the extent of debt. RBI has to examine the rationale of limiting debt level at Rs 50,000, as it could be too high or too low within the target segment of customers depending on the purpose for which loan is availed and efficiency of use. MFIs have to go beyond the credit bureau checks to truly measure the indebtedness levels and also the repayment capacity. By matching the credit terms more closely to the cash flows of the client, lenders can mitigate this risk and build client relations.

The rigour of measuring debt levels by MFIs is meaningless if other players lending to the same segment of customers are not required by RBI to report data to the credit bureaus. With its large presence in both outreach and portfolio terms, bank loans to SHG members should be reported and incrementally taken to individual member level. The credit reference information should also provide the repayment track record at individual client level to enable MFIs use credit reports as comprehensive inputs to decision making. With the availability of track record, banks should also price their loans to MFIs in such a way that cost of funds to MFIs comes down and thus the MFIs will be in a position to offer lower pricing for their clients.

Responsible lending requires banks and MFIs to create greater awareness among borrowers than the present practice of explaining the loan terms. They should also be educated about management of loans, cash inflows and outflows. Management of funds is important since often clients have irregular income, many are in seasonal businesses, which have peak demands, which may or may not coincide with the loan disbursement, and there can be mismatch between the cash flow of the client and the loan term. Financial literacy to customers should include credit bureau operations, grievance procedures for rectifying credit reports and using credit bureau reports to get better loan terms.

Practice of responsible lending is more clearly evident in the approach to OID. But the practice is limited to MFIs. The others, especially banks that also lend to same segment of customers and all other programmes and projects that lend to SHGs also should take a cue from MFIs and ensure that customer interests are better protected. The regulator has a role to play in persuading banks others to seriously examine issue relating to OID in their customers.

APPENDIX A5.1 EVOLUTION OF CREDIT BUREAUS



Source: MFIN.

NOTE

1. This is basically on account of non-availability of data on loans from other sources—the only verifiable source of information is that of MFI loans available through Credit Bureaus.

6

Financial Inclusion in North-east

Not Getting a Due Share

FINANCIAL INSTITUTIONS IN NORTH-EAST

In terms of geographical size, North-east India constitutes about 8 per cent of the total India's size. North-east India's population (all eight states combined) is approximately 40 million (2011 census), constituting 3.1 per cent of the total Indian population (of 1,210 million). Of the country's net sown area North-east accounts for 3.1 per cent with agriculture being a major livelihood activity. North-east is a special region for several reasons that are not discussed as these are beyond the scope of this report. Provision of financial services is the first responsible finance action that should have been taken by banks and policy establishment. Scarcity of banking network, shortcomings in the functioning of the network, issues with product quality and high costs of accessing bank branches are some of the fundamental problems affecting the hinterland in the North-east. The availability of financial services in North-east is shallow. The poor road and telecommunication connectivity, sparse population density, credit indiscipline in expectation of loan waiver, low morale of staff posted to the region and law and order problems in some pockets contribute to low expansion of financial services in the region.

According to the CRISIL's financial inclusion index, Inclusix, which covers three parameters—branch penetration, deposit penetration, and credit penetration—at an all-India level, the index is placed (on a scale of 100) at 40.1 in 2011, reflecting under-penetration of formal banking facilities in most parts of the country. While the southern region witnessed highest financial inclusion with an index of 62.2, north-eastern region registered lowest with 28.5 (Khan 2014). In terms of the regional spread of the bank offices, while north-eastern region accounted for about 2 per cent (2,785 bank offices), southern region accounted for about 28 per cent (30,925 bank offices). Thus the Institutional network in the region is very thin. Commercial banks and RRBs provide services in the vicinity of the branch and urban areas. Cooperatives have a very weak presence in the North-east states, which mostly have a two-tier structure. The primary cooperatives are not supervised well by the state cooperative banks on account of the distances. The population per branch (Table 6.1) was lower than the national average in five out of eight states indicating that people had better access to bank branches. But the ground reality was that the spatial distances between villages and the branches

Table 6.1 Branch Network and Savings Services, March 2013

North-eastern Region	No. of branches in 2013	Population per branch	State share of population	Savings in 2013 (Rs bn)	State share of savings in 2013	Average savings per account in 2012 (Rs)
Arunachal Pradesh	145	9,535	0.11%	72.15	0.10%	116,998
Assam	1,800	17,316	2.58%	777.29	1.10%	135,343
Manipur	133	20,464	0.22%	53.55	0.10%	114,770
Meghalaya	319	9,292	0.24%	139.72	0.20%	139,380
Mizoram	141	7,738	0.09%	42.29	0.10%	154,414
Nagaland	143	13,850	0.16%	64.58	0.10%	113,599
Tripura	380	9,661	0.30%	119.13	0.20%	178,515
Sikkim	114	5,331				
All-India total	96,059	12,921		70,513.32		270,860

were large and often required traversing difficult terrain. As a result the number of people that were willing and able to access banking services was effectively lower. The number of outlets of rural financial institutions (including rural post branches, primary credit societies, and bank branches) per 1,000 sq. km ranged from a low of 5 in Arunachal Pradesh to a high of 159 in Assam. Five out of eight states had less rural financial institution outlets per 1,000 sq. km compared to national average of 83.

The savings level in each North-east state except Mizoram was well below the state's proportional share of population. The average savings per account lagged behind the national average by a large margin. In credit too, the region did not enjoy adequate flows. The state and regional shares of credit were well below than the levels warranted by the population. The credit deposit ratios in the region were much lower than the national ratio and indicated that there was an outflow of resources from the region to other parts of the country.

Credit supports economic activity. Agricultural credit as a proportion of agricultural GDP in these states was much lower than the all-India level (Table 6.3). Agricultural sector in the North-eastern region is clearly not receiving adequate support from banking system.

Table 6.2 North-east Region: Credit Availability

North-eastern Region	Credit Outstanding in 2013 (Rs bn)	State Share of Credit in 2013	State Share of Number of Small Loan Accounts	Average Amount per Small Loan Accounts (Rs)	Credit-deposit Ratio
Arunachal Pradesh	15.31	0.03%	0.19%	66,606	28.4
Assam	285.76	0.52%	2.54%	53,973	40.3
Manipur	14.69	0.03%	0.19%	63,509	33.2
Meghalaya	32.74	0.06%	0.38%	52,132	28.2
Mizoram	14.90	0.03%	0.14%	64,196	41.9
Nagaland	18.02	0.03%	0.36%	55,869	47.6
Tripura	38.69	0.07%	0.33%	44,215	31.7
All-India total	55,064.96			56,019	79.0

Source: RBI.

TABLE 6.3 Agricultural Credit to Agricultural GDP Ratio

State	Agricultural credit/Agri-GDP Percentage
Arunachal Pradesh	4.7
Assam	12.2
Manipur	N.A.
Meghalaya	3.5
Mizoram	13.5
Tripura	18.8
Nagaland	N.A.
Sikkim	13.5
All-India total	47.7

Across the country Kisan Credit Cards (KCC) have been the preferred means of providing credit to farmers. The position of issue of KCC in the North-east has not been encouraging. Less than 10 per cent of farm holdings have been provided KCCs (Table 6.4). The average loan limits sanctioned have been well below the national average – about one third. In States like Sikkim and Manipur a negligible proportion of farm households have been provided KCC. The average limit sanctioned in Tripura under KCC was less than 20 per cent of the national average.

FINANCIAL INCLUSION MEASURES TAKEN BY RBI AND BANKS

Given the difficulties faced by people in the region, supply side efforts have been taken by financial institutions under RBI guidance. As part of the financial inclusion plan (FIP), customer service points were opened in 4,562 locations; however, only 54 per cent are reported active. Low business volumes and resultant low remuneration levels are the major reasons for CSP inactivity and attrition. The number of Basic savings accounts that were opened saw an exponential growth but in 50 per cent of the accounts no transactions have ever taken place.[1] Banks are yet to sanction overdraft facility in savings account on account of risk perceptions and the weak monitoring capacity within banks. Banks have started issuing debit cards on basic savings bank deposit accounts (BSBDAs) (ATM card on RuPay platform). Currently average deposit balance in the new savings accounts is Rs 400 per account, which is insufficient to generate viable business for the banks.

Credit linkage has remained poor as revealed by the data in Table 6.2. While KCC for farmers has been issued selectively for a small number of farmers (Table 6.4), General Credit Card (GCC) has not taken off. Since KCC and GCC require credit discipline, high default in loan accounts has acted as a deterrent among

TABLE 6.4 Kisan Credit Cards in North-east (March 2012)

State	No. of KCCs Issued	No. of Farm Holdings in the State	Sanctioned Limits (Rs lakhs)	Average Sanction per Card (Rs)
Assam	251,144	2,720,000	78,036	31,072
Arunachal Pradesh	6,990	109,000	2,406	34,425
Meghalaya	24,418	241,000	7,804	31,958
Mizoram	5,836	110,000	3,258	55,820
Manipur	2,590	151,000	1,006	38,825
Nagaland	10,557	1,173,000	3,859	36,549
Sikkim	1,793	75,000	1,273	71,012
Tripura	92,179	552,000	13,320	14,450
North-east region total	395,507	5,131,000	110,961	28,055
All-India total	11,756,976	137,757,000	9,166,607	77,967

field staff to propagate this product. Banks have to find means for making credit available. While credit limits can be approved, clients will need to make regular transactions in the savings account. After observing the operations in the savings account for 6 months, the branch manager can activate the credit limit. After one year of activating the credit limit, the limit can be enhanced depending on the operations in the account. However, a critical problem is the difficulty of monitoring clients after a loan is given. Given the distances, shortage of staff, language difficulties and law and order problems in different parts of the region, banks have not ventured too far out in to the hinterland. The supply side issues require solutions so that bank personnel can respond to demand side issues adequately.

The problems in the North-east in availing services from financial institutions lead us to conclude that customers face hardships in terms of achieving access and also ensuring quality of services. The distances from villages to branches result in extra costs and time outlay by the customers. There is no certainty of transaction completion once the customers reach the bank branch. Repetitive visits become necessary especially in case of credit. Changes in the branch staff pose challenges to the customer as the document requirements might change with change of personnel at the branch. With most branch managers in the North-east not having local language competence, the information requirements of customers are not satisfactorily fulfilled. The forms and applications of the bank usually are not available in the local language but in English and Hindi. Customer grievance redressal mechanisms are not publicized and frequently there is no follow-up on the complaints.

Knowledge about insurance products remain low among customer service points (CSPs) and clients (NCAER 2011); training to business correspondent (BC) agents, claim settlement system, proper selling and avoiding misselling, adequate remuneration to BC agents for selling insurance are aspects which require more detailing before insurance products are rolled out. Crop insurance coverage has been patchy in the North-east. Across the cropping seasons Kharif 2011, Rabi 2011–12 and Kharif 2012 the maximum number of farmers covered in the eight states was less than 45,000. Against 52 lakh farm holdings in the region this was less than 1 per cent coverage. Of the farmers covered in the region a preponderant majority, 36,500 (80 per cent) were from Assam. The numbers covered in Sikkim, Meghalaya, Tripura, Mizoram were a mere few hundreds to justify crop insurance as a serious attempt at mitigating farm risks. Arunachal Pradesh and Nagaland did not have any coverage of the crop insurance scheme. The Weather Based Crop Insurance Scheme (WBCIS) did not take off at all in the North-east. In Assam 70 farmers had been covered under WBCIS and in other states there was no coverage. Neither business planning nor product marketing seem to have been done with the farmers in mind in the North-east. While the Government of India subsidized the premium and supported the insurance company with claim settlement, the North-east farmers did not get the benefit of a risk reduction mechanism. From a responsible finance viewpoint, the near absence of a valuable risk management product (which is available in other parts of the country) does not seem appropriate.

Training to business correspondents had been reported to be perfunctory which is also one of the reasons for low product offtake. Marketing support as also technological backstopping of the BCs in the field has not been to the required level. Low and delayed remuneration reduces motivation of CSPs and can result in high attrition rates. Responsible treatment of the CSPs in terms of adequate training, timely remuneration, addressing their operational issues promptly and regular interaction and review of their performance by branch and senior management are areas which require vast improvement.

Though literacy levels are high in the region, financial literacy especially product literacy is low among the households. Outreach programmes have largely been mass campaigns through video shows and very few in depth trainings to develop capacities of people have been conducted. Mobile based operations, operational aspects of the overdraft facility, and insurance and pension product literacy are aspects clients need to know to make use of these products and services.

The Committee to formulate special FIP to deepen financial services in the North-east region set up by Ministry of Finance, Government of India in 2013, has estimated a cost of Rs 100–110 crore per annum for the banks (all 8 states) towards IT infrastructure, recurring payments to service providers, payments to CSPs, etc., The bulk of the cost—more than 60 per cent—is expected to be payments to CSPs. The Committee found that adequate commission from DBT will meet the costs and commissions will be the key to viability and success of the BC model. In Tripura with a large majority of households financially included (100 per cent of villages have either bank branch or a CSP providing financial services)[2] and government using bank accounts for making welfare payments, the CSP remuneration levels are higher than in rest of the North-eastern region. Similar efforts in other states will ensure that customers are better served in their villages saving time and costs.

Aadhar cards to provide unique identity that can fast-track financial inclusion are yet to be issued in any significant numbers except in Tripura and Sikkim. In Assam, Aadhar has not made any headway. Aadhar-seeded bank accounts were seen as a complete solution for routing government payments. In the North-east with difficult terrain, Aadhar-enabled payments system is a boon, but the operationalization of the same seems difficult in most of the states at the current levels of Aadhar enrolment (Table 6.5).

TABLE 6.5 Aadhar Card Enrolment

State	Aadhar enrolments (Mn)	Population (Mn)	Population enrolled (%)
Arunachal Pradesh	0.03	1.38	2.17
Assam	0.09	31.16	0.29
Manipur	1.00	2.72	36.76
Meghalaya	0.01	2.96	0.34
Mizoram	0.07	1.09	6.42
Tripura	3.22	3.67	87.74
Nagaland	0.82	1.98	41.41
Sikkim	0.56	0.60	93.33
North-east total	5.80	45.56	12.73
All-India total	657.15	1,210.19	54.30

The quality of services for acquired customers requires improvement. Savings accounts take time to get activated as the cards to be issued have to come from a distant location. A survey of CSPs found that in Assam the number of days taken to get an account activated was 42 against the national mean value of 9 days.[3] 100 per cent of surveyed CSPs indicated that forms are not available in local languages in Assam whereas across the country 47 per cent of CSPs reported that forms are available in the local language in their area. In case of a CSP not being available or being unable to transact for any reason, the customers should be in a position to transact with another CSP of the same bank as a fall-back arrangement. The CSP survey revealed that in Assam such an arrangement did not exist and the customers had to necessarily approach the base bank branch for transactions.

The oversight of CSPs is another weak area; any conflict between the BC Company and CSP or problems in customer protection is likely to have a long-term impact on the reputation of the bank and as such, banks need to enforce strict channel discipline by improving oversight. Standardization of processes and education of clients about these processes could lead to better control and reduce risk.

Banking services in the North-east do not stand the test of responsible finance adequately. The effort level in the hands of banks to ensure outreach of services to the hinterland has been weak. Expansion of network in NE has been tardy, on account of many factors both external and internal. Infrastructure, connectivity, logistics have posed problems to banks. Banks have also been affected by internal issues such as lack of prioritization of North-east, inadequate staffing, viability concerns and exaggerated risk perceptions in expanding services in this region. The mandate under financial inclusion to serve excluded people has thus not been fulfilled well. While there are ongoing and increasingly vigorous efforts to increase the level of service coverage, the customer does not seem to be the focus of these efforts. Most banks seem interested in showing number of points of presence and savings accounts which do not reflect effective inclusion.

SELF-HELP GROUPS: LOW IN OUTREACH AND SHALLOW IN FINANCIAL SERVICES

Joining a neighbourhood SHG is the first step to be included for many of the financially excluded women. SHGs offer an opportunity to deposit a fixed sum as savings every month (Table 6.6). In excluded communities this offers a unique opportunity for asset building. Internal loans usually help in consumption smoothening and reduction in their vulnerability. SHGs expect to be linked to banks for credit to undertake small income generation activities initially, gradually

TABLE 6.6 Savings Performance of SHGs for 2013 and 2014

State	As of 31 March 2013		As of 31 march 2014		YOY
	No of SHGs	Savings amount	No of SHGs	Savings amount	Percentage change in no of groups
Assam	271,072	10,751	285,327	11,290	5
Arunachal Pradesh	5,033	412	2,588	153	–49
Manipur	12,656	235	9,039	95	–29
Meghalaya	9,573	516	7,230	537	–24
Mizoram*	3,117	612	187	4	–94
Nagaland*	8,478	186	2,437	210	–71
Sikkim	3,529	79	343	36	–90
Tripura	10,438	219	9,148	558	–12
North-east total	323,896	13,010	316,299	12,883	–2
All-India total	7,317,551	821,725	7,429,500	989,741	2

Source – Microfinance in India, NABARD, 2013 and 2014.
Note: * For Mizoram and Nagaland, the data of 2013 includes regional rural banks (RRBs) and district central cooperative banks (DCCB). However, for 2014 the figures from these two institutions are shown as 0. This partially explains the huge drop in number of groups; however, even commercial banks reported drop in number of groups.

expanding the array of activities over repeat loans. Some of the entrepreneurial women can also graduate to be individual customers of the banks based on their credit history.

The number of groups that have a savings account with the bank, and are thus savings linked, was reduced by 2 per cent during 2014 as compared to 2013. Except Tripura, the other states show very low growth or negative growth in the number of groups and savings amount. Figure 6.1 shows the per-group position of savings for the years 2013 and 2014.

Lending by Banks to Self-help Groups

The details of bank loans disbursed to self-help groups and loan outstanding for the years 2013 and 2014 are given in Table 6.6.

Loans disbursed in terms of number of groups has shown decline in all states except Arunachal Pradesh; per-group loan disbursed is shown in Figure 6.2. As compared to All-India figure of per-group disbursement of Rs 1.75 lakh in 2014, in 6 states the per-group disbursement is below the national average.

