



Sa-Dhan

The Association of
Community Development
Finance Institutions

Client Protection & Social Performance of Indian MFIs - An Empirical Report

CLIENT PROTECTION & SOCIAL PERFORMANCE OF INDIAN MFIs

An Empirical Report



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LIST OF ABBREVIATIONS

APR	Annualized Percentage Rate
CEO	Chief Executive Officer
CGT	Compulsory Group Training
CoC	Code of Conduct
CRM	Client Relationship Management
GRT	Group Recognition Test
ID	Identity Card
JLG	Joint Liability Group
KYC	Know Your Customer
LAB	Local Area Bank
MACS	Mutually Aided Cooperative Societies
MBTs	Mutual Benefit Trusts
MFIs	Microfinance Institutions
MIS	Management Information System
MIX	Microfinance Information eXchange
MoA	Memorandum of Association
NBFC	Non-Banking Finance Company
NCAER	National Council for Applied Economic Research
NGO	Non-Government Organization
NREGA	National Rural Employment Guarantee Act
NSSO	National Sample Survey Organization
PPI	Progress out of Poverty Index
PPP	People, Profit and Planet
RBI	Reserve Bank of India
SBS	Side by Side
SC/ST	Scheduled Caste/Scheduled Tribe
SHG	Self-Help Group
SIDBI	Small Industries Development Bank of India
SPM	Social Performance Management
SPTF	Social Performance Task Force

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FOREWORD

The Microfinance sector in India has achieved incredible growth in terms of both outreach and sustainability. The mainstream financial sector has increasingly recognized the microfinance sector as an important ally in expanding financial inclusion to the un-reached and under-reached segment of the population.

Sa-Dhan has been publishing financial data for the past six years. During the previous few years the need for collecting social data has emerged. The effect of Microfinance on clients' lives- the social performance of Microfinance institutions (MFIs) - moved into focus of the public. The government, regulators and other stakeholders want to know more about the mission, processes and outcomes of Microfinance institutions.

This report is the result of Sa-Dhan's first systematic attempt to collect and analyse social performance data from its members. It covers the information on implementation of its Code of Conduct and social performance of members. Altogether 109 members have reported on the Code of Conduct and 63 on social performance.

Sa-Dhan's work on the Code of Conduct has been evolved over years as the industry grew. The crises that hit the industry underlined the need for implementation of the Code. The results of the report could be interpreted in the present crisis in Andhra Pradesh for realigning our collective efforts to avert such crisis in future. The urgent issues of client protection such as transparency and fair practices are given importance. They will put a perspective on the problems arising from inside and outside the sector. Besides, the results of social performance would feed into strategic initiatives of those connected to the sector.

We thank all the members who contributed data for the report in spite of their preoccupation in responding to the recent developments.

A dedicated team consisting of Dr. K. Natarajan, Mr. Ardhendu Nandi and Mr. Thomas Mehwald worked on this reporting project. They deserve our special acknowledgement.

We are grateful to Ms. Frances Sinha and Ms. Komal Rana, EDA Rural Systems for the technical guidance in finalizing the Social Performance indicators and analysis of data for the Social Performance of the report.

The technical support extended by Mr. Atul and Mr. Deepak Alok of M2i for conducting field validation of the Code of Conduct compliance reports is duly acknowledged.

We are thankful to Ms. Achla Savyasaachi, Mr. R. Prabha, Mr. K. Balasubramanyam, Mr. Somesh Dayal, Mr. Nilesh Arya for giving feedback and guidance for the project team.

We gratefully acknowledge the generous funding support of Michael & Susan Dell Foundation and Ford Foundation routed through EDA Rural Systems for the section on social performance.

As the report being the first ever product on social performance analysis of its members by Sa-Dhan, the feedback from all the readers would help the team refine the approach in the next phase of reporting. We welcome critical feedback and suggestions from the readers.

Mathew Titus
Executive Director

1. SOCIAL PERFORMANCE MANAGEMENT AND REPORTING

In the recent past there has been increasing focus on the sustainability and financial performance of Microfinance Institutions (MFIs) globally. However, few would disagree that microfinance is essentially a double-bottom line industry – sustainability is not the end in itself; rather it is the means to achieving social goals. These goals can differ: some MFIs may have a mission of poverty alleviation, others of women empowerment, while yet others may be working for increasing access to formal financial services.

Despite the long standing understanding that social goals and objectives lie at the heart of microfinance, it is only in recent years that an organized attempt has been made to define social performance and answer questions about its measurement and management. More and more microfinance stakeholders now believe that unless a MFI's systems, activities and outputs are deliberately geared towards its social vision, it is difficult to make the impact that the institution is aiming at. In other words, like financial performance, social performance needs to be actively managed and monitored by institutions if they are to achieve their social objectives. For a MFI, performance management thus means focusing simultaneously on its financial and social bottom lines.

Social Performance

Microfinance Institutions, invariably, have a social mission—they seek to improve access to finance, reduce poverty, empower women, build community solidarity or promote economic development. Social performance refers to the MFIs success in meeting these goals. Like financial performance, social performance has to be managed through effective translation of mission into practice.

Social Performance Management (SPM) has three components:

- Setting clear social objectives and creating a deliberate strategy to achieve them
- Monitoring and assessing progress towards achieving social objectives
- Using social performance information to improve overall organizational performance.

There are six key questions that will help MFIs put these components in practice:

- What are your social objectives and how do you plan to achieve them?
- Who uses your programme's products and services?
- Why and when do clients leave the programme or fail to fully utilize your services?
- What is the effect of your programme on current clients?
- How will you use information about social performance to improve your services?
- How do you maintain and improve the quality of the systems you use to answer these questions?

Figure 1 : Managing results



Benefits of Social Performance Management:

- Higher retention of clients through monitoring of and responsiveness to their satisfaction with MFI-programmes
- Higher retention rate translates into lower cost and higher profit
- Making investment more attractive to potential clients because of demand driven services and word of mouth from the current satisfied customers
- Lower operational cost as MFIs begin to use resources more effectively based on better understanding of investment
- Demonstration of social performance to stakeholders thus improving MFI's position in a competitive funding market.
- Better risk management especially in the context of uncertain political and regulatory developments

Global:

The Social Performance Task Force (SPTF), created in March 2005, has been charged with clearly defining social performance and addressing questions about measuring and managing social performance. It consists of over 850 leaders from all over the world from every microfinance stakeholder group: practitioners, donors and investors (multilateral, bilateral, and private), national and regional networks, technical assistance providers, rating agencies, academics and researchers, and others.

The social performance reporting standards are the results of an iterative process since 2006, through which the SPTF has engaged with organizations already active in developing social assessment tools both within microfinance (SEEP, Cerise, *Imp-Act*, the FOROLAC network, the specialist rating agencies and more recently the Campaign for Client Protection) as well as in the corporate sector (Global Reporting Initiative, GRI); and piloted with MFIs across the world since 2006.

The Social Performance Pathway developed by the SPTF and the indicators thereon have been the reference documents to collect data from MFIs for analysis, reporting and monitoring of social performance of MFIs across the globe. Several national and regional networks have been using the indicators for mapping the social performance of member MFIs.

At Sa-Dhan:

In 2009 Sa-Dhan joined the SPTF and has been adopting the global learning in social performance to inform and improve the practices of Indian MFIs. Sa-Dhan's principal intervention in social performance arena includes: awareness creation, implementing Code of Conduct, data collection and reporting.

Sa-Dhan introduced social performance reporting in 2004 on socially and politically relevant indicators like SC/ST and minority client, outreach to poorest districts of the country etc. Sa-Dhan also introduced financial performance standards, standards on MFI accounting and an advisory set for enhancing financial transparency.