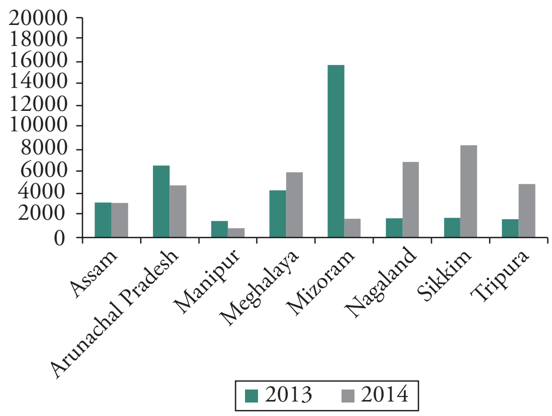


FIGURE 6.1 Savings per Group

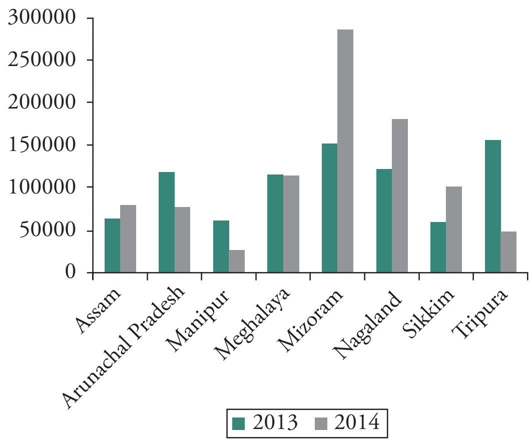


FIGURE 6.2 Loan Disbursed per Group

TABLE 6.7 Loans Disbursed

State	Loans disbursed				YOY
	As of 31 March 2013		As of 31 March 2014		Percentage change in groups
	No. of SHGs	Loans disbursed	No. of SHGs	Loans disbursed	
Assam	21,497	13,756	14,918	11,868	–31
Arunachal Pradesh	112	133	136	105	21
Manipur	659	406	352	95	–47
Meghalaya	400	462	175	200	–56
Mizoram*	544	827	7	20	–99
Nagaland*	796	974	150	271	–81
Sikkim	359	213	67	68	–81
Tripura	801	1,251	396	192	–51
North-east total	25,168	18,021	16,201	12,819	–36
All-India total	1,219,821	2,058,536	1,366,421	2,401,735	12

Source: Microfinance in India, NABARD, 2013 and 2014.
Note: * For Mizoram and Nagaland, the data of 2013 includes regional rural banks (RRBs) and district central cooperative banks (DCCB). However, for 2014 the figures from these two institutions are shown as 0. This partially explains the huge drop in number of groups; however, even commercial banks reported drop in number of groups.

Loan Outstanding

The bank loan outstanding to SHGs and portfolio quality for the years 2013 and 2014 are given in Table 6.8.

Except Arunachal Pradesh, all other states show a negative trend in number of groups with outstanding loans which is an area of concern. The indicator of percentage of SHGs with savings accounts with banks

TABLE 6.8 Loans Outstanding and Portfolio Quality

State	As of 31 March 2013		As of 31 March 2014		Percentage Change No. of Grps With Bank Loan	Percentage of SHGs With Loans OS 2014	NPA as Percentage of Loan Outstanding in 2014	Change in Percentage of NPA for 2014 as Compared to 2013
	No. of SHGs	Loan Outstanding	No. of SHGs	Loan Outstanding				
Assam	121,490	64,856	109,587	65,549	–10	38	7	–1
Arunachal Pradesh	392	388	456	301	16	18	22	11
Manipur	4,591	2,092	3,934	1,388	–14	44	55	19
Meghalaya	2,376	1,762	3,075	1,268	29	43	19	11
Mizoram*	2,667	1,947	112	210	–96	60	62	61
Nagaland*	2,428	1,794	1,678	1,260	–31	69	21	7
Sikkim	2,856	1,238	222	232	–92	65	10	0
Tripura	6,860	5,599	5,505	5,172	–20	60	7	3
North-east total	143,660	79,676	124,569	75,380	–13	39	8.8	0.3
All-India total	4,451,434	3,937,529	4,197,338	4,292,752	–6	56	6.8	–0.2

Source: Microfinance in India, NABARD, 2013 and 2014.
Note: * For Mizoram and Nagaland, the data of 2013 includes regional rural banks (RRBs) and district central cooperative banks (DCCB). However, for 2014 the figures from these two institutions are shown as 0. This partially explains the huge drop in number of groups; however, even commercial banks reported drop in number of groups.

having a loan outstanding also shows a dismal picture—while 56 per cent of SHGs have an outstanding loan at all-India level, for North-east as a whole, the figure is 39 per cent. Four out of eight states have lower ratio than the all-India position. The portfolio quality has deteriorated in almost all states except in Assam (see Figure 6.3).

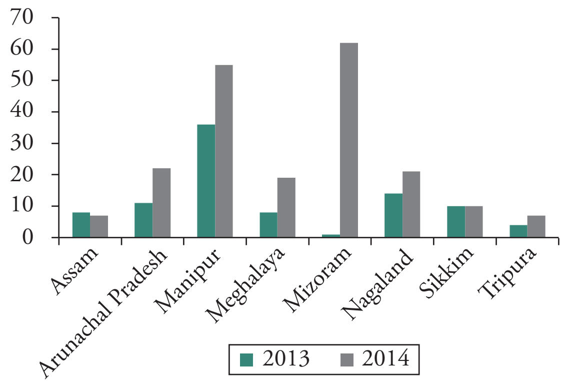


FIGURE 6.3 NPA as Percentage of Loan Outstanding

Public sector banks followed by RRBs are the major financiers of self-help groups. State co-operative banks operational in the states have only limited outreach. Private sector banks have very low exposure to SHGs in the North-east.

As can be seen from Tables 6.6 to 6.8, SHGs in the North-east are lagging far behind the rest of the country in average savings and average loans. Savings per SHG ranges between 20 per cent and 80 per cent of the all India average in six out of the seven states. Only Mizoram has a higher than all India average savings rate. Similarly the loan outstanding per SHG is also lower at 65 per cent of the national average for North-east as a whole. NPA levels are higher than national average by 2 per cent overall; four of the North-east states have very high level of NPA to loan outstanding in their SHG portfolio.

Specific studies carried out on the quality of SHGs and their ability to meet member needs find that 50 per cent or more of such SHGs have serious issues in terms of group discipline and maintenance of records (Reach India 2011). Groups have been saving regularly. Weaknesses in the group formation process are, lack of involvement of group members in formulation of by-laws which later on leads to problems of compliance and enforcement resulting in poor member discipline. Lack of repayment discipline that emerges from ill-defined repayment terms, infrequent contact with SHGs and poor enforcement of peer pressure is a key weakness of the SHG movement in the state.

Credit flow to SHGs is irregular and erratic and shortages of manpower and pre occupation with branch operations are two most critical difficulties facing bank branches in lending to SHGs. Though grievance redressal mechanisms exist in banks, customers are not familiar with the same. The Banking Ombudsman for the North-eastern States is located in Guwahati, too far away for most of the rural clientele in the region. As per State-level Bankers' Committees (SLBCs), there is very little capacity to form good quality groups in most of the states. NRLM has been rolled out in all the North-eastern states. As per the SLBC convenors considerable difficulties are being experienced in rolling out the programme in terms of recruitment of staff, identifying community resource persons, etc. Overall, the responsiveness of the government and banks to financial services needs of SHGs has been less than adequate, leading to very shallow services and low quality effort from the supply side.

MFIs IN NORTH-EAST: PROVIDING FINANCIAL SERVICES IN DIFFICULT TERRAIN WITH LIMITED FUNDING SUPPORT

Outreach and Growth

Two sets of MFIs are operational in the North-east—MFIs which are head quartered in one of the North-east states and operate only in these states; the others are Pan-India MFIs with headquarters outside the North-east states but are expanding operations in these states. The larger MFIs like RGVN, NERFES have registered growth rates of 15 to 20 per cent year on year. However this growth is largely achieved from lending larger loans to existing customers. Though new clients can be acquired, MFIs are concerned about their ability to raise resources to lend to new clients. Many of the smaller MFIs have registered less than 10 per cent loan portfolio growth. They have not added new clients. Though there is a vast potential to expand customer base and also enter new areas, the ability to raise loan funds is the constraining factor for North-east MFIs (NE-MFIs)

TABLE 6.9 Outreach of MFIs, March 2014

Name of state	Active loans (no.)	Number of unique clients	Amount of loan disbursed during last year	Loan outstanding (Rs)	Average loan size outstanding (Rs)
Arunachal Pradesh	576	576	7,327,000	4,963,492	8,617
Assam	1,010,133	1,005,467	16,180,491,289	12,547,883,151	12,422
Manipur	18,358	18,061	176,968,000	211,074,669	11,498
Meghalaya	23,734	23,574	424,363,825	336,697,883	14,186
Mizoram	259	259	2,468,000	2,910,200	11,236
Tripura	256,091	255,081	4,620,846,000	3,247,820,522	12,682
North-east	1,309,151	1,303,018	21,412,464,114	16,351,349,917	12,490
India	28.00			279310.00	9,961
NE Share	4.68%			5.85%	–

Source: Equifax.
Note: Data pertains to those MFIs that report information to Credit Bureau.

to expand outreach. The larger MFIs such as Bandhan, Ujjijvan, RGVN operating in the region have been able to expand their outreach (Table 6.9).

Ability to Raise Resources to Service Clients

Local MFIs that operate in the North-east, like other MFIs elsewhere, are highly dependent on bulk loans from banks and financial institutions for on lending to clients. These MFIs struggle to raise funds since they have to deal with high risk perception of banks. Banks prefer MFIs with larger portfolios, wide spread operations and those located in states where it is easier for them to monitor. Most of NE-MFIs operate in one or two states and have concentrated operations; they also have small portfolios and higher cost of operations due to low density of population. Banks perceive the North-east as high-risk region—with law and order problems, poor transportation and communication facilities. The frequent media news on clashes and disturbances also increase the rigour of due diligence by banks with a negative bias—they insist on granular data on portfolio quality of disturbed area, flood prone area, etc.

NE-MFIs have to contend with external MFIs for bank funding. Banks lend to Pan-India MFIs for their portfolios in the North-east and often deny loans or sanction small amounts to NE-MFIs since their exposure limits to North-eastern states is achieved by lending to larger MFIs. Due to high risk perception, their loans to NE-MFIs are also priced higher; banks have been lending at 15 per cent rate of interest to NE-MFIs, whereas MFIs in other regions have been able to raise funds at cheaper rates. Thus NE-MFIs find that they are unable to compete with other MFIs on loan size as also interest rate.

Existing banking partners prefer not to increase their exposure but sanction the earlier loan sizes and not increase the loan amount even when the track record of repayment of MFIs has been good. Thus for increasing the outreach and loan size for existing customers, the MFIs have to search for new banking partners each year. Unlike in other states where local offices of banks accept loan applications from MFIs; in the North-east the MFIs have to deal with their controlling offices which are in Guwahati or Kolkata which increases the cost of raising funds. Though year on year funds flow has been improving, NE-MFIs find loan fund raising both time consuming and resource intensive.

RRBs in the North-east have been lending to the local MFIs but at higher costs—15 per cent rate of interest and 1 per cent processing fee. Reportedly the public sector commercial banks are reducing their exposure to NE-MFIs and their lending terms have also become stringent. Collateral of up to 100 per cent of the loan amount and also personal guarantees of the Directors are insisted upon. A few NE-MFIs have offered such collateral including personal guarantee of directors which has set a precedent for banks to demand such collateral from other local MFIs as well.

Box 6.1 Bankers' Insistence in Personal Guarantee

We have to take a principled stand. Pan-India MFIs do not offer such collateral; they are seen as too big to fail. Banks insist on such collateral only from small MFIs. Once a few MFIs provide such collateral then banks insist from all of us. Women from North-east who we cater to largely are highly credit worthy and have maintained very good repayment rates. Banks should appreciate and empathize with us—we face several odds and also our clients. We have maintained good repayment record. Banks should develop confidence in us and be our partners in true sense.

Source: Personal communication with the head of an NE-MFI.

The rating system also seems to contribute to the woes of NE-MFIs. They provide lower grades to NE-MFIs since they have a small portfolio and concentrated in a few states. The lower credit rating impacts credit availability from banks, which have a larger pool of MFIs to choose from.

North-eastern Development Finance Corporation Ltd (NEDFi) has been consistently funding several NE-MFIs at very reasonable rates of interest (8 to 9 per cent). NEDFi has a rigorous appraisal mechanism and insists on personal guarantee of the promoters and collateral up to 50 per cent of the loan amount in case of MFIs where the governance structure is promoter controlled. NE-MFIs widely appreciate the role played by NEDFi in supporting smaller MFIs at reasonable cost of funding which has helped the MFIs to reach out to clients in hilly areas.

Access to equity for small MFIs has been a problem across the country. MFIs that operate exclusively in the North-east face higher odds in attracting equity. Domestic equity is hardly available. Without equity inflows, NE-MFIs find it difficult to negotiate bank loans on account of CRAR and leverage ratio limitations.

GOVERNANCE

Governance standards are considered weak in North-east MFIs. According to NEDFi, except in RGVN, governance is weak in most of the MFIs in the North-east. Basic understanding of the business of microfinance is lacking is some of the board members who are from social sector back ground. NEDFi takes a board position in the MFIs when their loan exposure is more than Rs 1 crore and try to ensure that governance standards are improved. As part of governance NEDFi also build the capacity of the management and also some of the board members to deal with gaps in governance and oversight.

Most MFIs have to depend on a pool of local Directors since costs of inviting a Director from outside the region are high. For many of the small MFIs these costs are unaffordable. Many of the local directors are socially oriented but do not always have skills to set strategic directions for improving social performance for which they require capacity development. Some of the MFIs prefer board members who are known to the promoters/key management. Most of the MFIs even those in NBFC form have not appointed independent directors. Even independent Directors appointed by some boards are not really independent since they are closely linked to promoters and thus appointed. According to a CEO, the promoter is comfortable when the director is aligned with the interests of the promoter. Different sets of board members also mean balancing different interests at board level, which takes time and also requires conflict resolution skills. In such an environment, within boards, customer interests may not be a priority.

Box 6.2 Few Good Practices in Ensuring Responsible Finance by Boards

In RGVN, Directors on the Board interact with Zonal managers every quarter and visit branches to interact with staff to understand client needs. A special report on SPM is placed in every board meeting, client grievance redressal is reported and all exceptions are reported to board. Out of the profits, 10 per cent is set aside for client development.

Chanura, registered as a society, operating in Manipur has eminent persons from the voluntary sector as board members; only one member is an ex banker. The board has a sub-group on social performance which gives focused attention to these aspects and board members once or twice in a year randomly visit the field to interact with clients. In order to reward the board members, a sitting fee is also paid which is not a usual practice among NGO-MFIs.

Many local MFIs in the North-east are rated low on governance aspects by the rating agencies on account of the background of board members which also pulls down their overall rating. However, according to a CEO of MFI, 'In spite of having an illustrious board, credit rating does not improve substantially since rating agencies view North-east as risky and doubt small MFIs' capacity to withstand external shocks. More importantly the staff members of rating agencies neither have deep understanding of microfinance nor do they spend adequate time to understand the MFIs governance and risk management systems'.

Most local MFIs in the North-east have to improve their governance standards and capacities of their boards in guiding the business and especially in responsible financing related aspects.

BOX 6.3 Two-pronged Approach for Board Development

'We need a two-pronged approach—MFIs need to scout for competent directors from within the region and even from outside. We also need to build the capacity of existing boards systematically on microfinance, risk management, social performance management etc; board members should know what information to ask for from the management. Lenders and equity investors should push this initiative'.

Abhijeet Sharma, Professor, Indian Institute of Bank Management, Gauhati.

STAFF DEVELOPMENT AND RETENTION

North-east MFIs depend largely on human resource pool of local area from field officers to senior management staff. Despite margins being squeezed, most of them give emphasis on training and continuous capacity building of staff. RGVN, NERFES being larger players have well developed systems for training of staff. In RGVN for example, credit officers on induction under go a basic training, field accompaniment with senior staff for three months and thereafter a test is conducted. Those clearing the tests are given a long-term job. Smaller players offer one week intensive training followed by field accompaniment for 15 days. MFIs provide training on communication with clients, importance of code of conduct, etc. Refresher training is offered by only larger players; others build the perspective and skills of staff in the monthly meetings. However, client interaction and information sharing with clients are given priority in trainings and in the meetings. Smaller MFIs like Chanura follow fives day a week and use one of the Saturdays for trainings. MFIs find that training costs are high. Multi state MFIs find cost of training of middle management high since the staff have to travel to a central location by air due to poor road connectivity.

With bank branch expansion in the North-east, attrition of staff is increasing. MFIs are losing their well trained staff to private sector commercial banks. The banks have a policy of recruiting local talent for the field and branch counter jobs and the well trained MFI staff find the opportunity and salary structures attractive. Losing middle management staff is hurting MFI business since to groom existing staff to raise to higher levels takes time and for new recruitment often they have to compete with banks. The larger MFIs such as NERFES and RGVN have formal staff exit interviews whereas others have more informal feedback. Often the higher salary is cited as reason for leaving.

MFIs have very little leeway to improve remuneration packages given the thin margins under which they are currently working.

MFIs working both in plains and hilly terrain have different salary packages for staff working in these two regions. Since cost of living is high in the hills, MFIs are offering higher salary packages, transport allowance etc. Staffs usually stay separately from the branch office which enables them to balance work and leisure. RGVN which till now had branch cum residence premises is changing this system.

Staff satisfaction and their needs is assessed in periodical meetings by MFIs. Salary hike and change of place of posting are two most common requests of staff. Arohan carried out a third party survey on staff need assessment and plan to carry this out each year. Two important needs expressed by staff are salary hike and periodical interaction with senior management. While periodic interaction with staff is easily manageable by MFIs, they will have difficulties in increasing salary.

MFIs find that there is limited opportunity for field officers to raise to higher levels of the organization. Field staff are very good at mobilization and collections; while with adequate experience, training and hand holding support from area managers they are able to perform well as branch managers. However, to rise to the level of area manager requires more of staff management and problem solving capacities which these staff are not able to attain. MFIs now realize that they need to hire a separate cadre of more skilled and competent staff who will work as interns in branches and then raise to the level of area managers. However, this will require cooperation from other field staff who also have aspirations of rising to higher levels of management. Field staff are mostly from scheduled tribes who are by nature polite and well behaved. MFIs also train them on dos and don'ts in their behavior with clients. Since incentive based on targets of recovery induce unacceptable behavior and also pressure on clients, very few MFIs have recovery-based incentives. Staff behavior is not an area where clients have complaints.

FINANCIAL PRODUCTS

Loans for income-generation purposes is the major financial product offered by the MFIs. Most MFIs offer weekly/fortnightly recovery periods; very few have monthly repayment of loans. Insurance coverage is achieved largely through credit life insurance. Some MFIs are planning to distribute pension products during the year.

NE-MFIs state that there is hardly any difference between one MFI to another in the IGA loans. With detailed regulations in place, MFIs do not find too much scope for creative product design. All MFIs diligently follow the RBI norms and end up with very similar loan products. Some MFIs offer developmental loans. RGVN provides loans for water, sanitation and education of Children. UNACCO Financial Services offers solar energy equipment loans. Most MFIs offer staff loans. These loans are usually priced the same as IGA loans since the cost of funds and operating costs are high for the MFIs. The usual rate of interest is 26 per cent. Some of the MFIs depending on funds availability also offer micro enterprise loans of more than Rs 50,000 to select clients which are also priced on par with regular microfinance loans. These loans enable clients to graduate to become individual borrower for expansion of enterprise.

According to NEDFi, MFIs have very little scope for product innovation since the funds flow is very limited; Innovation requires flexibility. With limited funding from financial institutions and operational aspects circumscribed by RBI, MFIs have very little flexibility. Though clients are largely from rural areas and undertake agriculture/horticulture as main occupation, none of the MFIs offer specific products for agriculture. MFIs feel that the present guidelines do not allow the flexibility of quarterly/bullet repayment and thus prevent agriculture friendly products.

CEO RGVN points out 'MFIs have high level of repayment since the credit officers visit the clients weekly/fortnightly and the households pay from whatever surplus the family has. If MFIs change the recovery pattern to suit repayment from cash flows of the activity alone, MFIs may not be able to recover loans fully. The experience of the banks in collecting lumpsum repayments once or twice in a year has not been positive. The repayment has to be at regular intervals – weekly/fortnightly or at best monthly'.

MEASURING AND ADDRESSING CLIENT INDEBTEDNESS

The outreach of MFIs is concentrated in a few states and even in these states in the plain areas rather than in the hilly and difficult terrain. In plains there is high concentration and competition among the MFIs. Some of the banks like HDFC bank are also operational in plains. In the hilly terrain, MFIs servicing these small remote villages are often the only source of formal credit for the villagers and hence they do not use credit bureau either for reporting loans provided or raising the credit record of a prospective client.

NE-MFIs report that there are gaps in the credit reference data available from the credit bureaus. RGVN subscribes data to both the credit bureaus and also use the information from both the credit bureaus for credit checks but still finds that adequate and accurate information is not available. Chanura, MFI operational in Manipur mentions that most MFIs operating in the state do not subscribe data to credit bureaus. In the plains, clients are also trying to beat the system by sharing different identity documents to different MFIs; staff members need to be well trained to capture all the information related to the client which will improve the quality of match.

NBFC-MFIs external to North-east but operational in North-east are reportedly not uploading all client data in respect of all loans to the credit bureaus, but selectively for some branches and that too infrequently. A few of the Non-NBFC-MFIs are also sharing data but infrequently since only in the months when they disburse the loans these MFIs are uploading data. Since the data is not updated regularly, smaller NBFC-MFIs find the credit reference data to be of limited utility. They rely only on the credit officers to ascertain the debt levels of the clients and thus avoid the costs of credit reference checks through credit bureaus.

NEDFi a major lender to the MFIs in the North-east, does not insist on credit bureau check of client debts from their partner MFIs. NEDFi states that there is little point in insisting on the local MFIs to use the credit bureau since the bigger players especially Pan-India MFIs operating in North-east are not regular in sharing the data. Smaller players already are saddled with high costs of operations and an ineffective credit bureau check only adds to costs of operations without adding value to the appraisal process.

In the plains of the North-east, where there is intense competition, multiple borrowing is rampant according to the stakeholders (Box 6.4). Three contributory factors to intense competition are mentioned by MFIs:

(a) Some of the Pan-India large MFIs reportedly use the credit bureau data to capture the clients of smaller MFIs. Based on CB information on the loans likely to be closed, they lend large sums of Rs 30,000 to 50,000 eliminating the clients' need to borrow elsewhere. However, clients do not want to snap their relationships with local MFIs and continue to borrow from local MFI as well.

(b) In market places in urban areas as many as seven MFIs operate; many traders borrow from all the MFIs. Even private sector banks are targeting the same clients- they neither subscribe data to credit bureau nor use their data for estimating indebtedness.

(c) Local cooperatives, which are more in the nature of informal Accumulating Savings and Credit Associations (ASCAs), are operational in the market areas and are one of the major sources of credit for the traders. Information on this borrowing is neither available not normally ascertained by MFIs while lending.

BOX 6.4 Multiple Lenders

While on field visit to one of the branches in Guwahati, I visited the clients who were traders in the market. Some of the clients were speculating which MFI I was from and took the name of 3 MFIs; on deeper probing I found that some of them are borrowing from as many as 5 to 7 MFIs marking one day in a week for each MFI meeting and repayment. I asked staff to check on credit bureau information for the branch and found that some MFIs operational in the branch area are not subscribing data to the bureaus. Though technically we were second lender, in actual terms we did not know. I have now asked the branch to scale down lending in the market area and find clients in other pockets.

Source: Rupali Kalita, Managing Director, RGVN.

NE-MFIs while agreeing that credit bureau is one of the means of checking the client debts, mention that the present issues with data sharing (especially by external NBFC-MFIs and banks) need to be sorted out so that the credit referencing is effective and useful. Otherwise credit bureau referencing adds to the costs of the local players, whereas the external players use the data for developing their competitive strategies.

Ultimately, the management of MFIs has to be conscious of the unhealthy competition in different pockets, and take measures to ensure that clients are not exposed to credit risk. They need to rate the branches as per risk of client over indebtedness, and take suitable measures. In most parts of state where single MFI is operational credit bureau check may not be necessary as of now but sharing of the data enables the credit bureaus build data over a longer period which will be useful to the MFI and clients.

ADDRESSING CLIENT GRIEVANCES AND IMPROVING CLIENT SATISFACTION;

North-east MFIs have taken steps to ensure that the industry code of conduct is followed by the staff at the branches. The present emphasis is on ensuring that the clients are provided all the information related to the MFI and its products so that they are fully aware of the terms and conditions. Senior staff members are assigned branch visit responsibilities and during such visits they also interact with clients to measure their awareness levels. Larger MFIs have internal audit teams who look into client awareness aspects and the reports are placed before boards.

Most of the MFIs have installed complaint boxes in the branches; a few also have dedicated telephone lines for the clients to lodge complaints. MFIs find that complaint boxes are not well used (Box 6.5).

Box 6.5 Improving Usage of Complaint Box

Realizing that clients are unable to write detailed complaint, Grameen Sahara developed a checklist consisting of the major and typical complaints. The client marks the aspects she is not satisfied with. The key of the complaint box is with the central office and every fortnight the letters are taken out and the complaints are addressed.

Source: Personal interaction with COO, Grameen Sahara.

Most of the MFIs have not carried out studies on client satisfaction levels and do not have feedback system from clients apart from the periodical visit. Impacts have also not been measured. RGVN periodically carries out impact assessment and client satisfaction studies.

Regulation Aspects

North-east MFIs especially those working in the hilly terrain incur high operational costs. MFIs functioning in Manipur, Mizoram, and Nagaland find it difficult to operate within a margin of 10 per cent. The case load of a credit officer is only 300 clients where as in the plains of Assam the credit officers can cater to 600 clients. Moreover, MFIs report that banks apart from interest fee of 15 per cent levy several charges (processing fee, documentation fee, stock audit, audit of books, etc.), which increase the cost of funds by as much as 3 per cent. MFIs want RBI to compute these costs as well while fixing margins. Margin norm for NE area needs to be revised considering their high cost of operations, and cost of funds lowered to ensure that clients do not pay high rates. MFIs also reported problems with the periodic statements to be filed with RBI. They incur costs on engaging consultants to get the statements right so that they are acceptable to RBI. RBI should provide handholding support to MFIs for filing these returns and statements so that MFIs are able to avoid extra costs in compliance with regulations.

Finding equity is a major problem for most of the NE-MFIs. The India Microfinance Equity Fund (IMEF) has a much larger geography to cover and therefore the NE-MFIs get a very limited share of an already small IMEF. Keeping in view the financial inclusion objectives and quality customer service that MFIs are able to achieve, Government of India needs to set up a dedicated equity fund for the North-eastern region which can be managed by NEDFi.

CONCLUSIONS

The general problems faced by customers in the country are faced in North-east too. Reluctance of banks to open SHG savings accounts, protracted delays in sanctioning loans, denial of follow-up loans after repayment of earlier loans, excessive documentation requirements, poor service quality when customers visit branches and failure to acknowledge complaints are all too common in the North-east too. The additional issues that North-east SHGs face arise from sever short staffing of bank branches, failure of connectivity and technology in the branches, frequent closure of branches on account of law and order situation, lack of local language leading to miscommunication and the distances between habitat and branches compounded by limited public transport services.

The efforts of the banks have not been on lines designed to promote responsible finance; the financial inclusion initiatives seek to put in place points of presence that will satisfy governments and RBI; not the customers with quality services. Banking in the North-east has a long way to go; apart from creating a local presence suitable products and processes have to be introduced and the BC network strengthened with well-trained CSPs in the field. Trust levels in the local populace should increase and then only revenue potential in expanded credit business can be fully tapped by banks. Banks should begin to believe that there is a business case in North-east and that can be realized with responsible business practices.

As for MFIs, the resource constraints limit the ability of MFIs to expand and include a larger number of people. With all the constraints in resources and regulatory restrictions on margins, MFIs had managed to provide about 1.4 million loans by March 2013 in the North-east. In comparison with their large resource base banks managed to provide only 1.12 million loans by March 2012. It is to be noted that MFI loans are all small ticket and given to poor and women clients. In terms of targeting and making a business out of banking with the poor it is clear that MFIs score over banks. A responsible approach to customer and business on the part of banks would be support to MFIs, leaving them to retail business to the small customers in the remote areas. The differences in capacities of local MFIs and national MFIs make the playing field uneven.

Unless the market place becomes even, the local MFIs will find it difficult to reach the remoter parts of the region. The present focus on good roads and well-connected areas might become the sole focus forever, denying services to those in remoter areas. The solutions for some of the remoter parts of these states may lie in encouraging local financial institutions and linking them with formal mainstream financial institutions rather than setting up branches.

On responsible finance aspects most MFIs seem to go beyond the regulatory minimum. Their regular and on-going contact with the customers, provision of awareness to customers, transparency in communication of product features, observance of code of behaviour and door-step services have already made them a preferred institution of customers despite rates of interest being higher than what is charged by banks. Regulatory regime should take the contribution of MFIs in to account and help them realize their full potential.

NOTES

1. Data shared by SLBC convener, SBI, Assam; this data has been gathered for the Committee to formulate a special financial inclusion plan to deepen financial services in North-east. The committee has been appointed by Department of financial services, Ministry of Finance, Government of India in 2013.
2. Minutes of 108th meeting of the State Level Bankers Committee January 2014.
3. CGAP-CAB survey of CSPs 2012, 2013.

7

Insuring the Lives and Livelihoods of Vulnerable

Long Way to Go

India is recognized globally as a first mover in micro-insurance in terms of product development and enabling regulations. Rural and Social Obligations were introduced in 2002 for all commercial insurers, mandate das a defined percentage in premium initially and subsequently amended to a certain number of policies across their insurance portfolio for rural and social sectors. This mandate not only increased outreach but also led to innovations and product design.

India is one of the first countries to introduce specific regulations in micro-insurance. The Insurance Regulatory and Development Authority (IRDA) introduced micro-insurance regulations in 2005 and amended the same in 2013. IRDA has defined micro-insurance products based on the type of cover offered with pre-defined caps and coverage limits. The regulation resulted in the creation of a new distribution entity 'Micro-insurance Agent' which enabled community-based institutions such as SHGs, NGO-MFIs and NGOs to act as agents with fewer hours of training for sales staff and a well-defined commission based incentive structure.

It is important here to distinguish the different types of insurance schemes in the 'micro' space. The target group for micro-insurance is poor and low-income households. Usually households living below USD 1.25 per day (very poor) are excluded from market assessments for insurance since they are too poor to pay insurance and will benefit more from social insurance/social security schemes of the governments. There is often confusion between pure insurance offered by insurers and social security packaged as insurance by government. Depending on parties underwriting the risks and payment of premium, the following typologies emerge:

TABLE 7.1 Distinction between Micro-insurance and Social Security

Micro-insurance	The risk is underwritten by an insurer and the premium is paid by the individuals insured (fully/ substantially).
Social micro-insurance	Government/ quasi-government agency fully or substantially subsidizes the premium to be paid to the risk carrier for commencement of risk cover. Usually operates on the premise of a Public-Private Partnership framework especially for health, crop and cattle insurance. Example Rashtriya Swasthya Bima Yojana (RSBY).
Social security	No insurance mechanism is in place but benefits flow in the form of a payout when a risk event occurs; government bears the costs entirely.

According to the Landscape Study of Micro Insurance in Asia and Oceania, 2013,[1] India leads other Asian countries in terms of insurance outreach. With 111.1 million people covered, India contributes to 65 per cent of the people covered in the continent, the outreach achieved largely through state supported social micro-insurance schemes. The Indian micro-insurance sector also accounts for 66 per cent of all insurance premiums generated across the continent. Central and state governments have supported micro-insurance by providing premium support across sectors such as health, Livestock, Life and agriculture insurance. India registers the highest number of products offered and the highest number of insurers. However, the sector has been able to cover only 9 per cent of the overall population and 15 per cent of the potential micro-insurance market[2] in the country.

TYPES OF MICRO-INSURANCE PRODUCTS

Micro-insurance products in India can be classified into four different types (Mukherjee 2012a):

Insurance Providers

Commercial insurance companies are the leaders both in terms of number of products as well as outreach.

A few community-based co-operative insurance schemes are functional in the country. Examples of schemes using a cooperative insurance model, which also includes risk transfer to the insurance sector, include UPLIFT, DHAN Foundation, SHEPHERD and SEWA. They work on the principle of risk pooling from different client groups. These institutions have partnered, set up

TABLE 7.2 Different Types of Micro-insurance Products in India

Products registered as micro-insurance products	17 insurance companies have registered 36 life micro-insurance products with IRDA (2013). 23 individual and 13 are group policies. For non-life, separate products have not been registered till 2012–13 and, hence, the data is not available. However, during 2012-13 some insurance companies have been given clearance by IRDA to offer micro health and accident policies.
Rural and social products based on the group's income profiles and occupation class.	Individual life insurance products, savings linked insurance products. Group term life and credit life. Individual general insurance products which are marketed through channels who do not qualify to be micro-insurance agents. Postal life insurance products.
Community-based products in partnership with insurance companies	About 40 insurance schemes run by different NGO-MFI and community-based organizations in partnership with insurance companies. The MFIs or NGOs plan the coverage, premium and distribution mechanism in these schemes. Often these policies are offered as combination of three or more group insurance policies of different insurance companies, each covering specific types of risk.
Independent community-based micro-insurance products	Community-based health insurance managed on co-operative/mutual principles.

health service providers (such as hospitals or network hospitals) to offer quality services as advertised by these products. The member owned governance structure can ensure that the member's needs and resultant benefits are adequately aligned. They could solve many of the problems of the partner-agent model, in particular, securing clients' trust, keeping surplus funds within the community, more transparent and incentive compatible claims processing by members and client-centric products. But most importantly, they have lower premium and administration costs since policyholders pay with their time and effort. This seems to be more agreeable to communities.[3]

Distribution Channels

Insurance companies have a variety of distribution channels to work within the country; NGOs, MFIs, community-based institutions and banks. IRDA since 2013has included more entities as micro-insurance distributors. District Cooperative Banks (DCBs),[4] Regional Rural Banks (RRBs),[5] Urban Cooperative Banks, Primary Agricultural Cooperative Societies,[6] other cooperative societies and companies appointed as Banking Correspondents by nationalized banks, can now distribute micro-insurance provided they were not already licensed to solicit insurance business or to work as referral companies (IRDA 2013). Whether this initiative will increase business volume is to be seen. Individual agents appointed as Business Correspondents (BCs) by banks were allowed to work as micro-insurance agents, provided they were not already licensed to solicit insurance business or appointed as specified persons of corporate agents, or employees of insurance brokers. LIC has appointed some of the BCs appointed by banks as micro-insurance agents.

Some insurers report increasing distribution through banks, RRBs and cooperatives and other aggregations like dairies rather than through MFIs and Self-help Promoting Institutions (SHPIs). The expansion of the micro-insurance agent network can take points of sale nearer customer's habitat and can improve customer comfort. Using existing institutions that are familiar with the small clients is likely to result in better coverage on account of increased customer confidence in the agents. However, these distribution channels will have to ensure that customer protection aspects relating to client education, product information sharing, appropriate sales and prompt servicing of claims are adhered to.

CURRENT OUTREACH OF INSURANCE TO POOR AND LOW INCOME HOUSEHOLDS[7]

Insurance Regulatory and Development Authority publishes data of the insurance industry. These data sets include outreach of products registered as micro-insurance products, government-supported social insurance schemes and other products offered to residents in rural areas.

Life Insurance

There has been a steady climb in the outreach of policies in the rural and social sectors over the years; the social sector coverage has increased from 0.8 million lives in 2001–02, to 18.2 million livesin 2012–13. Insurance penetration achieved under the social obligations mandate represents 2 per cent of the country's population between the ages of 18 and 65 years and 13 per cent of all lives covered in new business in the country in 2012–13.

In 2012–13, 11.34 million rural life policies (not lives) were issued. The Aam Aadmi Bima Yojana (AABY) and Janashree Bima Yojana (JBY) both managed by the Life Insurance Corporation of India (LIC) are estimated to account for 80 per cent of rural and social sector outreach in terms of lives covered.[8]

Classifications in Outreach in Life Insurance

Registered Micro-insurance (life) products: About 36 life micro-insurance products had been filed with IRDA by 15 out of the 23 commercial insurers as on 2013. They include LIC's three hybrid term and endowment products and ten other savings products of private insurers while the rest is comprised of term insurance products.

During 2012–13, in all, 19.01 million lives were covered and Rs 3.1 billion was collected as premium, equivalent to 0.3 per cent of all new life premium collected and 16 per cent of all new lives covered[9] by life insurance in the country in 2013. At a rough estimate, life micro-insurance represents 33 per cent of all the rural and social sector lives covered in the country. For LIC micro-insurance constituted 11 per cent of new policies written during 2012–13 (Table 7.1).

Postal life insurance: There are four schemes in Rural Postal Life Insurance (RPLI) administered by Department of Posts, with a minimum sum assured of Rs 10,000 and a maximum of Rs 0.3 million. The small sum assured is indicative that the scheme reaches low income households. In 2011–12, 16.26 million rural postal insurance policies were in force,[10] out of which 2.71 million was new business sourced in that year.

Government life insurance schemes: LIC is the sole administrator of a number of government social security insurance schemes that offer term life cover and other benefits such as disability benefits and children scholarship. The two largest social security insurance schemes are Janashree Bima Yojana (JBY) and its successor, Aam Admi Bima Yojana (AABY). Typically the central government subsidizes 50 per cent of the premium while the remainder is borne by the SNA, NGO, or the beneficiary. A state nodal agency (SNA) such as SERP, Kudumbashree or an NGO, implements the scheme. In 2012–13, a total of 48 million lives[11] were covered in various social security schemes.

Life insurance through NBFC-MFIs: As of March 2014, 28 out of 44 NBFC-MFIs reported to MFIN that 30 million microcredit clients were enrolled in mandatory credit-linked life insurance for a total sum assured of Rs 508 billion through partnerships with insurance companies (MFIN 2014). Many MFIs cover the lives of the borrowers' spouses as well. MFIs have insured 51 per cent more lives during 2013-14 as compared to the previous year. If data from SKS and L&T is also included the coverage would be even higher. Most NBFC-MFIs sell Group Term Life (GTL) policies while only five NBFCs sell Credit-Life.[12]

General Insurance

In 2012–13, in all 20.6 million policies were sold and premium of Rs 116 billion collected in rural areas[13]—it is estimated that 28 per cent of rural premium was for crop insurance, 16 per cent for health insurance, 2 per cent from personal accident (PA) which are applicable to low income households. Out of Rs 32 billion premium collected under social sector, 49 per cent was from health insurance, 6 per cent in PA and the rest in other schemes including commercial lines.