The introduction of the voluntary Code of Conduct in 2007 and implementation among its members through compliance reporting as part of client protection monitoring, constitution of a Grievance Redressal Committee to resolve matters pertaining to implementation of the Code of Conduct are the other important steps that have been taken.

Social performance workshops have been held across regions to create awareness and to identify indicators of performance reporting. Country wide workshops have been held and exposure programmes for the members for introducing credit plus services and livelihood projects.

The latest intervention has been during 2010-11 to identify social performance indicators suitable for Indian MFIs, collect and analyze data and publish this report.

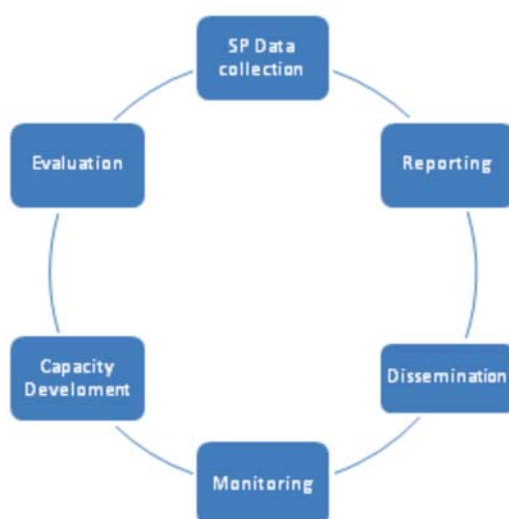
Box 1 Social performance initiatives

The Report

The present report is the outcome of Sa-Dhan's pioneering attempt to gauge the social performance of its member MFIs, bring the performance information to public domain to benchmark it for future interventions. This is timed in such a way that the microfinance sector gets sensitized to social goals in the wake of reputation risk triggered by the Andhra Pradesh crisis.

The social performance work of Sa-Dhan would be part of a systematic process to improve the social impact of its member MFIs. Different stages of the process are depicted in Figure 2.

Figure 2 : Sa-Dhan Social Performance Project Cycle

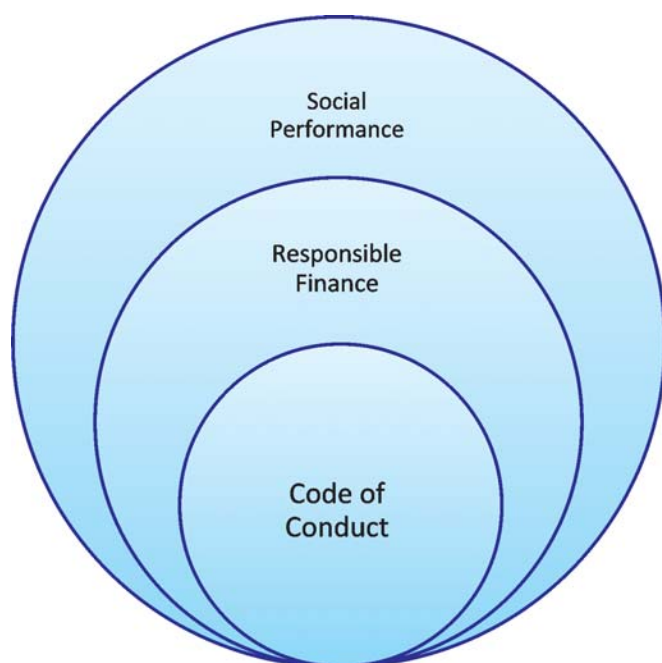


The Indicator and Data

The social performance concept is well established now with SPTF initiatives. The reporting standards have been useful for the national MFI associations to collect data and report. The reporting would cover client protection issues as one of the components of social performance. Sa-Dhan has begun the systematic data collection work on social performance before the Andhra Pradesh crisis which heightened the client protection issues to an unprecedented extent. Sa-Dhan now reports the status of the performance of members on the Code of Conduct as the client protection indicator of social performance. Thus, Sa-Dhan has adapted the SPTF indicators in a way to generate information on social performance separately. This has offered scope for studying the Code of Conduct of Sa-Dhan members against

different set of indicators borne out of the Code of Conduct. Based on its experience, Sa-Dhan has juxtaposed different components of social performance for intervention in the order of priority. The components are illustrated in Figure 3.

Figure 3: Components of Social Performance



As understood from the figure, social performance is the largest domain encompassing responsible finance and Code of Conduct as inner components deserving higher priority in the client protection standpoint. In the present report, the results of analysis of Code of Conduct compliance have been presented in chapter 2 and that of social performance, with indicators other than client protection, have been dealt with in chapter 3.

The indicators for Code of Conduct compliance analysis have been developed crystallizing the different principles enshrined in the Code. Similarly, the indicators for social performance have been developed with technical guidance of EDA Rural Systems, the partner in this project. The indicators, adapted from SPTF indicators, have been scrutinized by a working group consisting of industry experts and Sa-Dhan members and finalized keeping in view ease of reporting by Sa-Dhan members.

The details on methodology of data collection and the sample size etc are given in the respective chapters.

Limitation of the analysis

This report has been prepared based on the analysis done on self reported social performance and Code of Conduct data. More than one third of the self reported Code of Conduct data pertaining to a portion of member organizations has been cross-checked. Validation of Code of Conduct data has been undertaken on certain organizations randomly chosen while entire social performance data sets are self reported. This fact and the predominantly qualitative nature of the data handled in the process, perhaps leaving room for elements of subjectivity, have to be borne in mind while interpreting the contents of the report.

2. CODE OF CONDUCT COMPLIANCE OF INDIAN MFIs

Sa-Dhan has built the perspective for Microfinance in India since its inception in 1999. This included advocating financial performance standards through consultative processes with stakeholders and members. With the growth of the sector, Sa-Dhan started working on Code of Conduct for its members. The need for this was underlined by the increasing issues of unhealthy competition coming up in different parts of the country. The focus on self sufficiency and financial performance left little room for considering the flipside of competition as viewed from the clients' perspective. Client protection as laid down in the Code of Conduct, of late, got the attention of funders, regulators and other stakeholders.

The genesis of the self regulation framework and the Code of Conduct is important to be kept in mind when reading this section. Ethical microfinance and client protection has been discussed in Sa-Dhan as early as 2004. The Code now has assumed high importance in managing the reputation of the sector. The chapter deals with the evolution of the Code of Conduct and analysis of Code compliance by members. At the end a summary of initiatives to be conducted by Sa-Dhan has been presented.

The Principles of the Code

Sa-Dhan drafted a Code of Conduct in 2006 to strengthen the collective of microfinance institutions. The Code's core values are given below:

- i. Integrity: To service low income clients in a manner which is ethical, dignified, transparent, equitable and cost effective.
- ii. Quality of service: To provide various services to the clients in a convenient, participatory and timely manner.
- iii. Transparency: To provide complete and accurate information to the clients and to educate them about the terms and conditions of the products.
- iv. Fair practice: To ensure delivery of services in an ethical manner considering client's dignity and with an understanding of client's vulnerable situation.
- v. Privacy of client information: To respect privacy of data and information received from the clients.
- vi. Integrating social values in to operations: To ensure high standards of governance, participation, management and reporting.
- vii. Feedback mechanism: To provide formal and informal channels to the clients for receiving feedback.

Code: Version 1

The Code of Conduct, encompassing the above core values, was introduced in January 2007 on a voluntary basis. The importance of the Code was well established: the Sa-Dhan Code of Conduct was the reference document for the Reserve Bank of India as noted in its 'Report on Trend and Progress of Banking in India 2007/2008.

Code Implementation by Members:

Implementation of a Code of Conduct needs infrastructure like monitoring, enforcement, and capacity building. Funds for these structured activities were scarce for Sa-Dhan. Similarly, structured data on compliance to the Code was limited. The mode of implementation had been looked at in terms of adopting the code through the members' respective board resolution, display of the code in all their offices, translation of the code in the local languages etc.