Health: After the introduction of government subsidized schemes, coverage of hospitalization insurance among low income households, has taken rapid strides in the last five years. Since the Yeshasvini Cooperative Farmers Healthcare Scheme in 2003, there have been considerable investments on the part of the government to improve hospitalization access through insurance in public–private partnerships (PPP).[14]

A total of 210 million low income lives[15]are estimated to be covered by various government health schemes representing 17 per cent of the population of the country and 58 per cent of the BPL population. Moreover, 69 per cent of Indians who had health insurance were covered by a subsidized government health scheme.[16]

However, while about 25 per cent of Indians are covered by a health scheme, only 5 per cent by private health scheme.[17] This leaves an estimated 800 million Indians without cover against health risks.

Livestock: The National Livestock Insurance Scheme, administered by State Livestock Development Animal Husbandry Departments, is a subsidized loan-linked scheme. It accounts for 90 per cent of all livestock

Table 7.3 Life: New Micro-insurance Business 2012–13

Insurer	No. of Life Micro-Insurance Products	Premium Collected (in Rs millions)	Total Lives Covered (millions)	Percentage of Micro to Total Premium	Percentage of Micro to Total Lives Covered
Private Total	36	183	1.45	0.1	3.5
LIC	6	2,931	17.56	0.4	21.8
Industry Total	42	31,145	19.01	0.3	15.5

Source: IRDA 2013.

insurance today (Sharma and Shukla 2010). Even after 30 years of governmental efforts, coverage by the Livestock Insurance Scheme has been modest. In 2012–13, only 0.5 million farmers and 0.39 animals were reported to be insured while there are 304 million bovine animals,[18] and 120 million farming households. However, some insurers are displaying interest in this space and loan linked sales (outside Government subsidized schemes) is picking up, largely through individual agents. Last year, IFFCO-Tokio registered 62 per cent growth in the sales of Pashudhan Bima; 40 per cent of TATA-AIG's livestock portfolio and 30 per cent of United India's impressive cattle portfolio of Rs 1.07 billion are from non-government schemes.

Agriculture: The Central and State Agricultural Ministries implement most crop insurance schemes in India through public-private partnership framework with the Agriculture Insurance Company of India (AICI) occupying a leadership position.[19] Currently, there are two schemes under the ambit of the National Crop Insurance Program in existence since November 2013, the Weather-based Crop Insurance Scheme (WBCIS) and the Modified National Agricultural Insurance Scheme (MNAIS) prescribed for farmers availing of crop production loans. The premium is subsidized up to a maximum of 50 per cent depending on the premium rate capping defined by the government which is shared equally by the State and the Central Agricultural Ministries. Crop insurance premium subsidy is also available for non-loanee farmers subscribing on a voluntary basis. Outreach under voluntary subscriptions is low.

Commercial banks were only insuring 10–20 per cent of their notified crop loans, with RRBs (23–73 per cent) and cooperatives (28–50 per cent) faring better but still there exists a considerable gap. The low coverage is because banks are reluctant to mandate the bundling of crop insurance to their borrowers (AFC 2012). Voluntary take up is increasing especially under the weather based index insurance schemes, though gradually. For instance, Cholamandalam MS reports that 20 per cent of their WBCIS sales comes from non-loanee customers, while Weather Risk Management Services has intermediated about 20,000 voluntary policies.

TABLE 7.4 Outreach of Crop Insurance through Government Schemes (in millions)

	2007–08	2008–09	2009–10	2010–11	2011–12
NAIS	18.44	19.20	23.90	17.58	16.74
WBCIS	0.66	0.38	2.36	9.30	11.62
MNAIS				0.36	1.18

Source: Ministry of Agriculture, Govt. of India

In 2011–12, 16.74 million farmers were covered in NAIS, 1.18 million by MNAIS and 11.62 million by WBCIS for a total of 29.54 million. This figure represents 25 per cent of all farmer households and 31 per cent of small and marginal farming households. The total coverage under the three insurance schemes in 2010–11 crop seasons was 221 lakh hectares, which formed about 15.5 per cent of the net sown area.

Personal accident: Personal accident appears to be the most profitable non-life product, based on qualitative self-reported information. Government-subsidized schemes covered 6 per cent of all Indians that had PA cover in 2011–12, representing a 4 per cent share of the total PA premium in the country (among all income classes). The PSUs have launched a highly successful Janata Personal Accident product, with significant outreach.

OBSERVATIONS ON THE OUTREACH

Impressive but Oscillating Outreach

The micro-insurance regulations and mandated coverage under rural and social sector resulted in improved access to insurance across low income populations. The regulations also made it possible for SHGs, Section 25 companies, MFIs, and non-governmental organizations (NGOs) to become micro-insurance agents to serve their members. However, micro-insurance outreach has been modest and oscillating during last nine years. Restrictions on the micro-insurance product definitions, in particular, the caps on sum insured and hence low commissions earned, and restrictions on who could be a micro-insurance agent and the market that could be targeted, are some of the reasons for low outreach.

The data of IRDA shows that while outreach numbers have increased over the years there is drop in coverage in many sectors in the last two years. This is especially seen in life insurance and personal accident. Coverage mostly comes in the form of short term policies, usually a year. Many policies filed with regulator for 3 to 5 year product are actually offered for one year or up to the term of the credit as credit life. The oscillating numbers show that the insurers and distribution channels are unable to offer sustained risk cover for poor and low income households. They are unable to sustain their efforts and increase outreach.

Moreover, the substantial out reach of life and personal accident insurance products may not be attributed to the informed demand for such products. Life insurance products are relatively easy to introduce, price and manage and easy for clients to understand. They are easily distributed since they are linked with other products such as credit and also distributed through channels which have relatively high touch with the clients (MFIs and NGOs). Moreover, the selling point in schemes like AABY, which has a large outreach, is the government subsidy towards premium and the promise for scholarships for school going children. Overall government schemes account for a majority of the policies sold to poor and low income households. Compulsory enrolment of clients in credit life insurance accounts for bulk of life insurance where clients bear the full premium charges.[20] The outreach in terms of voluntary enrolment for products for which clients pay full premium are minimal largely due to issues relating to suitable products, delivery channels, regularity of income of target customers and their low awareness levels.

Though health insurance accounts for large numbers in outreach, it is largely for tertiary care and hospitalization. Central and several state governments have welfare oriented health insurance schemes for hospitalization where premium is heavily subsidized. While government's schemes have large coverage by outsourcing many operations, the schemes face challenges in the future because of a high claims ratio and dependence on political will.

The insurance coverage for crop is inadequate considering the large tracts of land under unirrigated agriculture. In value terms the insured amount was for a total of Rs 4,647 billion for both the *Kharif* and *Rabi* crops. Compared with the estimated GDP from agriculture in 2010-11 the value covered was about 3.9 per cent, which is meagre. The outreach in terms of number of farms requires improvement and the value insured has to increase considerably for this to be a serious risk mitigating mechanism for farmers.

The companies are by and large fulfilling rural and social sector obligations. Though the regulator might have wished that these obligations would drive more innovations, the insurers, in the light of viability concerns, are adopting a target fulfilling approach.

A reliable database on outreach is not available and there is considerable overlap in data. In case of credit-life insurance, the customers borrowing from two MFIs in many locations, end up having two policies. This gives an exaggerated picture of coverage at the macro level. Existing data being reported needs to be redesigned as there are overlaps, some do not have number of lives covered but only the number of group policies or sum insured, life is reported in some cases in policies in force, but in other cases in new policies. So it makes outreach and penetration assessment harder. IRDA needs to take effective measures to make insurance companies to report on outreach transparently. The data made available in the public domain remains incomplete and does not serve to provide a clear picture of the extent of penetration both in terms of people and value assured. Without clarity on outreach, it would be difficult to plan future interventions for insurance inclusion of vulnerable people.

Customer Protection in Micro-insurance

Customer protection gains importance in micro-insurance since the target groups are not used to formal insurance products and their literacy levels are very low. Uninformed semi-literate insurance customers are left vulnerable to wrong choices and are unable to realize the full benefit of their products. Some are led to purchase insurance even though savings may be a better option for some of their risks. They confuse savings with insurance and purchase the policy believing that they will get some amount back if the risk event does not occur. In case of mandatory life insurance bundled with a loan the clients may not even know that they are insured—they may not know what risk is covered, amount of coverage how much they will receive or the process to make a claim. In case of voluntary products, lack of information means that they will be targets for miss selling or be influenced by sales pressure. Disclosures on exclusions unless adequately informed can lead to poor experience and dissatisfaction.

Customers may also be unaware of their duties especially on prompt payment of premium or their rights regarding grievance redressal.

Customer protection in micro-insurance covers four broad aspects: (a) Customer education and transparent information sharing, (b) appropriate products and processes to ensure appropriate selling, (c) claims settlement, and (d) adequate capacities of insurers and distribution networks to provide sustainable services.

(a) Education and Information

While the vulnerable groups are familiar with savings and credit products they are not aware of how insurance works and the benefits of insurance. Customers need education on insurance mechanisms and processes. They also need information on specific products. More importantly they need to know about their rights and obligations, and information on how to use the product effectively (including maintaining and renewing the policy, filing claims, and resolving questions or problems. Agents/Staff of the distribution channels should be appropriately trained to share adequate information to market the products to clients and service policies.

NCAER in 2010–11, at the behest of IRDA carried out a national survey on insurance awareness covering 29 states and union territories covering a sample of 14,560 rural households and 15,640 urban households. The sample included both insured and uninsured families. The key findings on awareness levels are (NCAER 2011).

- Many households do not fully understand the concept of insurance although those insured seem somewhat better in this regard. A high proportion of the households interviewed associate insurance mainly with loss of life, since they do not have much knowledge about other forms of insurance covers that are available in the market. For a number questions on views on various aspects of insurance, a fairly large proportion of uninsured households could not give any answer. For instance, the households are not at all sure about the extent to which an insurance cover can compensate for losses.
- Apart from lack of knowledge about insurance, there are also misconceptions such as the ability of insurance to prevent certain unforeseen events or to prevent damage to assets, and this applies to both insured and uninsured households. In the case of uninsured households the misconceptions are greater.
- Insurance agents are a major source of information on insurance in rural as well as urban areas. In addition, friends and relatives and the media, especially the visual media, a real so important. Agents seem to play an important role not only as a source of information, but also in influencing the households' decision to take an insurance policy. This is the pattern in both rural and urban areas.
- The reasons given by the uninsured households for not taking an insurance policy include 'too expensive' and 'availability of only limited range of products'. Since agents seem to have a great deal of influence on the households, they can educate the public about the range of available products and options to suit different income levels.

The survey points to the acute need for information and knowledge building on insurance. The experience of MFIs also highlights the difficulties in imparting insurance related education/training. All NBFC-MFIs offer credit life insurance and NGO-MFIs offer life and other products as well. As part of the unified code of conduct the MFIs have to educate the clients on product related information and also disclose the pricing/premium and charges. Many MFIs offer financial literacy trainings on insurance as well. However, in spite of their efforts in client education and information sharing, the COCA reports (Srinivasan 2013) point out that client awareness on insurance is a weak area and MFIs have an uphill task in imparting client awareness on insurance.

Present initiatives of RBI and other reputed institutions in financial education and literacy include aspects related to insurance as well. M-CRIL in the desk review of 63 financial literacy imparting institutions found that 54 per cent of them cover insurance (GIZ and IFC 2013). Many institutions covered under the review have followed good practices of developing appropriate material, ensuring that the customers understand the concept of micro-insurance and also provide appropriate guidance where the products can be purchased (Box 7.1).

Box 7.1 Micro-insurance Education/literacy

In order to educate the rural people about risk management and savings in general, Bajaj Alliance Life Insurance company has designed a tool kit (with support from GIZ) which is flexible and attention grabbing. The modules are short enough to fit the time constraints of audience. The programme aims to educate low income households on Insurance and risk mitigation from the better understood subject of savings. The training provides all information about insurance products so that they can take informed decisions. The training does not make any effort at description/marketing of own products of the company but guides the interested participants to the distribution channel/branch. The trainings are conducted by the company's agents in coordination with the MFI/Bank which will be selling the products.

However, CARE's experience shows that such training requires grant funding and the costs of such intensive training cannot be in built in the business model of insurance companies. Box 7.2 discusses financial education initiative taken by CARE.

There is very little literature or studies on effectiveness of micro-insurance literacy trainings and their impact. Financial literacy on micro-insurance like other financial services has to be part of marketing strategy of the insurance company and distribution channel, instead of one-off training event on financial literacy. Funding for the trainings can be raised from grant for which IRDA can play a developmental role like that played by NABARD for promotion of SHG bank linkage programme. Instead of each training institution/technical agency reinventing the wheel, an open source repository can be created with relevant user manuals and guides. This repository can then be used by stakeholders based on their requirements. Some context based adaptations will need to be made. The present efforts in financial literacy have to be more oriented towards outcomes.

Organizations offering micro-insurance should anticipate confusion or misguided assumptions and gather information on what negative experiences and preconceived notions are held by target clients about insurance. Explicitly addressing how their product addresses customer issues and providing clarity on misconceptions upfront can preempt later grievances. Product education as well as claims procedures are aspects that literacy programmes should address more strongly.

(b) Appropriate Products and Processes

Insurance products need to be appropriate and suit the needs of the clients in terms of the risks covered, the level of coverage, premiums, exclusions, and other product characteristics. Products need to be marketed and explained to customers before enrolment. The marketing should be transparent, not misleading, and should provide sufficient and appropriate information. Enrolment procedures should be simple, clear and customers should be provided with full disclosures especially on exclusions. Procedures for maintaining and renewing policies need to be simple and easily accessible to minimize the risk of an unintended cancellation or lapse in coverage.

Product design: At present, there are only marginal differences in product features of the different products meant for the target groups that are on offer in any type of cover. According to MFIs and NGOs the differences in price and commission are the key differentiators from one product to another. Many MFIs and NGOs have

Box 7.2 CARE's Financial Education Initiative

CARE worked with its NGO partners under its Insuring lives and livelihoods programme (ILAL) to design comprehensive programme content that included four phases: (i) Risk Education—clients learned to appreciate the difference between manageable and unmanageable risk; (ii) Insurance Education—clients learned different ways to manage risks proactively and efficiently, (iii) Product Education—field officers introduced ILAL products to clients, highlighting specific product features that were relevant to the risks clients faced; and (iv) Product Logistics—field officers explained payment procedures, insurance product features, and claims processes. Partners delivered insurance education through a variety of channels using multiple tools, including: workshop trainings, mass media outlets, strategically placed and sequentially ordered posters, cultural programs (songs, drama, and puppet shows), and village and block-level mass awareness campaigns. Materials were simple, user-friendly, and picture-based. The first-time purchase of insurance products after the education was very high.

limited bargaining power for product features especially pricing since their outreach is small and they also lack the expertise to negotiate with the insurance companies.

There are issues between the risks faced by the customers and the products on offer. IRDA has defined the product features – type of cover, the minimum and maximum amount of cover, term of cover and age of the policyholder in life, health and accident as a rider etc., for micro-insurance products. The regulator in fact has prescribed the product features. The sum insured limits for a product to qualify to be a micro-insurance product are Rs 30,000 for non-life and Rs 50,000 for life products. The rationale presumably is that only the poor are likely to self-select into purchasing this product. The micro-insurance regulations were designed to make it easier for insurers and intermediaries to service selected groups of low-income households and at the same time offer products at reasonable price. The product definition is found to be restrictive and sum assured inadequate to cover the risks of clients and be viable for providers. Some of the restrictions on product terms should be revisited.

Inadequate Cover: Moreover, this cover is not adequate to cover the risks faced by a poor household. For example, Rs 50,000 as a cover for a life is equivalent to one year's income at around the minimum wages. A family losing the sole bread winner can hardly be expected to manage in such circumstances. Jersey cows costs between Rs 60,000 to Rs 75,000 while a small store owner has inventory of about Rs 200,000; the value of a house under *Indira Avas Yojana* is more than Rs 30,000. With the under-protection clause of the insurance regulations, after subtracting the deductible, the payout would be even lesser than the loss. Hence, the micro-insurance product limits can exclude or under-insure a large number of the poor. Given high inflation rates since 2005, the maximum sum insured of micro-insurance should be increased and be inflation indexed. This will make the product more appropriate for customers apart from improving the business case of insurers and increase commission of agents. Box 7.3 explains appropriate risk cover.

Design issues in different types of insurance:[21] The following design issues may be found in insurance types.

Life: It is deemed that the demand for term cover is low while it is higher for savings products such as LIC's savings linked insurance products. This restricts products on offer and also the savings linked plans may not offer adequate client value. The popular Government schemes can also offer better coverage for the price that is charged.

BOX 7.3 Appropriate Risk Cover

IFMR Trust's KGFS is a unique model whereby the client goes through a detailed appraisal process at the end of which the advisor recommends a suite of products including risk cover that are appropriate for a client. Further, it measures its outreach not in terms of the number of polices sold or premium collected but in terms of the total human capital coverage. This information is monitored by the CEO and hence actively collected and monitored at the field level. This brings in transparency, decreases inadequate coverage of assets and aligns customer's welfare with organizational incentives. However, not many other organizations are implementing similar processes probably due to the intensity of process and manpower costs involved.

The compulsory credit-life products are easier to be over priced while simple products sold automatically to clients typically should be relatively cheap (GIZ and Micro-insurance Network 2013). The recent regulations and code of conduct ensure that MFI clients are informed of the insurance product thus putting at rest some bad practices of overcharging under such compulsory micro-insurance by a few MFIs. The product is designed to protect the lender more than the client. Borrowers have limited say in choice of insurance company. There is little transparency in pricing. Since borrowers are often compelled to purchase the insurance in order to access the loan they do not challenge the product features. This is an inadequate product with potential for unfair pricing practices. The association of the clients with the MFIs is short term with client dropouts very high in some regions. These make design of long term products challenging; also both insurers and aggregators like MFIs to sell annual term policies.

***Agriculture*:** The loan-linked MNAIS and WBCIS help the farmer repay the outstanding loan to the bank, and partially cover the loss of income in case of crop failure. But there are significant issues in establishing crop loss that is on an individual farm or a small area such as an entire village. The risks are quantified in average terms over large geographical areas and thus do not relate to specific risks of farms. Where farmers are prevented from even sowing on account of weather conditions, the losses

BOX 7.4 Price and Extent of Coverage under AABY

The specific challenges in the design of the AABY scheme are related to its price, extent of coverage offered. The extent of life and accident cover required for an individual should be closely tied to the individual's human capital. Analysis reveals that the extent of coverage provided by AABY does not provide adequate cover for even a 50 year old in the lowest income quintile. The current price of the AABY product is much higher than extant term life insurance policies in the Indian market. It is estimated that AABY premiums are more than 160 per cent of the market price. Therefore, the extent of cover provided for the current premium of Rs 200 should be higher than Rs 30,000, and is estimated to be in the range of Rs 50,000 or higher for natural death, keeping accidental death coverage at Rs 75,000.

Source: IFMR 2013.

are covered to the extent of 25 per cent of insured value, which might not sustain the livelihood of household.

Livestock: Similar to crop insurance, government-subsidized mandatory credit-linked schemes are designed to enable the policyholder to repay the bank loan. It is distributed to loanee farmers through the partner-agent model by banks, cooperatives and RRBs. Premiums are decided by insurers at the state level through a bidding process (subject to a cap of 4.5 per cent), the Government subsidizes 50 per cent of it, while the farmer pays the remainder. The product covers up to two animals per farmer for a maximum of three years. Only productive animals (largely cross-bred cows yielding more than 1,500 litres of milk) are eligible, thereby excluding many indigenous animals. The product only covers death of animal, although low yield, disease, extended dry periods, price fluctuations and lack of inputs are other common risks faced by the farmer. As a result of the high incidence of fraud, the insurance companies are forced to adopt cautious measures at the time of policy issuance and claim settlement. There is little or no actuarial data available with public insurers which is also not digitized and hence has limited usability. This leads to an increase in insurance premium and a higher order of difficulties in proving claims making it unattractive for dairy farmers. Insurance of other livestock such as goats, pigs, poultry are fraught with difficulties that practically turn farmers away from the products.

Health: Traditionally health schemes in India have focused on secondary care although some like in Tamil Nadu and Andhra Pradesh include tertiary care. However, poor and low-income households frequently mention primary and outpatient care as the major risk they face against which they incur regular out of pocket expenditure. International Labour Organization ILO, based on a study of health micro-insurance providers in India, has found that constant 'dripping tap' of outpatient expenses for treatment of both acute, often infectious, disease, as well as chronic conditions over time, that drives three times as many families into poverty as do inpatient expenses.[22] The borrowing pattern in SHGs and also MFIs indicate that health expenditure is one of the frequent reasons for which clients borrow at high rate of interest of more than 24 per cent.

However, poor households still find the primary care—outpatient treatment expenditure a burden for which there is little product innovation. Insurance for outpatient care has to be carefully designed keeping in view affordability and tangible benefits. There is an increasing interest in both government schemes and NGOs to add outpatient care. RSBY, DHAN Foundation and UPLIFT already offer outpatient care.

Currently, the RSBY product offers insurance cover of up to Rs 30,000 for secondary treatment. Beneficiaries are however not covered for tertiary care, and this is particularly an issue for lower income households because the cost associated with tertiary care is substantially higher than secondary care. A single event of hospitalization for tertiary care can send a household into a poverty spiral. Some states have taken the lead on this, with Tamil Nadu and Andhra Pradesh offering tertiary insurance cover for households. Moreover, the current tenure of contracts for insurance companies under RSBY is one year. The short tenure of the contract does not provide adequate incentives for insurers to develop preventive hospitalization mechanisms against high-risk diseases, as these strategies will take time to yield outcomes in the form of lower claims from insurers (IFMR 2013).

While privately provisioned health insurance has declined since the onset of state sponsored schemes which are almost free for targeted groups, it has not been completely displaced. Some insurers continue to target a similar client base or offer products that cover risks that State Supported schemes do not. For instance, Vimo SEWA started a hospital cash product as a top-up to RSBY across its members. DHAN Foundation offers an outpatient product to ride on top of Universal Health Insurance Scheme and Tamil Nadu Government's health insurance scheme.

Health insurance dovetailed to the needs of customers often lags behind due to the complex nature of the product, difficulties in managing the partnership and lack of sustainability.

Box 7.5 Are We Really Giving Social Security Options?

Case of Ramamani Nahar, Phulbani (small family of 3)
MFI Loan Amount: Rs 20,000
Credit Linked Insurance: Rs 20,000
Monthly Household Expenses: Rs 5,000
Monthly Income: Rs 8,000
Monthly Savings: Rs 100 (SHG a/c) /Rs 400 through other way
Anticipated Future expense: Rs 50,000 child's education

1st case : Normal life expectancy
She will be forced to take the whole Rs 40,000 in loan
One of the solution: a wealth creating endowment product
2nd case : Death after 3 months of loan disbursement
Family gets only Rs 2,500 as insurance settlement rest Rs 17,500 goes towards loan settlement

Source: Satyajit Das, Chief Finance Officer, Annapurna Microfinance Ltd.

Other observations in product design: The following observations also apply to product design.

Pilots and innovations: There have been a number of product innovations piloted especially in crop and health insurance. Almost every intermediary interviewed had piloted at least two insurance products. However, most of these pilots in products have been discontinued after the early stages due to difficulties in sustaining the business.

- IFFCO-Tokio's pilot in 2008–10 with using RFID ear tags to reduce fraud in livestock, and improving sales and distribution processes. The pilot covered 15,000 cattle. Scale-up is unclear.
- Launch of weather index contracts in 2009.
- Lac insurance for indigenous populations, which has not grown.
- In 2008 by IFFCO-Tokio and ICICI Lombard along with CARE-designed Salt insurance product protected salt farmers from losing their yield to rains. This weather index product had low design basis risk. However the high payouts due to Cycle Laila and the lack of reinsurers lead to the product discontinuation.
- Numerous community-based schemes.

A long-term business case has to be established in the very beginning to ensure pilots can be scaled up.

Composite products have not taken off: This feature is desired by insurers and clients alike. However, except for SBI Life's pilot,[23] no other insurers have taken it up, reasons cited being the mismatch between the long and short tenures of life and general insurance respectively, administrative issues such as more onerous claims processing, duplicate original document to be submitted to both the companies and also lack of understanding between insurers. These challenges compounded by the operational difficulties in integrating front and back-end processes as well as the technology investments needed to implement composite products, do not make a business case for the insurers.

***Efforts needed to lower costs and affordable premium rates*:** Insurance requires dedicated distribution channels and resources. The variable revenue and low client load in the short term makes standalone operations unviable. Process innovations and adoption of technology to reduce paper work is limited in the insurance industry. Data transfer between partners and customer care and services are highly automated with specialized software, call centres and use of mobile phones, etc. But other processes require paper work which is time consuming and also prone to errors.

Actuarial Data: There is lack of information on mortality related actuarial data to help insurers set premiums appropriately for the low-income segment. Reinsurers also demand higher fee because of the uncertainty surrounding mortality incidence rates on account of gaps in procuring a reliable time series of historical data. In some cases even though the data is available the reliability and credibility of this information is in question which fails to achieve the larger objective of making the pricing process fair and transparent .For example, for life insurance which is considered relatively simple to offer, there are no mortality tables in existence for the low income segment with the result the standard mortality tables from LIC are used which are not very accurate and results in a high level of uncertainty loading on the premium.

(c) Marketing and Enrolment

Customization and standardization of processes can reduce prices and better co-ordination between aggregators and insurers can improve the service quality (turnaround time for pay in, issuance of policy, claim servicing, renewal etc.) (Mukherjee 2012b).

There are several concerns and anecdotal evidence about client servicing. While a detailed study is needed to explore the extent of the problems, some examples are listed below:

(1) Forced bundling/Miss-selling: Exaggerating the coverage benefits offered by the product and forcefully bundling an insurance product with another product such as remittance or loan is heard of in the field. Insurers admit that while some amount of miss-selling may occur it is due to insufficient training and does not imply a wilful intent to cheat the customer. Some of the branch staff of banks in Tamil Nadu and Andhra Pradesh had insured the SHG members by deducting the insurance premium from the loan amount; SHG leaders became aware of this only 3 to 6 months after they were enrolled. In a few cases, the premium deducted is reportedly high at Rs 6,000 (neither the insurance policy details are known to SHG members nor are the policy papers available with them). While a few SHGs defaulted on loan repayment protesting against this practice, many other SHGs have repaid full loan amount even without ever becoming aware that their lives were insured.

(2) Micro-insurance has become mandatory: It is mandatory for the MFI clients; they are neither solicited about the real terms and benefits of the product, nor asked about it (Mukherjee 2012b). Many NGOs have limited funding for their programme and overheads since donor funding has been drying up especially in the southern states. Insurance commission is being viewed as a source of income for NGO sustainability. Since banks do not lend to groups without a NGO recommendation, NGOs force SHG members to enrol for insurance by making it compulsory and as a condition for recommending the bank loan.

(3) Low awareness: There are reports that some insurers target areas where there is low awareness of how to file claims as claims ratios in such areas will be low. Clients of government schemes are often not aware of being enrolled in a program. Anecdotes suggest that the JBY scheme for tribals is said to suffer from low utilization rates for this reason. Agencies and NGOs which sell the insurance do not offer adequate information to insured clients and undertake capacity building measures. The insured do not know about key product features of the policy which includes underwriting clauses, exclusions and claim processing. Retail clients of health products of some MFIs have claim rejection rates as high as 45 per cent. This is because the product had exclusions which were simply not explained to/understood by policyholders (Box 7.6).

Box 7.6 Awareness Among Insured Policy Holders

There is a lack of knowledge about the various aspects of insurance even among policy holders. For instance, not all policy holders know that their policies could be cancelled because of non-payment of premium. Though most know when they can claim their policy amounts, and to some extent the procedure involved in claim settlement, they have no idea about the time taken for a claim settlement or the amount they would receive if the policy is surrendered before maturity.

Source: NCAER 2011.

(d) Claims Processing and Settlement

Positive claims experiences only serve to increase the trust in insurance products. While the insurance companies are putting in place systems and procedures to prevent frauds and unauthorized claims, given the target group's literacy levels, the procedures and documentation requirements for filing a claim have to be simpler and flexible. Adequate and timely notification of approval and rejection of claims have to reach the claimants and requests for any additional documents have also to be given in a timely manner. Claims also need to be paid promptly in a time-bound manner.

BOX 7.7 Dependence on Agents

Even after taking a policy, households expect help from the agents. A significant proportion of the policy holders said they would consult the agent if they are not satisfied with the mode of premium payment and would approach the agent in cases of dispute or disagreement with the insurance company. However, dependence on agents comes down with the increase in level of education. Households with no education or with a lower level of education are more dependent on agents. This brings out the need to ensure that the agents are trained thoroughly in all aspects of insurance, so that they in turn can provide the right kind of information to policy holders.

Source: NCAER 2011.

It is the joint responsibility of the distributors' and the insurer to help clients complete the claim documentation. While in the case of credit life products sold through MFIs there is a shared interest in completing the claim procedures, in case of other distribution channels and products the experience can vary. It is difficult for the claimants to procure and submit original documents needed for claims such as police reports (First Information Report, or FIR, and post mortem report) and municipal death certificates. Incorrect claims documents are a common reason for settlement delays or rejections. There have been very few recent studies on the experience of clients in claim settlement. However, anecdotal evidence suggests that clients need support in filing claims and facilitating settlement (Box 7.7).

Life: The claim rates under different products and schemes for the year are given in Table 7.5. The claims incidence rates for AABY (0.19 per cent) and JBY (0.21 per cent) are lower than those in other categories. This is not necessarily because true population mortality rates are lower among this segment. Moreover, the claims incidence rates vary considerably between regions - from 0.64 per cent in Andhra Pradesh to as low as 0.06 per cent in Uttar Pradesh. It is acknowledged that low levels of awareness among the community, a consequence of the quality of the information campaigns and implementation capacities of the nodal agencies in those states partly explain this variation. Customers are not clear on how to make claims and what documentation is required to support the claims. For example the documentation required for death claims due to snake bite (accidental death) is different from that for normal death (natural causes). These nuances are not known to claimants.

Some NBFC-MFI's report issues with quality of claim servicing. Insurers' claim settlement rates and turnaround times deteriorate when claims incidences are high in one policy period or even in one geographical region. Insurers are reported to provide worse claims servicing to small NGOs who have less bargaining power due to small sizes. Some of these issues may be alleviated by the availability and usage of historical data on claims, making transparent the assumptions on costs made to price actuarially fair premiums and making the claims settlement processes transparent.

Recently IRDA has advised insurance companies to pay the claims directly to the bank accounts of the claimants and not route through the distributor like MFIs since there have been some instances of claims being paid by insurers to MFI's not being passed on to clients/nominees or being adjusted against outstanding dues. Many clients/nominees do not have bank accounts, thereby delaying the payout. It has been suggested by sector respondents that the claim amount could be more expeditiously routed through the MFI while technology could be leveraged to ensure the client receives the payout such as by capturing a digital photograph of the payment made to the client and uploading it as part of the claims settlement process.

As per the data reported to the IRDA, 98 per cent of the claims received under micro-insurance have been

Table 7.5 Life Micro-insurance Claims Incidence rates[24]

	Individual policies	Group policies	Individual micro policies	Group micro policies	AABY	JBY
Private Total	1.72%	0.35%	0.47%	0.48%		
LIC	2.05%	0.56%	0.26%	0.99%	0.19%	0.12%
Industry Total	2.00%	0.47%	0.29%	0.96%	0.19%	0.12%

settled within 30 days in both individual and group loans category (IRDA 2013), which is indeed very good performance. However, the settlement time in case of other categories is not available.

Agriculture: Outreach has been largely to loanee farmers. Timely claim settlement continues to be a challenge in MNAIS. In 2012, 26 per cent of all MNAIS claims in the country took between three to six months for settlement, while 35 per cent took six months or more.[25]

Livestock: In livestock, a key challenge to insurers is the high prevalence of frauds whereas the policy holders also face difficulties in meeting the paper work - a health certificate from a recognized vet costs as much as the insurance premium and they face difficulty in obtaining a post-mortem report within 24 hours of the death of the animal for lodging claims.

(e) Grievance Redressal

Clients need to have access to seek redress for denied claims and complaints, through internal and external channels. The insurance companies have a toll free number dedicated for product related enquires as well as grievance redressal. Experience so far shows that these numbers are not known and hence usage is low. The complaints received are largely regarding claims settlement. MFIs have developed client redressal system which is used by the clients regarding insurance products as well. Unlike MFIs, other distributors do not have systems for measuring client retention and also client satisfaction with the products.

(f) Role of MFIs, SHG and their Federations in Micro-insurance

MFIs have client orientation, sound understanding of low income markets and an existing credit relationship, they offer largely life insurance products covering their credit risks and non-life insurance outreach through NBFCs is close to zero today. This is not due to lack of effort. Almost all MFIs have, at some point, piloted health, livestock, crop or other products but almost all of these pilots have been subsequently abandoned. A number of factors have contributed to this lack of success.

(a) *Group-based term life mandatory insurance policy* is the most prevalent risk cover for the credit customers of the members of MFIs. For MFIs, life cover is valuable to protect their loan outstanding in the case of casualty of a borrower and group policies are less expensive to provide group cover compared to individual policies

(b) *Non-life voluntary insurance*: Most NBFC-MFIs work as a master policy holder for one or more of companies for following reasons; (i) they are not eligible to be a micro-insurance agent, (ii) being a corporate agent is too complicated or legally unclear, (iii) they do not want to be tied to one insurer. (Being corporate agents credit officers have to be trained for intensive 100 hours and also in products which they will never handle such as key man insurance and several such other products). However the MFI trains its staff, markets the product, creates consumer awareness and education and conducts the actual administration, in addition to assisting in claims documentation. While as a MPH, they receive reimbursement for some expenses, overall they do not report making surpluses by selling voluntary general insurance and cross-subsidize it with income from loans. This has partly dampened enthusiasm to sell more general insurance products. Livestock, for which many rural clients borrow, and shops and small businesses for which many urban clients borrow, MFIs find difficult to offer insurance since aggregation is difficult due to few purchases each month in each branch, the documentation required is high and transaction cost for the MFI is also high since the insurance has to be done after the asset/working capital has been purchased. Being large in size, NBFCs tend to bargain hard with the insurers on the premium, thereby squeezing their margins. After the regulations on margin caps, NBFCs have had less surplus from credit to invest in client training and education; non-life aspects which require more efforts and resources in client training.

(c) *Servicing*: Insurers' claim rejection rates and turnaround times deteriorate when claims incidences are high in one policy period or even in one geographical region and they tend to raise premium the following year. In the case of one NBFC, claims settlement times increased from two to four weeks when the number of claims increased. When the number of claims in a particular region spike there is increased scrutiny mechanisms employed by the insurance company to understand what has sparked this sudden abnormal increase. However, the information on the increased scrutiny and the expected delays in settlement should be shared transparently with the intermediary.

(d) *A bad claim experience may jeopardize the loan repayment*: This has been experience in health insurance, livestock insurance and weather index based insurance where complicated claims procedures and delayed settlements end up harming the relationship between the borrower and the MFI thereby placing the loan at risk.

(e) *Mismatch of tenures*: Most microfinance loans have tenures from one to two years. For multi-year insurance products, it is difficult for the MFI to do renewals or service claims after the credit relationship is over. Hence these products are not suited for microfinance customers. Further, following the microfinance regulations of 2011, loan tenure varies from 12 to 24 months, while group term life insurance products are designed for a one year period only.

(f) *Continuity of services*: Unlike banks and post offices which have very stable branch network, MFIs have closed down branches in areas with low business, default issues. This agility has contributed to their profitability. Moreover, clients at times do not want a loan and also drop out. Customer servicing can become an issue in such cases if longer term products are offered. Compared to MFIs, banks and post offices are better placed to offer products with individual products with long term tenure and it is assumed that the persistency rates will be higher.

So while MFIs believe insurance is useful to improve repayment rates and a natural synergy is expected, insurers and MFIs have not managed to figure out a viable relationship outside of Group Term Life although a sizeable infrastructure of over 10,000 branches and an identified market of close to 50 million clients and spouses exists. While NBFCs did focus on growth in lending prior to the microfinance regulations of 2011, now they are increasingly looking to deepen their relationship with their clients to go beyond credit and to increase customer satisfaction and loyalty. A recent survey by Ujjivan found high demand for insurance with the top priority being in health, saving and shop protection. Many NBFCs are actively looking to identify new products that are more likely to suit their clients.

BOX 7.8 Voluntary Insurance through Federations of SHGs by PTSLP

PTSLP implemented in Tamil Nadu with funding support from International Fund for Agricultural Development (IFAD) in six coastal districts of Tamil Nadu with the target group of poor and vulnerable households. As one of the risk mitigation measures, the project has been keen to offer affordable insurance cover for the households. Several rounds of discussions were held with the community for identifying the priorities and affordability. Women indicated that the premium should be Rs 1 to Rs 1.50 per day to be affordable for life, health, personal accident, livelihood assets and personal assets in the order of priority. Project carried out comparative assessment of products, branch network and willingness to work on longer term basis and chose LIC for life and United India Insurance for general insurance. After consultations with the community and insurance companies the existing products and processes were adapted to suit community requirements especially for affordability, enrolment and claims processing. Insurance companies in partnership with Panchayat-level federations of SHGs offer five insurance products covering life, personal accident, health of family members, savings linked insurance and hut insurance. PLF acts as third party administrator for health insurance. PLF earns commission for different products.

The products were piloted in 21 PLF for one year and then rolled out in all 104 PLF. All the products are voluntary in nature and the project has aim of providing insurance cover to about 80,000 households (about 50 per cent of the target households). The poor and very poor (project categorizes households into four—very poor, poor, near poor and not poor) who have purchased insurance form more than 75 per cent of the households under each of the product indicating their affordability. Enrolment and renewal is carried out in mission mode for 3 months once in a year. However, the members can enrol in between as well. The products are sold not only to PLF members but also to other residents in the villages which helps in increasing outreach and also viability.