Birth of Amended Code: Version 2

The Sa-Dhan Board monitored the implementation of code periodically calling for particulars from members. At the beginning of the year 2010, it urged the members to adhere to the code in letter and spirit in the light of critiques made by the stakeholders including the central bank and the media. In a detailed advisory mail letter (21 June 2010) written to all the members, the board exhorted members to adopt the following measures with immediate effect.

- Putting in place systems that prevent stray and rogue incidents from happening
- Adopting innovations and details that will increase optimism about the possibility of increased good practices on the ground
- Undertaking constructive exercise of closely engaging with the local administration, banking community, local media etc and to develop a rapport with them

Soon it became clear that reputation risk can be a serious risk to the performance of MFIs. The application of the Code started and a complete framework was designed to implement the Code (see annexure 2). Sa-Dhan's Board set out a consultation process to refine the Code to include additional provisions to make implementation of the Code imperative and also to add penal provisions against indifferent members on the matter. Accordingly, it formed a separate Code of Conduct subcommittee of the Board. The committee, beginning from January 2010, undertook several rounds of consultations with members and other stakeholders on the new provisions. RBI

fair practices guidelines have been incorporated¹. The client protection principles of international initiatives were taken as a basis to incorporate fair practices components. In addition, client education and financial literacy were added as components to the refined Code. The process took shape through consultation of the Reserve Bank of India (RBI), Small Industries Development Bank of India (SIDBI), Ministry of Finance, Ministry of Rural Development, Banking Codes and Standards Board of India, as well as exchange with the leading lenders to MFIs and other agencies. The work on the Code and the strategy were presented at the national conference in March 2010 and subsequently also in several workshops.

At the end of the consultation process, the board accepted certain new provisions and proposed suitable amendment to Memorandum of Association to be effected in the General Body. Finally it was adopted with modifications on 31 August 2010 by the Annual General Body meeting of Sa-Dhan. The Code of Conduct document is given in annexure 1.

Unravelling of Code of Conduct Compliance: Members' Reporting

Sa-Dhan started data collection on September 22nd 2010 using a reporting sheet that was developed in consultation with members and stakeholders. Sa-Dhan also conducted several workshops in Andhra Pradesh, Orissa, West Bengal, Tamil Nadu and Rajasthan to raise the awareness of its members on issues relating to the Code of Conduct, to start implementation of the Code into organisational structures and to understand the level of compliance.

Compliance Reporting & Validation

As of January 2011, 109 members of Sa-Dhan had furnished information through the reporting sheet. Sa-Dhan Code of Conduct compliance team performed field validation exercise to bring out the extent of compliance at the head office, branch and client level of MFIs. The Code of Conduct team supported by an independent agency undertook field visits to randomly chosen member MFIs to validate the self reported statements. In addition to visits for validation, Sa-Dhan also performed a desk validation of the compliance reports sent by MFIs. These validations were performed on the basis of the supporting evidence shared by the MFIs.

¹ RBI fair practices Code includes: proper acknowledgement to be provided to loan applications. Sanction letter along with terms and conditions (including interest rates) to be provided to the borrowers in writing. NBFCs should not resort to harassment. Boards of NBFCs should put appropriate grievance redress mechanism in place.

CODE OF CONDUCT: EVIDENCE AND INTERPRETATION

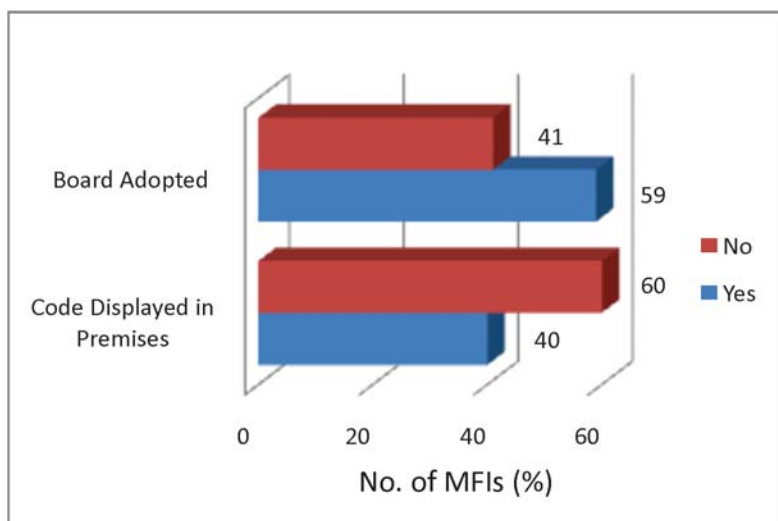
In this section we discuss the characteristics of validated compliance reports of MFIs. The total sample for this analysis is 37 MFIs out of 109 reported. The compliance reports of 15 MFIs were validated through field visits to these MFIs with interaction with head office staff, verifying the records at the branches as well as meeting their clients at the communities. The reports of another 22 MFIs were validated on the basis of supporting evidence presented by them. Given the limitations of this desk-review, some of the indicators could not be validated, as a result of which the total number of MFIs in our analysis varies for the different indicators.

The findings are presented under the seven components of Sa-Dhan Code with details and analysis of responses.

i. Integrity and ethical behavior

The Board is a governance body in an MFI making policy and important decisions. The Board's adoption of the Code of Conduct is one of the important steps for the organization to begin implementing it in its operations. As seen in Figure 4, of the MFIs for which the adoption of the Code of Conduct could be validated, 59% had formally adopted the Code through a resolution in their respective boards. The remaining MFIs were in the process of discussing it in their boards.

Figure 4 Adoption of the Code of Conduct

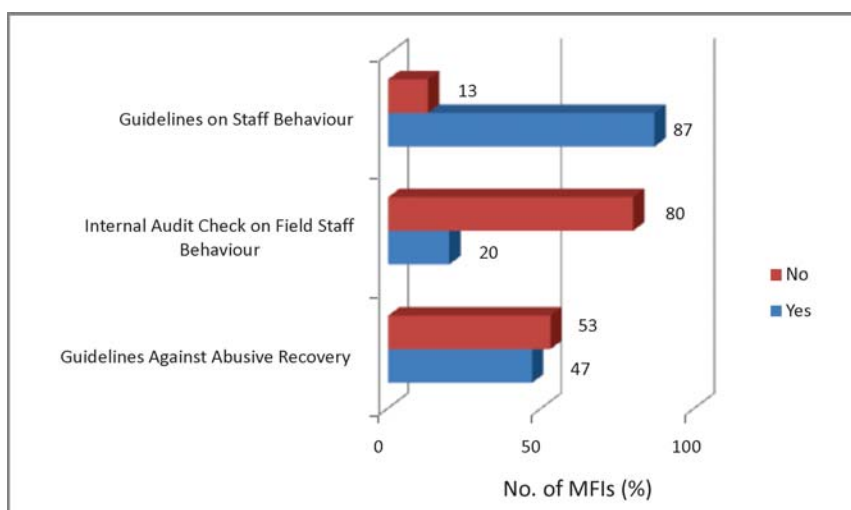


Similarly, translation of Board resolution into practice in some form or visible sign of adoption of Code could be the next step towards internalizing the Code. Display of the Code in the MFI premises is one such move. Displaying the Code of Conduct in the branch offices provides ready reference and recall for the staff members. 40% of the 15 MFIs visited for the purpose of validation had the Code of Conduct displayed in their offices.