(Continued)

TABLE 7.6 Details of Insurance Products for the year 2013*

Premium	Product coverage features	Commission Percentage to PLF	Number of policies sold	Premium collected Rs	Number of claims**	Claim amount **	
JBY	Rs 100	For natural death Rs 30,000 Accidental death Rs 75,000	NA	20,353	2,035,300	12	36,000
Health	Rs 150	Rs 30,000 for family of 5 members	15%	36,665	5,499,750	151	1,409,847
Personal Accident	Rs 25	Rs 50,000/- for accidental death	15%	35,389	884,725	2	100,000
Asset (hut and others)	Rs 10/- for *pucca* Rs 20/- for hut	Rs 30,000	10%	28,838	415,670	57	356,605
Savings linked insurance	Based on age starts from 18	Rs 10,000 to 50,000 for natural death Rs 20,000 – 1,00,000 for accidental death	5% for single premium 10% for monthly/quarterly/ half yearly/annually	1,582	445,093	-	-

** Claims settled as on March 2013.

The experience of past-3 years shows that:

Funding for creating insurance awareness among the households is key to the success; project invested heavily in training NGO staff as well as community leaders in (a) literacy on insurance, (b) product features, and (c) in processes.

While pilots yield good results due to concentrated efforts in small pockets, scaling up has many challenges for PLF as well as insurance companies in terms of turnaround time for enrolment and claims processing. Since a single branch in each district was dealing with the PLFs, enrolment processes were simplified and also digitized for quick enrolment. All forms were in English, which had to be translated into Tamil, the local language.

Women's education is a key determinant in purchasing behaviour; Kanyakumari district has better off take due to this factor, whereas Thiruvallur lags behind. Renewal rates are high in PLF with positive experience in claims settlement.

After initial euphoria, fatigue sets in PLF leaders and insurance spearheads who have to devote lot of time for the insurance related work without adequate pay. Some of the spearheads especially in PLFs with high claims report spending substantial time and money for pursuing the bills. The commission earned in initial years is often inadequate to pay them adequately. Project has carried out business planning sessions with faculty support of insurance companies; PLF insurance spearheads are clear about business volumes to be achieved to be paid adequately. However, there is a trade-off between affordability and adequate commission.

Claim experience has been good so far—companies have largely settled claims within one month. Under health insurance, cashless claim settlement is not uniformly adopted and there is over charging by some hospitals under cashless arrangement. Some hospitals also tend to admit patients instead of outpatient care. Meeting with doctors helped but some hospitals also needed to be changed. There are few health claims pending for six months and more. This has been largely due to inadequate documentation from clients—education of clients and support from insurance spearheads for claim processing is vital. Insurance companies have carried out a special survey to check on moral hazard and found that this system of involving grass root community has minimal hazard.

Health risks being more frequent in occurrence are more perceptible and appreciated from the members' point of view. Some member dissatisfaction has resulted due to low awareness about exclusions; the exclusions lists are now prominently displayed in SHG and PLF buildings apart from being explained at the time of enrolment.

Women tend to question very deeply and facing community in case of claim rejections or delay in claims has been an issue. However, given the wide spread benefit to members, PLFs mention that they will scale up the efforts.

Project mentions that sustainable micro-insurance provision is a 5-year sustained effort over which the institutional role, products and processes will be stabilized; appropriate grant funding for training and awareness building, meeting out of pocket expenses and minimal honorarium of insurance spearheads till adequate commission is earned are key to success.

SHGs and federations: There is no separate study on SHGs and federations being micro-insurance agents. The experience with BC engagement by banks shows that SHGs and federations are not given much preference by the main stream institutions since their capacity building needs are more than other aggregators. Some federations also have mutual insurance especially for meeting funeral expenses. The premium is usually deducted from loan amounts and coverage is usually Rs 5,000 to 10,000. Government initiatives use this social infrastructure to promote their insurance products; Government of Kerala utilized Kudumbashree programme to advance health micro-insurance. Federations in Andhra Pradesh distribute Government insurance schemes like AABY. However, the time and efforts of the women are voluntary in nature and they are hardly compensated. There are few initiatives like that of Post-tsunami Sustainable Livelihood Project (PTSLP) which has offers voluntary and comprehensive insurance cover for the members of SHGs through the structure of federations.

(g) Balancing Sustainability, Outreach and Customer Interests

Few private insurers or intermediaries report large viable business in micro-insurance as per recent studies. The main reasons cited are high distribution costs, operational difficulties between insurer and intermediaries, and high levels of frauds and claim processing costs. Similarly, almost none of the MFI, NGO and NBFC intermediaries reported breaking even on insurance sales. LIC and general public insurers reported viability, in part because they had made large investments in the rural sector in the earlier years in order to implement government mandates and thus are riding on those investments.

Life: It is difficult to assess profitability in savings and multi-year term products since it is the surplus of current assets over the net present value of the estimated future claim and expense stream. Profitability data is difficult to obtain in rural and social sector portfolios. Anecdotally, some private life insurers reported challenges to viability. One rough indicator of the pressure on profitability is the ratio of claims paid to new premium in group micro-insurance products (which are laden with one year term policies) which is greater than 100 per cent.[26]

There are several reasons for this—the poor profitability of the overall life portfolio in recent years, heightened negotiations by intermediaries (especially in credit-life by MFIs) and low persistency rates. Scale may be another factor. With low premium sizes, insurers expect to be profitable when the number of policies is very high. Distribution and administrative expenses are high due to the high cost structures of insurers. Even in the partner-agent model, insurers mention that they have to make considerable investments into building the capacities of MFIs. Many MFI intermediaries claim that micro-insurance is not profitable. However the risk-proofing of the loan made it still worthwhile to MFIs with the costs being absorbed by profits from their loans business.

General: For the most part, public insurers report finding the rural space financially viable since they have had experience working with rural and low income markets over a long period of time due to the government's mandates and by implementing government schemes, and because they have rural branches. Private general insurers have achieved breakeven or made surplus largely in government health schemes.

According to MILK Brief #26, none of the health micro-insurance models (community based, partner-agent or government schemes) that they studied was profitable except for SHEPHERD.

Moreover, even an NGO like SKDRDP with huge outreach is viable only because it is cross-subsidized by surpluses from micro-lending. The study finds that the key reason for losses was administrative expenses and not claims (Table 7.7). This is partly due to low take up rates of voluntary schemes (ranging from 8 per cent in BASIX to 33 per cent in the case of SEWA) although sustainability does not seem to vary substantially with scale. However, a larger client base leads to lower cost per enrolment. Annapurna, a cooperative model, has reported becoming sustainable.

Distribution, small size of aggregators and small scale of operations, low insurance awareness and low take-up are drivers of high costs.

The newer government subsidized crop insurance schemes, MNAIS and WBCIS appear to be profitable. The claims ratio of WBCIS from 2007 to 2013 was 0.76 and that of MNAIS for the period 2011 to 2013 was 0.79.[29] However the NAIS made high losses with

TABLE 7.7 Loss Ratios in Health

	Loss Ratio without Subsidy[27]			Expense Ratio[28]		
	2008–09	2009–10	2010–11	2008–09	2009–10	2010–11
Yeshasvini	187%	130%	109%	11%	9%	8%
RSBY–ICICI	97%	93%	73%	51%	40%	44%
SHEPHERD	52%	50%	54%	57%	60%	64%
Uplift	44%	58%	38%	83%	82%	67%

Source: MILK Brief #26.

the claim ratio being 3.31 for the period 2000 to 2012. Small landholdings and moral hazard are specific drivers of cost. In livestock, some PSUs reported being profitable (Table 7.8). Frauds and high transaction costs due to the expenses involved in identifying cattle, valuation, monitoring and verification of claims are primary drivers of costs. It is estimated that more than 25 per cent of the claims settled are fraudulent in nature. The lack of sufficient veterinarians for policy issuance as well as for treating animals, inadequacies in complementary services like fodder, artificial insemination and the expenses involved in identifying cattle, valuation, monitoring and verification of claims are other factors.

Personal accident appears to be the most profitable non-life product, based on qualitative self-reported information. Government subsidized schemes covered 6 per cent of all Indians that had PA cover in 2011–12, representing a 4 per cent share of the total PA premium in the country (among all income classes). The PSUs have launched a highly successful Janata Personal Accident product, with significant outreach.

Intermediaries' Commissions

Out of the 28 NBFCs that shared information (through MFIN) for the GIZ study, 26 were Master Policy Holders (MPH); two were corporate agents, while four were both. Most NBFC-MFIs have chosen to be MPHs although they do not receive agent commissions from the insurer, but only reimbursement for expenses. Very few MFIs (such as BASIX) offer any voluntary retail life products, although according to recent sample surveys, MFIs believe that there is considerable demand for individual products. Low rates of client acquisition make the expenses of marketing and servicing clients higher than the commission incomes earned.

TABLE 7.8 PSU Profitability in Livestock Insurance Schemes, 2011 (Rs lakhs)

Insurance Company	No. of Policies	No. of Cattle Insured	Premium Amount Collected	No. of Claims Reported	No. of Claims Settled	Claim Settled Amount	Incurred Claim Ratio (%)
United	3.01	6.01	8,545.92	61,213	75,142	7,002.11	82.8
National	0.16	0.49	4,626.95	19,327	16,243	2,876.51	65.09
New	0.31	0.61	3,562.28	23,182	11,147	1,656.91	46.51
Oriental	0.19	0.63	4,258.87	30,201	25,577	3,511	82.44
Total	3.66	7.74	20,994.02	133,923	128,109	15,046.53	69.21

Source: Annual reports of United India Insurance Company Ltd, National Insurance Company Ltd., New India Assurance Company Ltd. and Oriental Insurance Company Ltd., as cited in GIZ 2012.

CONCLUSIONS

Micro-insurance is a difficult business segment and developing viable products and delivery models for poor and low income households is a challenge. The sector is yet to attain a level of development in which well-designed products are widely available and effectively used by clients. The current environment of micro-insurance market is far from being responsive to customer needs. The state of business practice has to improve before it can be assessed to be responsible. Customer protection and customer comfort have not yet become priorities in the insurance market for vulnerable people. While the insurers are struggling with viability issues, responsible practices in design, marketing and servicing of policies are yet to gain recognition.

Collaboration between institutions that work closely with vulnerable people and insurance companies will bring about better product designs and delivery models. But such collaborative work is seen only in pilots and usually not scaled-up. The quest for short-term results prevents investments in approaches that have a longer gestation, but with greater customer acceptance. Learning from credit market in microfinance, insurance market should invest in stricter codes of conduct and higher standards of responsible business practices. While it is clear that some types of policies will continue to lose money till an appropriate scale is achieved, there is neither a call from the industry for government support (on the lines of subsidization of banks for providing crop loans at 7 per cent to farmers) nor is there any initiative from the Government except in specific schemes.

Supporting facilitative interventions can be useful for successful development of this market. The definition of micro-insurance has to undergo a qualitative change. The size of sum assured is not a satisfactory indicator. The kind of people that are covered should be a basis of definition of micro-insurance and not just the size of the cover. The limits of sum assured should be increased substantially as the risk cover that can be achieved under the existing limits are meagre and will not offer adequate compensation to the insured.

Paucity of schemes and products in different parts of the country especially relating to crops, livestock and life is matter of concern. Very low penetration levels in several states should be studied and remedial measures taken, as is being done in the case of banking services. Outreach data in terms of vulnerable population coverage and adequacy thereof are not reported clearly enough. IRDA should insist on better data and bring out analytical reports on outreach so that financial inclusion in insurance terms can be better assessed. The approach to mutual and alternative forms should be facilitative. IRDA should perhaps take up its development role in more depth and chalk up plans on how to increase penetration among vulnerable people sustainably.

The field practice as seen in several studies requires improvement. Investments in insurance literacy should vastly improve. Literacy should take a risk management approach and explain the role of insurance as a useful tool of risk management. Insurers should invest resources through their channel partners in educating the customers on the nature of insurance products and issues in selection of suitable policies. There is scope for improvement in both selling and claim servicing processes. Clearer articulation of claim processes at the time of underwriting, transparent communication of claim settlement norms, fixing of turnaround times for claim settlement, appointment of nodal officers in each branch office of insurers and the offices of micro-insurance agents, a well-defined grievance-handling mechanism that is available at the local level (within the district) are some of the elements of responsible business practice framework that should be improved for entities active in micro-insurance.

NOTES

1. Munich Re Foundation and GIZ RFPI, 2014, The landscape of Micro Insurance in Asia and Oceania, 2013.
2. 755 million people living between USD 1.5 and USD 4 per day are considered as the market for micro-insurance.
3. GIZ study found that UPLIFT and Annapurna members expressed high levels of satisfaction with the insurance cover.
4. Network of 13,427 branches of which 80 per cent are in rural and semi urban locations.
5. Network of 15,938 branches spread over 618 districts.
6. 95,663 located in villages.
7. The data for this section is drawn from a broader study conducted by Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) and the Insurance Institute of India in 2013 on the trends in micro-insurance sector in India and the impact of regulations on market development (Krishnaswamy and Rath (n.d.). However, observations are that of the author.

8. Best source of data on outreach to low-income customers is from IRDA annual reports on rural and social sector obligations.
9. Assuming that each new policy equals one life.
10. www.indiastat.com from Ministry of Communications and Information Technology and Ministry of Statistics and Program Implementation.
11. Based on data from LIC.
12. In credit-life, the cover diminishes as the loan outstanding becomes smaller over time.
13. In non-commercial lines of business, since these policies include group policies, this figure does not equal the number of individuals reached and hence is not easily interpreted.
14. The prominent examples of such programs are RSBY launched by the Ministry of Labour and Employment (MoLE) and state schemes such as the Tamil Nadu Chief Minister's Comprehensive Health Scheme (TNCMCHS), Rajiv Arogyashri Scheme (Andhra Pradesh), Vajpayee Arogyashree Scheme (Karnataka) and Rajiv Gandhi Jeevandayee Arogya Yojana (Maharashtra).
15. Authors' calculations; Krishnaswamy and Rath (n.d.).
16. IRDA Annual Report 2011–12
17. IRDA Journal, June 2013
18. Source: data.gov.in and Lok Sabha Unstarred Question No. 5538, dated 30.04.2013.
19. The earliest crop insurance scheme was run from 1972 to 1978 on a pilot basis. This was followed by the voluntary Pilot Crop Insurance Scheme (1979–84) which covered 0.6 million farmers. The mandatory Comprehensive Crop Insurance scheme (1985–99) covered 76.2 million farmers before being replaced by the National Agricultural Insurance Scheme (NAIS). NAIS has been discontinued as of November 2013 and has been replaced by the Modified National Agricultural Insurance Scheme (MNAIS).
20. Financed as part of the loan and collected as weekly/fortnightly/monthly equated instalments.
21. The data for this section is drawn from a broader study conducted by Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) and the Insurance Institute of India in 2013 on the trends in micro-insurance in India and the impact of regulations on market development. Krishnaswamy and Rath (n.d.). However, some of the observations are that of the author.
22. http://www.ilo.org/public/english/employment/mifacility/download/mpaper19_services.pdf.
23. Microinsurance compendium II.
24. Individual and micro data are for the year 2012–13 (IRDA), AABY/JBY data is for 2012–13 as on 31.10.2012 (LIC)—as quoted from the GIZ study.
25. IRDA Quarterly Journal 2012
26. GIZ study and Authors' calculations based on IRDA data on micro-insurance 2012–13.
27. Ratio of claim payouts to premium collected.
28. Expense ratio, the ratio of operating expenses to premium collected.
29. Report of the Committee to Review the Implementation of Crop Insurance Schemes in India, Ministry of Agriculture and Cooperation, Government of India May 2014.

8

Policy and Regulation[1]

There were a number of policy-related developments in the microfinance space during the year and some of these are likely to have a long-term influence over the sector. While the Microfinance Bill lapsed on account of the expiry of the term of the previous parliament, there are indications that a new version of the bill might be finalized by the new government. RBI had been proactive in resetting its regulations in a manner designed to help MFIs to overcome their problems and improve the quality of their services. In particular changes to regulations relating provisioning norms for Andhra Pradesh–based MFIs (AP-MFIs), relaxing net worth requirements of AP-MFIs, extending the period of implementation of lower margins for larger MFIs till the year 2014–15 and introduction of alternative interest rate cap by linking it to base rates of banks were announced. The major changes made during the year related to deferment of reduced margin cap for large MFIs to the year 2014–15, introduction of a new supervisory mechanism in the form of Self-regulatory Organization (SRO) (MFIN has been recognized as a SRO), resetting interest and margin caps, and simplification of registration requirements for MFIs. The reckoning among the MFIs and investors is that there is far more stability in the regulatory environment, despite the Microfinance Bill not being taken up for consideration in the last parliament. The Global Microscope of Microfinance Business Environment 2013[2] has ranked India at 28th out of 55 countries in Regulatory Framework and Practices. The overall ranking improved from 22 to 16 mainly on account of 'boosted by improvements in the dispute-resolution systems for microfinance clients' according to the Report.

Recognizing the significant problems of vulnerable people in accessing financial services, RBI had set up the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households[3] headed by Dr Nachiket Mor. The focus of the report is on providing universal access to financial services for the people in the country. One section of the report exclusively deals with customer protection issues. It provides a vision statement on customer protection: 'Each low-income household and small–business would have a legally protected right to be offered only—suitable financial services. While the customer will be required to give—informed consent she will have the right to seek legal redress if she feels that due process to establish Suitability was not followed or that there was gross negligence'.

A concept of supplier of financial services assessing the suitability of products offered to vulnerable clients has thus been brought in to the policy discourse. The committee specifically requires the suppliers to:

1. Fully understand the products that they offer to their customers.
2. Have a clearly laid out process including a customer due–diligence process which is Board–approved and demonstrably ensures that if it is followed it does result in the sale of financial products that are designed to enhance the financial well–being of the customer. This would go beyond standardized literacy and disclosure methods.
3. Have a process of customer audit that regularly reviews the actual adherence to this process by the staff of the financial services provider.
4. Accept legally enforceable liability for non–adherence to the process and for gross negligence in the manner in which it offers products to its customers. There would be no liability for specific customer outcomes per se.[4]

The Committee recommended a legal basis that would make the supplier liable. According to the committee, 'In order for a framework of Suitability to have teeth, there is a need for the imposition of legal liability on the financial services provider, as this will mean that it is in the firms' self–interest to ensure suitable recommendations and product sales to customers'. While RBI is yet to consider the recommendations in depth, these recommendations have the potential of transforming the manner in which financial institutions market their products.

The Committee also recommended the creation of new banking institutions for different segments of population and niche areas of banking. To meet the needs of small customers and the even increasing payments services the committee recommended issue of differentiated licenses for different types of banks. RBI has put out draft guidelines for licensing of small banks and Payment banks. The drafts had been placed in public domain for feedback and currently are under consideration of RBI for finalization. Some of the opinions on small banks tend towards defining the loan size narrowly and also requiring them to have a significant part of portfolio in such loans so that small man's access to finance is improved.

In November 2013, RBI, fulfilling an earlier policy commitment, notified the criteria for recognition of Self-regulatory Organizations in respect of NBFC-MFIs and invited eligible organizations to apply for recognition as SRO. The criteria included critical aspects of responsible finance and customer protection.

It should have a Grievance Redressal Mechanism and a Dispute Resolution Mechanism in place, including a specially appointed Grievance Redressal Nodal Officer.

It should be in a position to exercise surveillance over its members to ensure compliance with the Code of Conduct and regulatory prescriptions of the Bank through an Enforcement Committee

It should also have a developmental function of training and awareness programmes for its members, for the Self Help Groups and conduct research and development for the growth of the MFI sector.

In June 2014, Microfinance Institution Network (MFIN) was recognized as the first SRO in the country. MFIN has been active in setting up the operations of the SRO. MFIN is reportedly investing in the creation of an independent body of advisors to ensure that regulatory actions are not influenced by member interests. The SRO is likely to focus on customer grievances and code of conduct enforcement amongst its members. The SRO can regulate only its members. RBI does not *compel* all NBFC-MFIs to be members of SRO, but *encourages* them to do so. But in reality the lenders and investors are likely to insist on NBFC-MFIs in becoming a member of SRO, which in the current situation is MFIN. The SROs recognized by RBI can supervise NBFCs only. MFIs in other forms will not be covered by the SROs. The efficacy of this form of delegated regulation will be watched not only in India but also in other countries.

One of the positive developments that has provided confidence to MFIs in the sector is the grant of banking license to Bandhan Microfinance. This is seen as an endorsement of microfinance as a business and that it does not carry the stigma of exploitative business model in the eyes of the central bank. There are many MFIs that are hopeful of bagging small bank licenses as and when RBI opens the licensing window. There have been changes in the Companies Act that require a changed approach to governance and corporate social responsibility on the part of large NBFC-MFIs. These are dealt with in greater detail in the chapter on governance.

MICROFINANCE REGULATION

The powers available under Chapter III-B the RBI Act to regulate non-banking companies was made use of to regulate the MFIs in company form. The Department of Non-banking Supervision deals with regulation of NBFCs of different kinds such as Core Investment Companies, Loan Companies, Asset Finance Companies, MFIs, and the Deposit-taking Companies. While the powers to regulate NBFCs were available to RBI right from 1964, the regulation was more prudential in character and did not look in to operational and customer aspects of NBFCs' functioning. The political nuances of financial institutions dealing with numerous small customers eventually compelled RBI to adopt a granular approach to regulation of microfinance activities by establishing a separate category of NBFC-MFIs and issue specific regulatory guidelines. But these regulations do not apply directly to MFIs that are not in company form such as cooperatives, trusts, societies, associations and microfinance projects involving SHGs and JLGs. But these MFIs in other forms are subject to indirect regulation in case they access loans from banks for on-lending. Banks have been asked to ensure that the MFIs availing loan facilities from them comply with most of the regulatory guidelines relating to customer protection and market conduct, if these loans are to be reckoned for priority sector lending. *In substance the regulation of microfinance by RBI is more form based than function based.* In case of banking RBI has a clear function based regulation in force and banks regardless of form—such as cooperatives, companies, and chartered institutions created by an act of Parliament—are subject to RBI regulation.

The new regulatory framework for NBFC-MFIs is based on the recommendations of the Malegam Committee. In the aftermath of the crisis in the microfinance sector brought about by AP legislation, which virtually put a stop to all microfinance activity in the State, the RBI appointed a committee under the chairmanship of V H Malegam, a member of the RBI Board to suggest suitable measures for strengthening the regulatory framework of microfinance. Based on recommendations the RBI created a new class of institutions viz. NBFC-MFI and announced a separate set of regulations governing them. The major aspects covered in regulation of microfinance were (a) conditions for registration, (b) definition of microfinance through a loan size, (c) definition of microfinance clients through an income ceiling norm, (d) definition of qualifying assets through a loan ceiling norm, (e) introduction of restriction on multiple loans, (f) insistence on adoption of fair practices as also code of good conduct in the field, (g) stipulations as to purposes for which loans can be given and (h) restriction on lending by MFIs to purposes other than microfinance. The guidelines were comprehensive in their scope and range and included ceilings on rate of interest that can be charged and also the financial margins that can be earned by the MFIs. *Customer protection became the core of the regulatory stance*. RBI also differentiated between MFIs that are large (with an asset base of Rs 100 crore or more) and small MFIs and had a differentiated set of norms on certain aspects.

In substance the RBI regulations that seek to secure customer protection and responsible finance practices are as follows:

- NBFC-MFIs are required to lend mostly to vulnerable customers identified through income criteria.
- The loans should be given for income generating purposes to the extent of 70 per cent of their loan portfolio.
- The loan period should be long enough for the customers to be able to repay with their cash flows—specifically loans of more than Rs 15,000 should carry a two year repayment period.
- The rate of interest should be reasonable and should relate to their finance costs and reasonable operational costs.
- Apart from an interest rate cap linked to base rates of major banks, the MFIs should also work within a margin cap of 10 to 12 per cent.
- MFIs should not collect any collateral against the loans.
- The lending and recovery processes should be fair and friendly to the customer.
- Transparent disclosure of interest rates and loan terms to customer is a requirement.

While there had been positive impact of the regulations on responsible finance practices, there are certain issues with some aspects of the regulatory guidance that need to be examined in greater detail.

INCOME LIMITS FOR CUSTOMER SELECTION

As regards client selection, the annual income limits—up to Rs 60,000 in rural areas and up to Rs 120,000 in urban areas—reduce the customer population and might push MFIs towards to serving households that might not be able to absorb credit. The income levels in many local contexts are seen to be very low and it would be difficult to acquire many customers within this income range. An income level of Rs 60,000 per household in rural areas may not even be sufficient to fulfil basic needs of the family as it is very close to the poverty line income of the country. The country poverty-line income per household of five persons in rural areas was Rs 49,000 in 2011–12.[5] But this was different in different states. The range was between Rs 42,000 in Odisha and Rs 78,000 in Puducherry. Clearly the customer segment in Puducherry as defined by RBI will be well below poverty line and might not be able to handle credit. There were seven states in which the poverty line household income in rural areas was above Rs 60,000 in 2011–12. If inflation[6] is interpolated into the poverty line, then the average at the country-level poverty line income increases to Rs 61,000. This renders all possible clientele of MFIs to be below the poverty line. While targeting of microfinance at vulnerable sections of population is appropriate, asking the MFIs to serve the poorest of the poor is not a feasible strategy. Those households hovering near the poverty line are best equipped to utilize credit well and improve their livelihood activities. Households that are well below the poverty line are ideally supported by a combination of welfare and social benefit programmes and once such households improve their skill and asset base they would be in a position to utilize credit. RBI income norms should provide flexibility to MFIs to choose from near the poverty line, which could be up to 25 per cent above the line as it is set every year. Hard wiring of the income limit in absolute terms will make customer selection extremely difficult. The current income limits were set in 2011 and in the years that followed inflation at consumer level has exceeded 20 per cent, rendering the limits unrealistic. The income limits should be set as a proportion of a dynamic parameter such as poverty line income reset each year based on movement of CPI or the minimum wages for agricultural workers and urban manual workers, etc. This will ensure that limits do not become dated at any point of time.

A connected issue is that progress of customers over time through successive rounds of credit and resultant enterprise expansion. A customer acquired within the current limits of income might add to her income over time and exceed the limits laid down in a couple of years. When this happens whether the MFI should be asked to stop lending to such a customer? Just because the customer reaches a certain level laid down by regulation, one cannot expect that a bank or other financial institution will start financing such a customer. *Stoppage of credit on account of changes in customer income is a sure way of bringing the customer household back in to poverty.* The regulations should allow MFIs to retain acquired customers, despite their improving incomes beyond the regulatory limit, subject to the overall loan limits laid down for microfinance. This will ensure that customers do not face a disruption of their livelihoods on account of denial of credit, the MFIs are able to recover the costs of developing new customers over time with reasonable pricing and sustainability of both customer and MFI is not compromised.

The third issue with the income criteria is that of measurement. In the rural areas there is little awareness of what constitutes an income and how it is different from sales revenue. Most often people report the sales revenue from their enterprise or trading activities as income without reckoning the cost of materials that went into the sale value. Secondly it is difficult to ascertain the incomes that arise from different sources especially for vulnerable people who have multiple occupations at the same time and in different seasons of the year. Any income assessment will have to rely extensively on recall and hope that the recall by the customer is accurate. The RBI has instructed that a declaration by the customer may be taken as one of the ways of assessing the income levels. This however, is a highly unsatisfactory arrangement where the field officers would be hard put to provide any kind of certification of the accuracy or otherwise of what is declared. The income levels stipulation runs contrary to the appraisal requirement of an MFI. While strong income flows help MFIs provide loans through appropriate credit decisions, the income norms require that customers suppress their income level in order to make the customer comply with the definitions of microfinance.

EXCESSIVE DEBT AND MULTIPLE LOANS

The limit on total loans to MFI clients is set at Rs 50,000. The limit, while appearing reasonable to most MFIs, should be flexible and linked to a dynamic parameter. In a couple of years the increasing size of enterprises at the base level and inflation led reduction of purchasing power will make the current loan limit out of date. RBI could link the loan size to the inflation rate and automatically allow MFIs to reset the limit by the extent of movement in Consumer Price Index (CPI) from year to year.

RBI has also advised MFIs that no more than two MFIs can give loans to the same customer. MFIs have a responsibility to ensure that their loan at worst is only the second loan. This has to be ensured not only through enquiring from the customers but also through reference to credit bureaus. The overall amount that a customer can take from all MFIs put together is set at Rs 50,000. RBI has sought to tackle two different issues: (1) avoiding excessive debt (by setting Rs 50,000 as the limit of affordable debt); and (2) avoiding multiple loans which produce pressure on the customers on account of having to service multiple instalments from time to time. RBI has also stipulated that in case MFIs breach this stipulation and become a third lender, their loan should not be recovered during the currency of the earlier two loans. There is no evidence of MFIs monitoring this in the field or stopping recovery of their loans till the earlier loans are repaid.[7]

MFIs, apart from taking information on existing debts in the applications and appraisal formats from the customers, also make reference to the credit bureaus to get to know of the customer's level of debt and number of loans. The credit bureaus are supplied with credit sanction information and repayment information by the MFIs on a periodic basis. Based on this information the credit bureaus analyse whether the referred customers already have loans taken from other MFIs and if so, the details thereof. The credit referencing through the credit bureaus has brought in a lot of discipline in the market and has made the customers aware that they should not apply to a third MFI for a loan. However, there are locations in which people persist with applying for loans to many MFIs as a time. In some locations almost 20 per cent of the applications received have to be rejected on account of pre-existing loans to two other MFIs.

In the case of credit referencing there are several issues that can potentially create risky conditions. Presently the data upload in a number of MFIs is done on a monthly basis relating to their sanctions and also defaults of their customers. There is a blind period of up to one month in such cases during which other MFIs could provide loans in the absence of any information to indicate that a second loan has already been given but the data upload is still pending. Similarly some MFIs after having received a credit report take 7 to 15 days to sanction and disburse the new loan. This provides another window during which a third or fourth loan could be availed by the borrowers. Proposals under consideration for sanction are not part of the credit bureau records. So the MFIs, the credit bureau have to work together to ensure that the data uploads to the credit bureau take place more frequently and the time lag between receiving a credit report and disbursement of the loan is reduced to the barest minimum.

A more worrisome fact is that some MFIs do not upload loan data in some locations to credit bureaus. Some others do not make a reference to the credit bureau from some of their branches on the ground that there is no competition in the area covered by the branches. This is seen by MFIs as a cost cutting measure. Both these practices erode the confidence in the measures taken by the sector to deal with excessive debt. The regulator has perhaps not been closely examining the status of submission of credit records by MFIs to credit bureaus. If such an examination is made at the country level by asking MFIs for state-wise number of loans disbursed each month and the credit bureau for the state-wise number of credit records uploaded by the MFI, selective non-compliance by MFIs can be easily curbed. Further to avoid multiple loans arising from the time lag in data submission, there is a need to shift to weekly data uploads and eventually to daily data uploading. MFIs should also be required to use a credit report that is less than five days old while making disbursements.

RBI also required MFIs to ensure that the customers are not members of more than one JLG or SHG. Neither MFIs nor the regulator take this seriously. While through credit bureaus it might be possible to establish whether customers borrow from more than one MFI (and whether they members of a JLG or SHG for that purpose), it is difficult if not impossible to ascertain the number of groups with which a member is enrolled. The practical difficulties have made all parties overlook this requirement and focus on the number MFI loans as a more convenient proxy.

The regulatory initiative on avoiding multiple debts is not comprehensive. The measure of excessive debt is taken as number of loans from MFIs (not more than 2) and amount of loans from MFIs (not more than Rs 50,000). Households can and do have loans from other sources and far in excess of Rs 50,000. Sample surveys carried out by Centre for Microfinance (CMF)[8] estimated that about 77 per cent households in Tamil Nadu and 55 per cent households in Punjab had sourced out loans from multiple formal and informal sources. If customer is the focus on the regulatory initiative, the means of measurement of excessive debt should be very different. With even formal sector debt not fully accounted for in the credit bureau records, whether limited exercises of the type mandated by regulation will serve any real purpose? At best the current regulatory guidance will avoid unhealthy competition among MFIs. The regulator can attempt to limit non-collateralized credit availed by vulnerable customers from formal institutions including banks. In such a case all loans, given to defined vulnerable customers either individually or through groups of any description, should be part of credit bureau records. If banks are persuaded to submit all loans provided to SHGs, JLGs and individual customers to the credit bureaus, it might be possible to estimate the level of formal financial sector debt in the hands of individual customers; decisions of affordable-level debt and enforcement of lending and borrowing disciplines can then have some meaningful impact.

INTEREST AND MARGIN CAPS

In imposing interest rate and margin caps RBI has moved away from its stand of not imposing specific interest rate controls in the financial sector.[9] The interest and margin caps are more a response to the political challenge to RBIs jurisdiction. In case of banks till the mid-1990s interest controls over both deposit and credit existed and that too in great detail. With the financial sector reforms, RBI gave up muscular regulation and shifted to prudential and risk based regulation, leaving operational freedom to banks, which were supposed to be businesses. The AP regulation set up a challenge, virtually accusing the regulator of being a party to extortionate pricing by MFIs. A valid point of view at that time was that without price control it might be difficult to convince governments that RBI can be effective in regulating MFIs. Subsequently RBI has tweaked the interest and margin caps keeping the ground realities of finance costs and operating costs of MFIs. RBI allowed MFIs to exceed the 26 per cent cap on certain conditions, in case of high finance costs. RBI's circular of August 2012 (RBI 2012) rightly states that 'in a low cost environment, the ultimate borrower will benefit, while in a rising interest rate environment the lending NBFC-MFIs will have sufficient leeway to operate on viable lines'. Most MFIs in the sector have welcomed the caps as they provide certainty as also legitimacy to their pricing strategies. The margin cap in particular has a positive impact, driving MFIs to improve efficiency and productivity levels so that they can manage their profitability with the margin. Many leading MFIs have dropped interest rates by about 1 to 2 per cent from the first quarter of 2014, so that they are able to comply with the lower margin cap of 10 per cent. But the margin cap can also be seen as a license to price loans to the extent of regulatory limits. There are MFIs that have much lower operating costs and risk costs. They can operate profitably at margins of even 8 per cent. Given that demand for MFI loans is unlimited, even in competitive markets MFIs have pricing power. The interest rates may not seek lower levels on account of competition, but remain guided by the regulatory limits. The regulator has to figure out how to foster competition in the market with measures that will influence MFIs to optimize costs and offer better prices to customers.

Many commentators have pointed out in the past that margin caps restrict expansion in to new and remoter geographies as the extra costs cannot be absorbed by the MFIs. The markets in the margin, which require credit services more than the already covered areas, will have to wait that much longer till the MFIs feel able to manage the higher costs of new locations. There will also be some regions which will not be covered if the margins are inadequate to do business. MFIs have tended to adjust to the margin caps by raising the loan size. Over the last two years most MFIs have increased the loan size significantly and particularly so in the second and subsequent cycles. MFIN data reports that the average loan disbursed per account increased (by about 21 per cent) from Rs 11,872 in 2011–12 to Rs 14,340 in 2013–14. With staff costs remaining the same, the higher loan size leads to a fall in operating cost ratio, enabling the MFIs to cope with reduced margins. But there should be limits to such loan-size-led reduction in costs, as other risks will crop up with larger loans. MFIs should be on guard against the risk of excessive debt being pushed to customers.

RBI has asked MFIs to have only one processing charge not exceeding 1 per cent apart from the interest rate. Actual insurance premium can also be charged to the client. The interest rates have to be expressed as Annual Percentage Rates (APR) so as to provide a clear idea to customers and a basis of comparison between different MFIs loans. Regulation relating to pricing of MFI loans has demystified pricing, ensured transparency, reduced the load on customers and ensured that competition is real, based on comparable prices. Margin caps also ensure that customers of MFIs benefit from any fall in finance costs of MFIs.

RESPONSIBLE FINANCE

The emphasis of regulatory guidance on fair practices and observance of code of conduct are well laid and should continue. The key aspects stressed are that: (a) the MFIs should be transparent in communicating their loans terms and interest rates to customers; (b) customers choice on preferred instalment frequency (weekly, fortnightly, or monthly) should be respected; (c) field conduct of staff towards customers should be appropriate; (d) a well-defined grievance handling and complaint redress process should be put in place; and (e) the MFIs should comply with the industry code of conduct as well as RBI fair practices code. The MFI regulations issued by RBI are a significant departure in the level of detail relating to responsible and market conduct of financial institutions. Normally RBI focuses on the desired outcomes of business and leaves operational aspects and market conduct to the institutions concerned. In case of MFIs the regulatory premise has shifted from avoidance of systemic risks (such risks are a remote possibility as the volume of credit handled is less than 0.5 per cent of bank credit) to protection of vulnerable customers 'interests as there are political economy consequences of doing business with the poor. The field-level implementation on the responsible finance practices has been enthusiastic. SIDBI introduced the Code of Conduct Assessments (COCA) as a means of testing compliance of MFIs with market conduct guidelines. The COCAs indicate that by and large institutions have introduced several desirable measures that will improve customer comfort in dealing with MFIs. COCAs have the potential to be supervision tools. The results from the assessments are not yet fully used to drive desirable changes in the MFIs. While knowing scores on the COCA tool makes the position of MFI clear, the lenders and regulator can pursue improvements with MFIs concerned.

RBI has been firm in calling upon MFIs to eschew coercive recovery practices. RBI has specifically stipulated transparency in communicating loan terms to the customers and has indicated the minimum information relating to loan size, instalments, interest rates and other charges, annualized percentage rates of interest, contact information to lodge complaints, and acknowledging receipt of repayments in the loan cards/passbooks issued to borrowers, which should be in the local language. The further directions of RBI were to restrict collection of any kind of security deposits, collateral for loans and imposition of penalties for late repayment.