For the Code of Conduct to be effectively implemented, it is essential that it is documented and disseminated properly. This is done by incorporating the components of the Code of Conduct in the operational manual and training schedules of MFIs. Some of the MFIs have developed a Code of staff behaviour based on Sa-Dhan's Code of Conduct with necessary modifications to suit their operations. Such adaptations, in most cases, reflect MFI's ownership and commitment towards the Code of Conduct. In most such MFIs the adapted Code has become part of the operation and training manual.

Integrity and ethical behaviour requires MFIs to design appropriate policies and procedures to ensure that the clients are treated with respect and dignity. Most of the MFIs have put general instructions in their operational manual that the staff should behave politely with the clients at all times. The validation team that visited the MFIs also reviewed the presence of guidelines regarding ethical behaviour in their manuals or circulars. The results are presented in Figure 5.

Figure 5 MFI staff behaviour



A few MFIs had included finer details of the staff behaviour in their operational manual and operating practices. In order to ensure that the specified policies are followed, it is also important for the operational monitoring and internal audit functions to specifically check if there are any deviations from the specified policies. While most MFIs maintained that their monitoring -staff check that the field staff is not abusive towards their clients, 20% of the MFIs visited by the validation team had incorporated client behaviour aspects in their internal audit function.

As found in the field the staff may address clients as 'Didi' or 'amma' in order to sound respectful and build their confidence. The field staff should not visit the clients after dusk. Similarly, in the event of a tragic incidence at client's households, they should visit the client's house at best to extend moral support and not to conduct financial transaction.

ii. Transparency

Transparency is the central principle of a good system of finance². Information asymmetry between lender and borrower is especially pronounced in microfinance where the majority of clients are illiterate. Transparency requires the MFIs to disclose all terms and conditions to the clients before disbursement of loan. Important terms and conditions which need to be revealed to the clients are:

1. Loan term and instalment size
2. Diminishing balance interest rate
3. Processing charges
4. Deposit requirements
5. Prepayment charges and conditions

The terms and conditions of the loan should be given in writing and explained to the clients orally in the language understandable by the clients.

The idea is to enhance the amount of information made available to clients to enable them take informed decisions.

² Government of India (2011)

The importance of maintaining transparent pricing is high on account of varied practices of the MFIs with regard to charging interest rate. Some practices are outlined below.

Method of charging interest: Under a flat rate method of interest, the total amount of interest is equal to the product of the loan amount and the stated interest rate. The Instalment size is determined by dividing the total of the loan amount and interest by number of instalments. For example, on a loan of Rs12,000; flat rate of interest of 15% implies that Rs1800 will be collected from the borrower over one year. If the loan is to be repaid in 50 weeks, weekly instalments will come to Rs276. Equivalent interest rate on diminishing balance method will be about 28% in this example.

Flat rate method of charging interest is primarily used by the MFIs having manual MIS. There is a trend among the MFIs who have transformed themselves into the NBFC's to use a computerised MIS and use a diminishing balance interest rate system for accounting purposes.

Security deposits: Some MFIs require clients to leave with them certain percentage of their loan amount as security deposits. MFIs cannot pay any interest on the security deposits as per the central bank norm and hence the effective cost to the clients increases.

Upfront charges: Upfront charges are taken for covering the cost incurred in processing the loans. MFIs charge around 1% on the loan amount as upfront charges. The upfront fees charged by the MFIs increase the cost to the borrowers.

Prepayment charges: There are varied practices among the MFIs regarding prepayment of loans. While some MFIs collect only the outstanding balance in case of the prepayment, some other charge a penalty (usually 1-2%) on the outstanding amount. Such practices do not result in significant changes in the cost to the borrowers.

On the other hand, insisting on the clients making payment of all instalments (including interest) in case they prepay the loan raises the cost to the borrower.

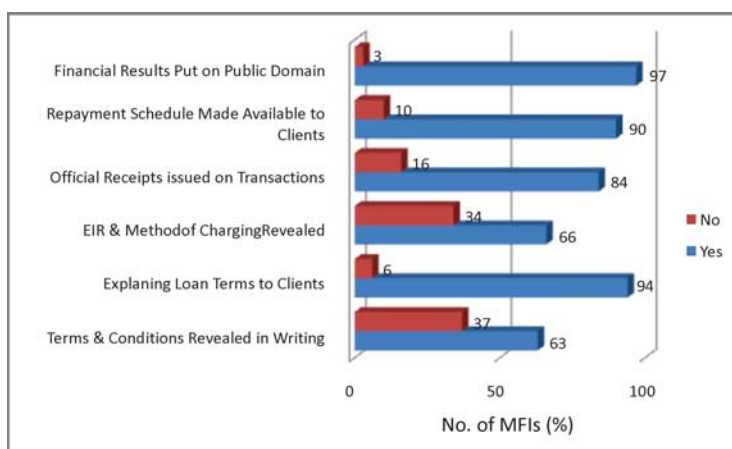
Box 2 Aspects of transparency

As can be seen from Figure 6, terms and conditions of the loans are mentioned in the loan application form, agreement or other documents for most of the MFIs. Most MFIs also provide repayment schedules as well as acknowledgement receipts for payments to their clients. Similarly, most of the MFIs put data on their financial performance in the public domain.

On the flip side, it was observed that some of the MFIs do not communicate effective interest rate to their borrowers in trainings or other communications. Communicating interest rate during training of the groups is important given the fact that most of

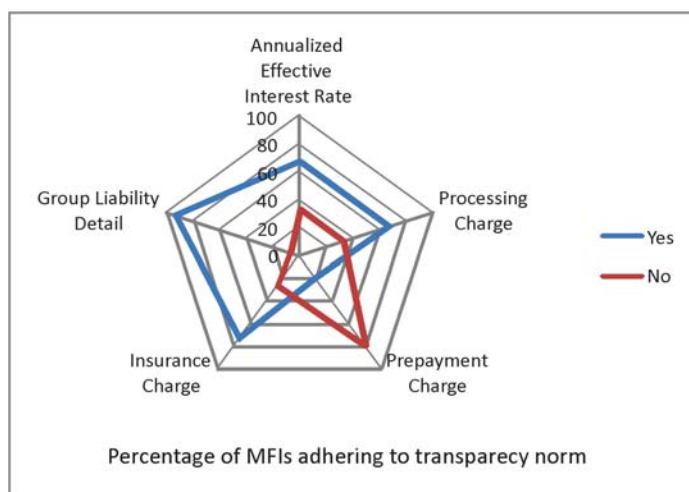
the clients are not literate. Almost all the MFIs communicate the nominal interest rate to their clients. There is however a need for MFIs to communicate the effective interest rates to the borrowers in a manner that they are able to compare the cost of loans from various sources.

Figure 6 Transparency of MFIs



In order to review the compliance with the specific aspects of the Code, the validation team also reviewed important sub-indicators in the visited MFIs. As can be seen from Figure 7, two-thirds of the MFIs tell clients about the effective interest rate, processing charges, and insurance details but many do not specifically tell about the prepayment terms and charges to the clients. In certain situations, prepayment terms and conditions may lead to the significant changes in cost to the borrowers.

Figure 7 Field level results on transparency



Some of the NBFC MFIs constitute Mutual Benefit Trusts (MBTs) of their clients and the MBTs in turn hold the shares in the NBFCs. Sources of funds for MBTs are often contributions from the clients. Client's contribution to MBT's funds is usually linked to the loan amount and most of the clients perceive such contribution as a condition for taking loans. It is critically important for MFIs to tell the clients about the details of the MBT structure and risks and rewards associated with such investments.

Sa-Dhan's advisory set advocates the minimum disclosure norms for interest rate, financial statements and annual reports. Scrupulous adherence to the norms advocated would enhance client protection and credibility among the other stakeholders.

iii. Client protection

The basic tenet of client protection is understanding the client's needs and situation while delivering micro financial services. The following section analyses the level of code compliance towards client protection under different sub-sections of the Code of Conduct.

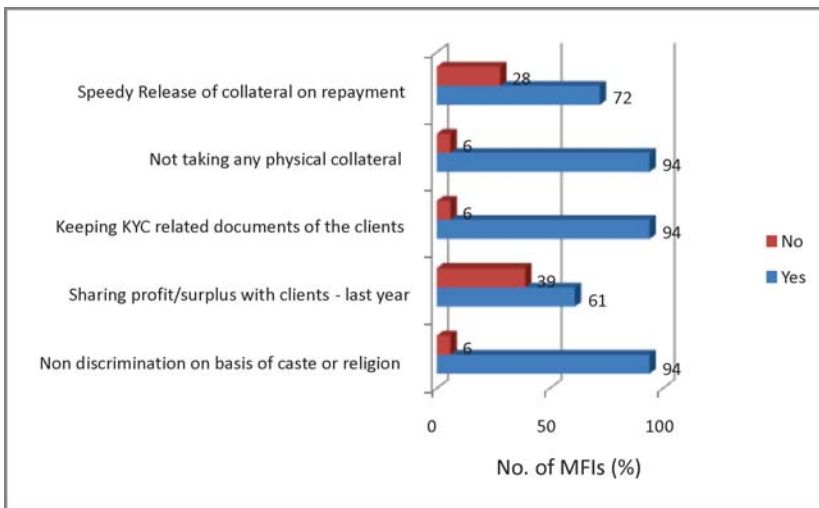
a. *Fair practise*

Fair practise requires that

- MFI should not discriminate on the basis of caste and religion
- MFI should share the benefits of cost reduction/profits with the clients and
- The MFI should not collect any collateral from the clients for small loan size (Rs 50,000 and below) loans
- Where collateral is collected it should be returned to the clients within one week of closure of the loan.

The performance of MFIs on the fair practices observed is depicted in Figure 8.

Figure 8 : Fair practice adoption



As understood from the figure, the majority of the MFIs validated follow fair practices as laid out in the Code. This is very encouraging. Their practice on non-discrimination among clients, collateral requirement, etc. is noteworthy; the percentage of MFIs following the practice will hopefully increase in future. This will enhance the client confidence and trust resulting in enhanced outreach. A recent example of client loyalty relates to the continued high repayment of loan by clients of MACS (Mutually Aided Cooperative Societies) in Andhra Pradesh even after the crisis which witnessed mass default by the clients of other forms of MFIs. The perceived and real ownership of MFIs among the clients under people owned MFIs could be the reason.

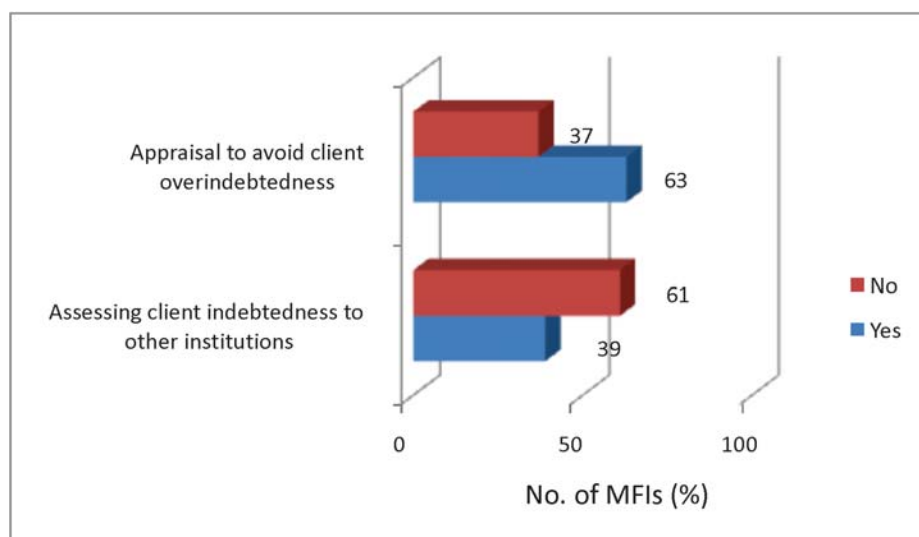
b. Avoiding over indebtedness

This principle requires that the MFI should carefully analyse the repayment capacity of the clients before extending loans to them. Analysis of repayment capacity includes analysis of income and expense patterns as well as indebtedness. Most of the MFIs visited by the validation team follow the JLG model where primary responsibility of assessment of loan repayment capacity lies with the group members themselves.

In case the groups are willing to take responsibility of each other's loan, the loan is usually sanctioned. However, most of the MFIs find it difficult to collect information pertaining to income, expenses and indebtedness which are required to properly analyse the repayment capacity of clients. MFIs are still discovering appropriate mechanisms of proper client analysis given the fact of missing client data sharing mechanisms such as credit bureau.

The analysis on the validated data shown in figure 9 bears testimony to the present status and calls for concerted efforts.

Figure 9 Client assessment features



Though the majority of the respondents are found to follow measures to avoid client over indebtedness, this practice should necessarily spread among all MFIs to avoid crisis that happened in Andhra Pradesh. This is a non-negotiable measure as understood from the fact that client over indebtedness is one of the reasons for the Andhra Pradesh Government in India to resort to precipitated action leading to the crisis.

The validation team also performed a review of the specific aspects of this Code component among the MFIs visited. Only 67% MFIs had a loan application format which would enable cash flow analysis of the applicant. However, in many cases where cash flow analysis is performed, results of such analyses are not used to determine loan size and duration. Further, for most of the clients internal audit does not check whether appraisal criteria are being applied correctly.

Table 1 Client assessment: results from field validations

Question	Yes	No
Does the format of loan application form enable cash flow analysis and analysis of indebtedness?	67%	33%
Does the operational manual link the loan sizes and duration with the assessment of the repayment capacity?	27%	73%
Does the internal audit manual (or guidelines) require internal audit checks to be performed on whether loans have been disbursed after an appropriate appraisal of repayment capacity?	20%	80%
Has the MFI provided training to its operational staff on how to assess the repayment capacity of the clients?	67%	33%

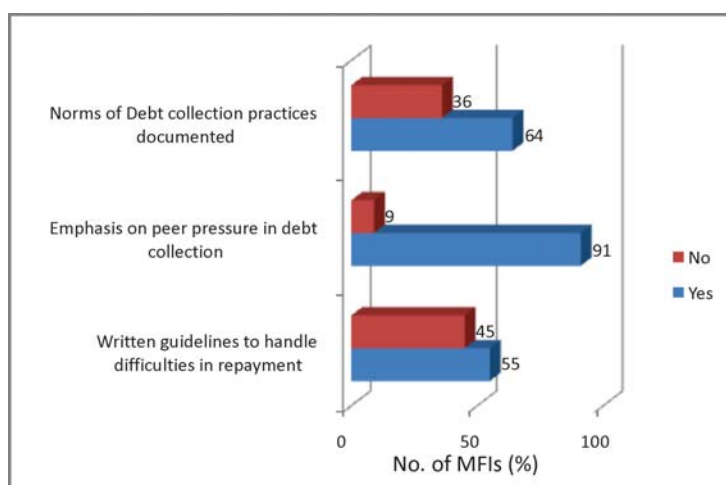
As observed from Table 1, the client assessment mechanism is yet to get institutionalized among the majority of MFIs. Therefore, sustained efforts to improve systems and procedures, capacity and willingness on the part of the MFIs will be required for this. This also implies significant changes in the operating methodologies for many MFIs.

c. *Appropriate Interaction and collection practices*

Recovery practices of some of the MFIs have been subject to close scrutiny and criticism in recent times. Many MFIs have policy approvals and guidelines that the staff would not use coercive means for recovery of loans as shown in Figure 10.