SELF-REGULATORY ORGANIZATIONS

As stated earlier, RBI had indicated that it will recognize industry networks as SROs and entrust supervision over the code of conduct compliance and some other matters to them. All MFIs should become members of such a network in order to remain registered as a RBI regulated MFI. The concept of SRO is now revisited after more than a decade. The task force on regulatory and supportive framework for microfinance headed by Mr Y.C. Nanda, then chairman of NABARD recommended creation of a SRO in 1999. The committee recommended that the major functions of SROs would be: (a) overseeing functioning of MFIs as base-level regulators, (b) undertaking registration, (c) evolving a proper systems for maintenance of accounts and reporting, (d) setting performance standards, (e) conducting inspections, (f) undertaking training, and (g) representing MFIs in various forums.

The willingness of member-based and member-supported networks to regulate and discipline is yet to be proved in any sector. In a group of peers it will be difficult to bring a member for disciplining and actually impose sanctions of any kind. MFIN has an enforcement committee dealing with complaints from members against each other; and Sa-Dhan has a Committee on Ethics dealing with grievances from customers of MFIs. The MFIN website carries a well-defined complaint procedure. There is not enough information in public domain in either network of complaints received, handled and action taken against the member MFIs. MFIN annual report 2013 states that 'In FY 2012–13, the Enforcement Committee (EC) handled more than six hundred complaints, most of them related to cases of multiple lending to single client based on Credit Bureau reports. The issues were dealt with as per procedure and brought to satisfactory closures. This we believe has had a salutary impact…' Public disclosure of the name of the organization, nature of the complaint and the action taken by the committee will build confidence in not only the measures being taken but also in self-regulation.

RBI may have to introduce external members in SRO committees to drive the agenda of supervision forward. Both the networks already have external members in their disciplinary committees. RBI should ensure that the committees are able to set the agenda, set up a mechanism that can receive complaints from anywhere (including whistle-blowers) and have a link with Department of Non-banking Supervision (DNBS) of RBI to inform either specifically or periodically of developments taking place in its work. RBI should also ensure that information is placed in the public domain of issues dealt with by the SRO with details of nature of complaints, institutions involved and the action taken. Investments in developing suitable human resources for self-regulation will be needed. The restriction on member contribution for the SRO might make it difficult for investing in the systems and infrastructure required for meaningful oversight. Hopefully, RBI/GoI will provide funding for such purposes to the SRO.

Through a combination of direct and indirect regulation, RBI has effectively covered nearly all the MFIs—companies and non-company entities. One should recognize that the RBI regulations are far more comprehensive and cover a wide territory. The regulations introduced were not only sound on the technical aspects but were appropriate politically too. The shift in emphasis from systemic soundness to customer protection is significant and has far reaching implications. What has been remarkable is the continuing engagement of RBI with sector and tweaking of the regulations from time to time to ensure that the regulations do not become an impediment to orderly growth of the sector. RBI has effectively managed to communicate its positive outlook of the sector to all stakeholders, its concerns at the negative aspects of MFIs' working to the industry players and crafted a set of regulations that balance the requirements of responsible finance with needs of business growth and viability. The infirmities and weaknesses in some of the regulatory guidelines are remediable. The customer interests at the core of the regulatory stance should continue well in to the future.

NOTES

1. With substantial inputs from N. Srinivasan, Sector expert.
2. Brought out by the Economist Intelligence Unit 2013.
3. The committee was set up in 2013, with 12 members mostly from the Financial Sector and with Dr Nachiket Mor, member of RBI Central Board. Some of the recommendations have already been acted upon while others are under consideration of RBI.
4. Quoted verbatim from RBI notification dated 26 November 2013.
5. Based on data released with the press note on poverty estimates 2011–12 issued by Planning Commission in July 2013.
6. The year on year (YOY) increase in CPI inflation was 11.17 per cent in 2012 and 9.13 per cent in 2013.
7. Some MFIs that tested the customers for multiple loans three to six months after disbursement of their loans have found that 5 per cent to 8 per cent of the sample customers have three loans or more.
8. The surveys were was carried out by CMF, IFMR, Chennai in 2013, commissioned by GIZ.
9 Unlike in the case of banks where RBI has explicit powers of selective credit control under section 21 of Banking Regulation Act, in case of NBFCs, chapter III-B of RBI Act does not provide specific powers for direction on interest rates. The powers mentioned in section 45L(1)(b) are 'give to such institutions either generally or to any such institution in particular, directions relating to the conduct of business by them or by it as financial institutions or institution'. The provision is vague and general enough to cover any aspect of NBFC functioning. Interestingly in 45L(2) the powers to call for information mentions interest rates in particular.

9

Reading the Tea Leaves

Will the Customers Occupy the Centre Stage?

The Microfinance Sector has been enjoying good growth rates in the last two years. While MFIs increased both outreach to clients and portfolio size, SHGs reported increased loans but a reduced outreach to credit customers. MFIN reported vigorous growth in both client outreach and also loan portfolios. The growth rates recorded were 20 per cent in terms of number of clients and 48 per cent in terms of loans disbursed. The MFIs that were not under CDR disbursed 56 per cent more than they had done in the previous year. Loan portfolio outstanding increased by 35 per cent. MFIs operate in 30 states with a wider distribution of portfolio across regions. Self-Help Group data has shown a reduced number of groups (–2.5 per cent) with loans from the banking system while reporting an increase in the amount of loans outstanding (9 per cent). In about 25 per cent of states and UTs there has been an increase in the number of groups that were disbursed loans. While number of groups borrowing during 2013–14 increased by about 1.47 lakh, the increase came almost entirely from three states—Andhra Pradesh (AP), West Bengal, and Karnataka.

The high growth rate in the case of microfinance institutions is a clear endorsement by investors and lenders of the strength of the sector and also of the credibility of the customers at the ground level. The favourable regulatory environment coupled with a benign policy outlook towards microfinance institutions sector have facilitated this turn around in the fortunes of microfinance institutions within a short period of three years. However, one has to ponder the larger question of whether the current high growth rate is healthy and is a sustained high growth rate desirable? The current year growth rate seems to be very high at least in the case of some large and medium MFIs. 14 out of 44 MFIs more than doubled their portfolio within a year. Such high growth rates in the past have been accompanied by lack of attention to detail and weakening customer relationships leading eventually to problems of some kind or the other. Just because there is a favourable policy environment and support from investors and funders, MFIs should not rush into very high growth rates stretching the internal systems and controls and exposing the business to higher levels of risk. The initial evidences of certain problems of the past such as excessive debt and agents becoming active have shown up in a few locations. There are also issues of low portfolio quality in some local geographical areas where the expansion had been fast and recent. These issues should gain attention of both the boards and senior management of MFIs so that the small emerging problems do not flare up in to large systemic issues. MFINs' SRO initiatives will be watched with alacrity. MFIN has the staff capacity and professionalism to supervise the field conduct of member institutions. Its key test will be in whether ill-advised actions of some of the powerful members will be subjected to discipline. The ability of SRO to be a reliable and independent observer and enforcer of rules among peers is likely to be severely tested in some of the competitive markets.

In the case of SHGs, the fatigue in the system seems to have fully set in. The declining number of groups supported show that the SHG methodology is not credible in the eyes of most banks and in most states. The increasing loan amounts have been mainly on account of higher loan sizes per group in AP. AP accounted for 55.4 per cent of loan disbursements to SHGs. The average loan disbursed per group in AP was Rs 2.64 lakh in 2013–14. In the rest of the country the average loan per SHG was about half of AP at Rs 1.33 lakh. AP, according to several other debt measurement studies seems to be heavily indebted at individual and household levels. The massive debt waivers promised in AP and Telengana (the erstwhile AP state) is causing alarm in the banking system as the borrowers in the state are heavily in debt to the banks. The exponentially increasing loan size in a small number of states and the contraction in credit linkage in 75 per cent of the states do not augur well for the future of this community-based movement. Pushing higher volumes of credit through the SHGs might exacerbate the loan burden and attendant problems. The decline in the number of groups that have started saving and also that continue to borrow from the banking system in most of the other states is a major cause for concern. The original promoters, financing banks and the governments seem to have no clear strategy in ensuring quality and sustainable services to SHG members. In some cases the market in which they were operating had been distorted by welfare intentions of the government that were ill directed both in form and in content. Member protection levels in SHGs need to improve. A coordinated campaign to promote responsible finance in and through SHGs is necessary. The approaches taken to promote responsible finance in MFIs hold several valuable lessons that can be adapted to SHGs.

The microfinance institutions must expect to face competition in future, but of a different kind. This time the competition is not just among the peers but also from the banking system that has invested in a larger number of points of presence in the form of BCs throughout the country. The on-going government programme of providing financial service linkage to millions of excluded people (which is, JDY) is likely to increase competition even for credit customers though with a time lag. RBI has declared its intent of permitting new niche institutions to come up for serving vulnerable excluded people. Draft guidelines on small banks and payment banks are already under consideration of RBI and it is expected that shortly some banks would be licensed in this space. These niche banks will offer severe competition to MFIs with their ability to do both liability and asset products for the same segment of clients that MFIs serve today. Whether this competition will result in avoidable wastage of invested resources in existing institutions has to be watched. Some of the existing MFIs are likely to transform themselves into banks, given a favourable regulatory dispensation, offering full-fledged services at the bottom of the pyramid. The regulator needs to take on board the unique opportunity of making already viable institutions into efficient providers of full-scale financial services.

In the financial inclusion landscape, the rapid scaling up of no-frills accounts, appointment of thousands of business correspondents (BCs) and opening of hundreds of new branches should result in improved availability of services and increased quality of a much better range of services than what is currently available. With the bank and agent economics of inclusion being highly suspect, it is very difficult to predict that people would get viable and sustainable access soon. Without the economics being proven, there is a danger that the current campaign will inflict losses on banks and belie the promises made to millions of customers. The sooner the RBI and the government look into the realities of profitability of inclusive banking, the better it would be for the customers and also for the institutions. Inclusion should be a much better thought out and well strategized effort in which banks' viability, institutional sustainability, agent economics and customer comfort should be seamlessly integrated.

Jan-Dhan Yojana (JDY) without adequate preparation in both the back and front offices of banks concerned might result in a few million more inoperative accounts and failing business correspondent agents. *The previous financial inclusion campaigns have added a few million accounts, but very few new customers that were excluded. There are many locations in the country where customers hold four to six financial inclusion bank accounts*. The current state of the sector as it relates to vulnerable and excluded people is that some of them nearer good access roads and branches of financial institutions get preferred access. They are in a position to have multiple sources from which they can avail financial services. Those who are farther away and located in remote areas suffer from a failure of services because it is simply far too expensive to link them with banks or financial institutions. The institutional viability issues whether it is that of MFIs or of SHGs or of the banking system in reaching the unreached has to be sorted out first. Based on a solution for the additional cost of reaching the unreached, new thinking on financial inclusion efforts should be done.

Under the new differentiated banking architecture, new players are likely to explore the potential of small banks and payment banks. There is adequate interest for opening of small banks while it is not so clear in the case of payment banks, which seem to have significant viability issues. These institutions will require a level playing field in order to take root and thrive. One of the biggest threats that these institutions will face is that of the government schemes that seek to subsidize credit. No bank can afford to provide credit at highly subsidized rates even if the government pays a part of the subsidy. The subsidized credit invariably suffers from indiscipline; being linked with a government scheme makes it morally acceptable for the customer to decide not to repay. The moral hazard arising from government's involvement in financial intermediation is something that the vulnerable clients can do without. The subsidized programmes also generate a high demand for credit that may not be really needed by a large majority of customers. The debt levels in some of the states are already high. The subsidized schemes increase the debt levels with negative consequences. A state-wise examination of debt levels especially among the vulnerable populations and rural areas has to be carried out independently to arrive at safe levels of debt to which these states can expand.

The other large issue is that of suitability of products to vulnerable people in particular. The Mor Committee had extensively discussed the need for financial institutions to ensure that customers are provided products that are appropriate and relevant to their needs and circumstances. In microfinance and in banking we still do not have a reckoning of what constitutes 'suitability'; because there is a demand for whatever form of loan that is marketed it has been assumed that these products are suitable. Institutions need to prioritize product and process redesign as core issues in trying to meet the customer needs from a demand perspective.

Responsible finance is not a theme relevant only to customers of microfinance. Customers of banks, cooperative societies, insurance companies and other financial institutions deserve protection. They need their savings to remain safe, their insurance policies to effectively cover the risks as promised and loans to be fair and non-exploitative. It is time to expand the field of operations of responsible finance and prioritize customer interests in all financial institutions. The committee on comprehensive financial services for Small Businesses and low income households said it best: 'There is a need to move to a customer protection regime where the provider is held accountable for the service to the buyer, by ascertaining that the products sold or the advice given is suitable for the buyer considering her needs and current financial situation, i.e. the customer must have a Right to Suitability'.

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Technical Partners

"**Equifax** Inc is headquartered in the USA and operates in 18 countries through North America, Latin America, Europe and Asia. It is a global leader in information management services and has been trusted by customers across geographies for over 114 years, working to deliver innovative solutions with the highest integrity and reliability. In India, Equifax Credit Information Services Private Limited (ECIS), a joint venture between Equifax Inc and seven leading Indian financial institutions, operates a consumer credit information bureau for lending institutions (Banks and NBFCs) and a specialized bureau for microfinance institutions (MFIs).

In December, 2012, Equifax Inc. had acquired 51% stake in NettPositive which is a Bangalore based specialized analytics and business intelligence firm. In Aug'14, Equifax Inc. announced the buyout of the remaining 49% as well. The combination of data and analytics will allow Equifax to leverage the capabilities of both companies – leading-edge data insights and advanced analytic solutions – which will enable us to help address complex business issues."

MicroSave is an international consultancy firm with 17 years of experience in offering market-led solutions to financial institutions and corporations, which focus on financial inclusion and render services to low-income segments of society. With a network of offices in eight countries, *MicroSave* has worked in 40 countries across Asia, Africa, and Latin America. *MicroSave* works with investors, donors, financial institutions, private foundations, corporate businesses, regulators, and governments to enable them to deliver high quality, affordable financial services essential for sustainable and inclusive growth of economies.

MicroSave provides consulting services in four domains: Digital Financial Services for Financial Inclusion, Inclusive Finance and Banking, MSME Finance, and Private Sector Development. The range of services includes strategy development and governance, product and channel innovation, organisational strengthening and risk management, research, training and dissemination. *MicroSave* has a team of over 100 professionals, comprising bankers, microfinance specialists, SME specialists, mobile and digital money specialists, livelihood, and rural development specialists.

MIX promotes responsible financial services for underserved communities through data analytics and market insight. We do this through two decision support platforms, MIX Market and FINclusion Lab. As basic infrastructure for responsible and inclusive markets, these platforms provide a necessary ecosystem to enable and inspire coordinated investment, effective policy, and positive social outcomes for the financially underserved.

Incorporated in 2002, MIX is a non-profit organization headquartered in Washington, DC with regional offices in Africa, Asia, Europe, and Latin America. Our efforts are strengthened through our collaboration with the following global partners: Bill & Melinda Gates Foundation, CGAP, The MasterCard Foundation, IFAD, Michael & Susan Dell Foundation, DFID, and Citi Foundation. MIX leverages an ideal solution model to ensure the sustainability and public good of our platforms.

MIX Market (www.mixmarket.org) is a public data hub where microfinance institutions (MFIs) and supporting organizations share institutional data to create transparency and market insight. This exchange enables users to establish reporting standards, reduce reporting burden, and promote responsible investment. MIX Market provides analysis on the risks and opportunities in the markets where MFIs operate and validation of social and financial performance.

FINclusion Lab (www.finclusionlab.org), is an analysis and data visualization workshop designed to inspire the coordinated delivery of responsible financial services to underserved communities. Currently in beta development, FINclusion Lab is MIX's latest product offering. FINclusion Lab tools enable users to analyze the access, quality, and usage of financial services for excluded communities at national and sub-national levels. Transforming financial inclusion data into insight, FINclusion Lab allows policy makers and financial service providers to optimize their strategies and measure progress toward national goals.

The Social Performance Task Force (SPTF) is a non-profit organization based in the United States that promotes social performance in the microfinance sector and participates in projects and initiatives around the globe. A small secretariat runs the day-to-day operations of SPTF, while an elected board of directors with representatives from all major stakeholder groups in the microfinance sector provides strategic leadership and oversight. SPTF's mission is to engage with microfinance stakeholders to identify or develop, disseminate, and promote standards and good practices for social performance management (SPM) and reporting. Between 2010 and 2012, SPTF managed a collaborative, industry-wide effort to develop the Universal Standards for Social Performance Management ("the Universal Standards"). SPTF launched the Universal Standards at its annual meeting in June of 2012 and, since then, has focused much of its work on promoting and supporting implementation of the Universal Standards. SPTF's vision is that SPM becomes standard business practice and is considered fundamental to achieving client-centered microfinance. SPTF membership is free and open to all, and it enables those who sign up to be informed of and participate in all of SPTF's various activities, which include trainings, development of resources, sharing of experiences, and facilitation of working groups to advance practice in specific areas of SPM selected by SPTF members. Today, SPTF has more than 2,400 members, with representation from every region of the world and a wide diversity of microfinance stakeholder groups: financial service providers, donors (multilateral, bilateral, and private), investors (development finance institutions and microfinance investment vehicles), associations and networks (global, regional, and national), technical assistance providers, rating agencies, academics and researchers, consultants, and others. To learn more, please visit www.sptf.info <http://www.sptf.info>.

The Smart Campaign is a global campaign to embed client protection into the DNA of the microfinance industry. It works around the world to provide MFIs with the tools and resources they need to deliver transparent, respectful, and prudent financial services to all clients. The Campaign works at multiple levels: raising awareness and commitment, shaping norms and standards, creating and mobilizing resources to assist in implementation, and, most recently, developing means to certify good performance of financial institutions. Industry uptake has been overwhelmingly positive: since the Smart Campaign launched in late 2009, it has garnered over 4,200 endorsers from 139 countries, including over 1,200 MFIs. As of October 2014, 24 MFIs have achieved Client Protection Certification, reaching 8.7 million clients. The Campaign partners with supporting organizations across the microfinance community who can assist in taking the campaign to all corners of the globe. We gratefully count among our selected partners national networks such as MCPI (Philippines), CMA (Cambodia), MFC (Poland), AMFIU (Uganda), PMN (Pakistan), COPEME (Peru), FINRURAL (Bolivia), Emprender (Colombia), and MFIN (India) among others.

About the Author

Girija Srinivasan is an independent consultant in the area of rural finance and livelihoods. Her core work has been in responsible inclusive finance. She has special interests in the community-owned institutions. After serving NABARD for 14 years, she took up consulting and established herself as a leading rural finance consultant, advising IFAD, GIZ, CARE, SIDBI, Frankfurt School of Finance, and other leading organizations. She has been involved in the project design, appraisal, and evaluation, apart from providing implementation support to many donor-funded projects. She has provided technical assistance to microfinance institutions to improve their responsible financing practices. Apart from India, she has worked in seven other countries. She is also on the Boards of various microfinance and technical support institutions. She is also the author of several publications.