..Our way of life has improved because of MFIs. The problem emanates when women take many loans and they are unable to pay the loan dues... -Villagers of Venkatarapet Village, Warangal District (AP)

Figure 10 Debt collection practices



In the MFIs visited by the validation team, the operations manual and related circulars were reviewed to see whether they contained specific aspects pertaining to appropriate debt collection practices. The observations of the team have already been indicated in Figure 5.

Most of the MFIs using the concept of joint liability insist on other members of the group to repay in case one or more group members are facing problems in repayment. In many situations particularly when other clients have to fulfil repayment obligations of other clients for a prolonged period, this creates tension within the group. It has been observed that while the loan officer of the MFI is able to collect scheduled instalments by ensuring contribution from members of the group, the group members make efforts to collect the instalments from the clients who have not repaid. Sometimes, this creates unpleasant situation in the villages. The probability of such things happening is higher in case of such MFIs who have a 'zero tolerance' for defaults and those who do not have policy for rescheduling/write-off of loans.

During the validation visits, it was found that some of the MFIs have specified guidelines to control specific aspects of behaviour like the following:

1. Staff would not confront the clients or their family members under any situation.
2. The staff would not enter the house of the client for recovery of loans.
3. Staff would visit clients only with the group leaders. More than two staff would not visit the client together for recovery.
4. Staff would not insist on recoveries in case there is severe illness in the family of the clients.

Box 3 Best practices in collection

It is important for the MFIs to have policies for the situations where clients are facing genuine difficulties in repayment of loans. If the MFIs are not considerate towards the clients facing genuine difficulty in repayments, it results in dissatisfied clients and poor client relationship management.

d. Privacy of client's data

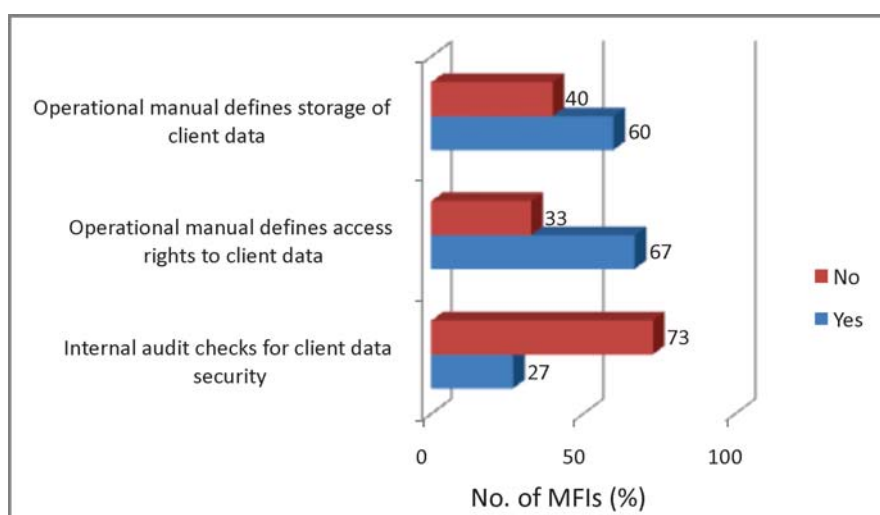
This dimension of the Code requires that documents and information obtained from the clients are kept secure and are not disclosed without prior permission from the clients. Most of the MFIs have a policy of keeping the documents obtained from the clients under the custody of the senior staff in the branches (usually the branch managers). The documents are barred from unauthorised access by outsiders. MFIs,

however, use credit related information in their regular operations like sharing data with the financial institutions. While most of the MFIs maintain security and privacy of data from the clients, MFIs do not proactively tell clients about the possible uses of the data and information obtained from the clients.

They also need to obtain explicit permission from the clients when their names and photographs are used in case studies and publicity material.

Validated compliance information pertaining to privacy of client's data for the visited MFIs is shown in Figure 11.

Figure 11 Client data security measures



Though a majority of the MFIs do have some policy in use of client data, monitoring of such policy through audit mechanism is yet to get institutionalized as understood from the figure.

This aspect of the code is critical when it comes to sharing of data to Credit Information Bureau being set up in India.

iv. Governance

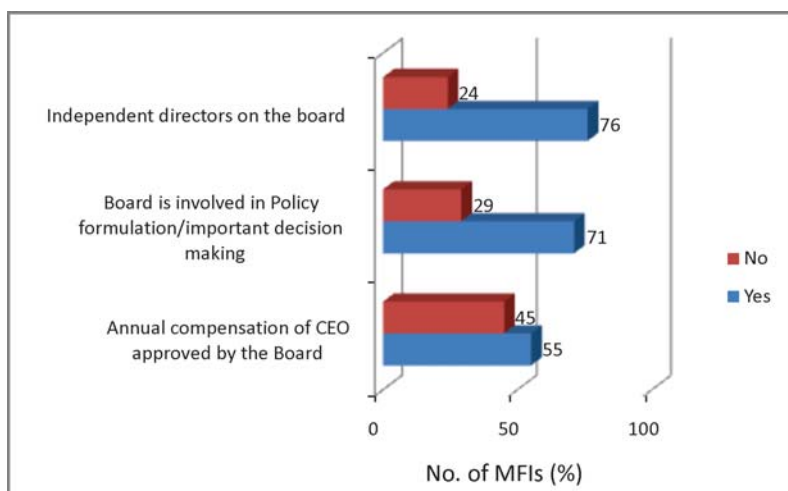
Sa-Dhan's Code of Conduct on Governance requires the following.

- The MFI should have independent members in its Board of Directors. This is to ensure that the affairs of the organisation are subject to scrutiny by independent persons.

- The Board is involved in policy formulation and effective decision-making. A well functioning Board should be able to provide oversight to the important functions.
- The annual compensation of the CEO should be approved by the Board. This is to ensure check on the CEOs taking unreasonably high level of salaries for themselves.

Some of the MFIs also have committees of the Board (e.g. audit committee, assets liabilities management committee and compensation committee) who look in to specific aspects of the performance. Indian MFIs performance on adherence to this Code of Conduct is reasonable. Majority of the MFIs sampled for the validation had independent directors and there was evidence that the board participates effectively in decision-making. Annual compensation of the CEO is specifically approved by the board over a half of the validated MFIs. (Figure 12)

Figure 12 Governance style



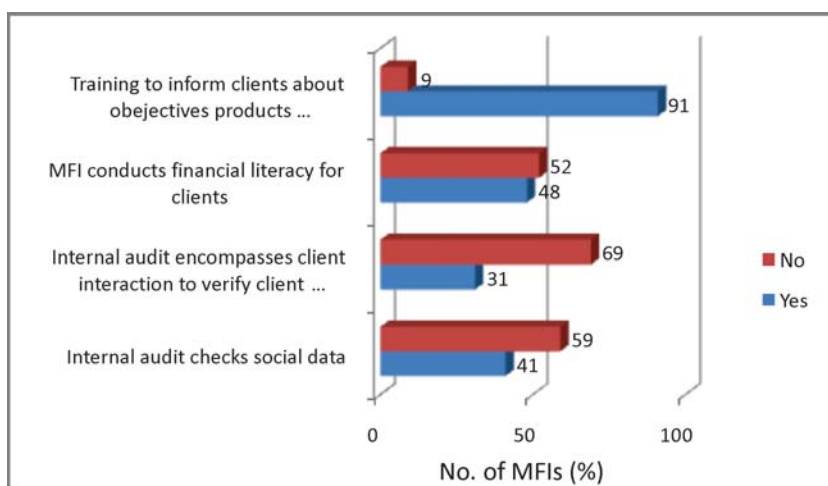
The Board, among other things, could constitute a separate sub-committee to deal with client protection, grievance redressal matters.

v. *Client education and financial literacy*

The Code of Conduct requires the MFIs to provide regular training to their clients on issues pertaining to financial literacy so that they are able to take an informed decision about their financial affairs. It is also imperative that MFIs conduct basic financial literacy programmes to make the clients responsible borrowers avoiding over indebtedness. This will also help manage the default risk better.

The Figure 13 suggests that most of the MFIs conduct regular training about the products and services which are offered by them and limited training is carried out to ensure that the financial literacy training having wider implications is done.

Figure 13 : Client education and financial literacy



The MFIs are incorporating delivering financial information to their clients on the loan terms, interest rate (weekly payment) and deposit requirement etc pertaining to the loan being contracted with the clients via, Compulsory Group Training (CGT) and Group Recognition Test (GRT). This could be the minimalist intervention to guide the clients only with respect to the loan transaction. The MFIs need to build on the existing system - CGT & GRT - to deliver financial literacy modules with contents on savings, responsible borrowing, insurance etc.

There is an ample scope and necessity for running financial literacy programme. Similarly, the internal audit system of MFIs needs to be geared to monitor client education initiatives as well as spending on such programmes.

vi. Competition

On the one hand, healthy competition plays a positive role in bringing down the cost of credit and improving the quality of service for the clients, on the other, unethical competition would have adverse consequences. This manifests particularly in the situations where in a rush to grow rapidly, MFIs provide loans (often of considerably higher sizes) to the existing clients of other MFIs without proper due diligence. This increases the possibility of the clients taking loans beyond their repayment capacity. Unhealthy competition also creates a favourable environment for unauthorised agents who take advantage of information asymmetry

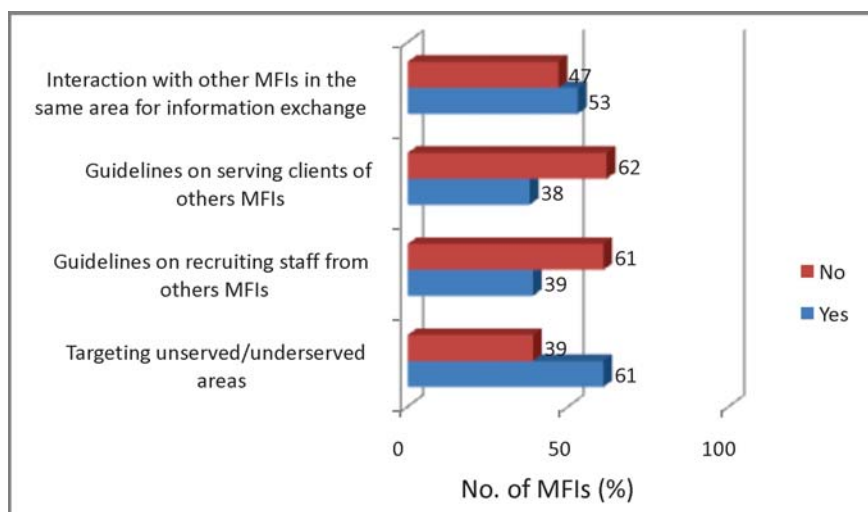
and weak appraisal to channel loans to the clients who would otherwise not qualify for MFI loans.

Sa-Dhan's Code of Conduct requires the MFIs to:

- Regularly and proactively interact with other MFIs in the operational area to avoid over-indebtedness
- To have precise guidelines for serving clients served by other MFIs
- To have precise guidelines for recruiting staff members from other MFIs
- To consciously go to the areas which are un served or underserved

While most of the MFIs share information at the national and state level as they are part of Sa-Dhan, sharing information at the level of the branches is not very common. As seen from figure 14, 53% MFIs in our validation sample had formal or informal sharing of information among various MFIs at the branch level. Similarly, 39% MFIs had a formal policy of following specified procedures while recruiting staff from other MFIs and 38% MFIs had a formal policy of following a specified procedure while recruiting clients from other MFIs.

Figure 14 : Competition and cooperation of MFI



The analysis of specific questions asked to the MFIs visited for validation also reveals that MFIs need to evolve specific guidelines in order to ensure that their staff members provide appropriate services in a competitive environment. The results are presented in Table 2

Table 2 Competition

Question	Yes	No
Does the operational manual of the MFI specify how to proceed while providing services to clients served by other MFIs?	27%	73%
Interview with field staff reveals that they are aware of these guidelines?	27%	73%
Does the HR manual of the MFI specify how to proceed while recruiting staff from other MFIs?	47%	53%
Is there documentary evidence to suggest that these guidelines are adhered to?	47%	53%
The operational manual/other policy documents mandate the MFI to go to areas which are underserved.	40%	60%

On the initiatives of Sa-Dhan chapters, district level committees of MFIs have been constituted in states like Orissa and Tamil Nadu. These committees have periodic meetings for information sharing.

Setting up of a credit information bureau would partly resolve the issue, if all the MFIs whole heartedly participate in the programme. Similarly, a central registry of employees serving in MFIs with details on their exit and entry, among other things, would help sharing staff movement. This could be the strategy towards long term solution for staffing related unhealthy competition.

vii. Feedback and Grievance Mechanism

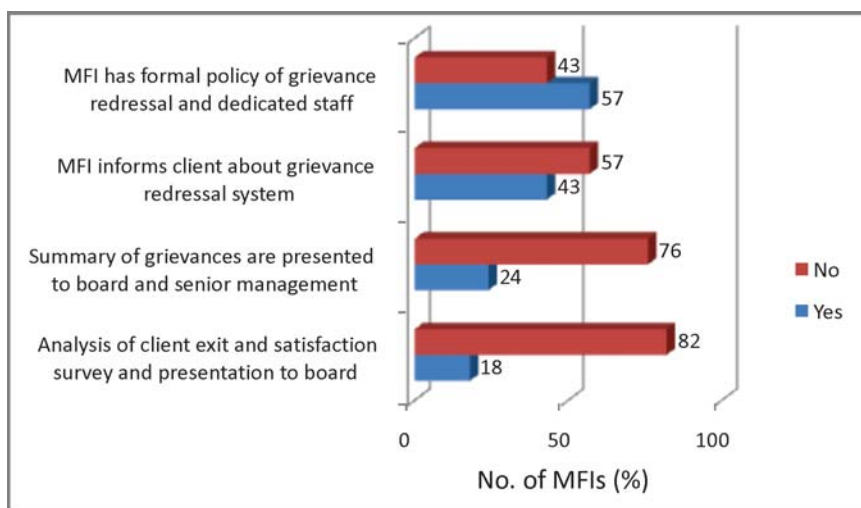
A sound feedback and grievance redressal mechanism is essential for the MFIs to maintain healthy relationship with their clients. This mechanism should, on one hand, require the MFIs to proactively obtain the feedback from the clients and on the other should enable the clients to complain in case they have any service related issues. This mechanism can also serve as an effective control system against staff fraud or other malpractices. Sa-Dhan's Code of Conduct requires the MFIs to have the following in place:

- MFIs should have a formal system of grievance redressal of clients
- They should inform clients and staff about their grievance redressal mechanism
- Clients should be informed of existence of the Sa-Dhan's Ethics and Grievance Redressal Committee

- MFI should also present summary of such grievances to the board and the senior management
- MFI should conducts Client Satisfaction Surveys periodically (at least annually)
- MFIs should analyse the report of the client satisfaction surveys and present them to their boards

Grievance redressal mechanisms in MFIs require improvement. In many MFIs the phone number of the head office is mentioned in the loan card provided to the client. Adding to this a mechanism for effective recording and follow-up on the complaints is needed; otherwise the grievance redressal mechanism in most of the MFIs would become inadequate. Most of the MFIs also are yet to set up a formal system of obtaining feedback from the clients. A strong grievance redressal mechanism and a system to obtain feedback is likely to result in overall improvement in client relationship management. Figure 15 shows the degree of implementation of measures on this matter.

Figure 15: Client grievance redressal system



Best practices would include MFIs appointing customer care executives in each branch to address queries of the clients. The MFIs may also have a centralised helpline number where clients can call in case they have any complaints. Recording and follow-up of the complaints is performed using CRM software.

Thus, client grievance handling mechanism needs to be bolstered among MFIs. The sporadic initiatives for ombudsman and mechanisms to address client complaints require further push. Similarly, the arrangement for clients and MFI staff filing complaints with Sa-Dhan deserves further publicity.

Prognosis:

The analysis of the validated compliance reports indicates that there is a scope of improvement on aspects of the Code of Conduct as well as strengths to be built on.

- The client appraisal system among MFIs to understand client's assets and liabilities and their financial requirements is weak. This may lead to over indebtedness among the clients. Intuition suggests that the more integrated a MFI is in the community the better it will know its clients and their need for finance.
- While acceptable collection practices are defined, some MFIs do not have guidelines on dealing with individual and mass difficulties in repaying loans. This, along with the staff incentive structure and the overall approach to tolerating default should be reviewed. A comprehensive action on these issues as well as reporting on them will help Sa-Dhan to build on the reputation of the sector.
- Financial literacy to help clients to take informed decisions should receive more attention among MFIs.
- Sharing of information and coordination among MFIs operating in a particular area is worth more efforts.
- Feedback and grievance mechanism to address clients' complaints is an important component of the Code of Conduct and must be institutionalised.

Crystallizing the findings from the Code of Conduct analysis, the broader frame work of intervention is given in annexure 2 (Code of Conduct implementation strategy). The other suggested initiative are as follows:

Table 3 Interventions based on Code of Conduct

Code Component	Initiatives warranted	Benefits / Client Protection
All the components	Institutionalizing the code through MFI Board adopted policy, dissemination and internalization of the principles within the organization	Clients would be protected from unintended adverse effect of MFI-intervention
Integrity & Ethical Behaviour	MFI policy/ audit/ training system to be geared up to set standards of and ensure right staff behaviour/ recovery practice	Clients would enjoy MFI service with dignity
Transparency	MFIs disclose details on loan terms , interest rate (APR) ,processing charge, collateral requirement, prepayment charges etc to clients in the language/manner understandable by them	The clients would take informed decision
Avoiding over indebtedness	MFIs design robust client assessment system to provide needy product and services, refrain from multiple lending, poaching clients from other service providers.	Clients get protected from debt trap and would resort to responsible borrowing
Appropriate collection practice	MFIs adopt policy, training and audit system to ensure ethical collection practice and avoid abuse of social collateral for recovery.	This would build trust among clients and improve asset quality
Privacy of clients' data	MFIs to get explicit permission from clients for disclosing client information.	Enhanced client trust and further transparency for the clients
Governance	Active board involvement in ensuring client protection/ ethical practices through strategy of exclusive Sub-Committee to monitor/advise	The clients would get professional service from MFIs and build loyalty towards to the MFIs
Client Education & Financial Literacy	The financial literacy module readily available among Sa-Dhan members may be incorporated into CGT/GRT	The clients would seek their financial solution from MFIs after proper financial planning
Competition	MFIs share information among fellow MFIs operating in a given area (e.g.: through District/Block level committees, credit bureau) and refrain from poaching clients/ staff.	The clients are not lured into debt trap and are given multiple choices of service providers
Feedback & Grievance Mechanism	Well publicized client complaint cell within MFIs with convenient access to clients and audit based monitoring of complaint disposal	The timely grievance redressal avoids client drop out and enhances client trust and loyalty

3. SOCIAL PERFORMANCE OF INDIAN MFIs

Monitoring social performance of its members began in Sa-Dhan ever since the financial performance analysis commenced in 2004. As stated in the first chapter, Sa-Dhan had been collecting financial performance data for informing the stakeholders on the movement of the sector including the performance of member MFIs. As part of that, important social performance parameters like outreach to women client, SC/ST clients, poorest districts, etc were identified, data collected on, analyzed and reported much to the appreciation by the central bank, the government and funders. This year, Sa-Dhan gathered data exclusively on social performance and presented the results in this chapter.

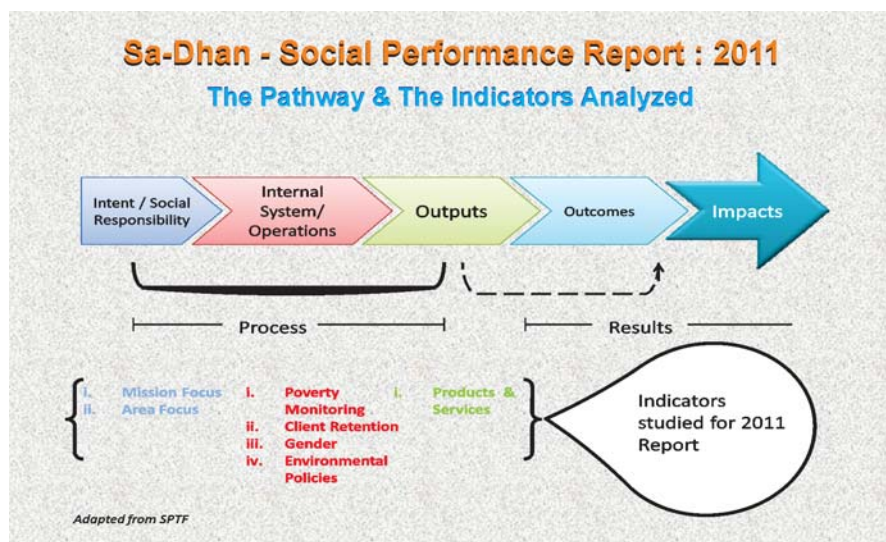
MEASURING SOCIAL PERFORMANCE

Globally, social performance measurement and reporting is in the nascent stage. Performance can only be understood and improved if it is measured. Financial performance indicators are recorded, measured and tracked over time by all MFIs and this information is used to inform management decisions. Similarly, in a double bottom line sector, that is: aiming for social and financial goals as in microfinance, it is equally important that mechanisms to measure social performance be introduced and institutionalized.

Consensus is being built among different national associations of MFIs and SPTF on the indicators of social performance. Sa-Dhan, for ensuring simplicity and ease of reporting by its members in this initial stage, has identified indicators appropriate to the Indian circumstances. Taking cues from SPTF indicators, Sa-Dhan with its technical partner, EDA Rural Systems³ collated data on select indicators this year (See Figure16)

³ EDA Rural Systems Pvt Ltd (EDA) is a development consulting organisation specialising in development research, sector studies, advisory services, impact assessment, Social Performance Assessment and Social Performance Management

Figure 16 : Social performance pathway

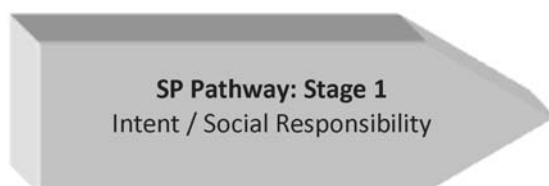


SOCIAL PERFORMANCE: EVIDENCE AND INTERPRETATION

A structured data collection format was prepared with questions built on the indicators and circulated to members seeking them to report on. Sixty three members responded and the data, mostly qualitative, was analysed and the results are presented here. Annexure 3 lists the participating MFIs. In addition, this analysis has been enriched with data available from the Sa-Dhan database.

Since each indicator reflects the different aspects of social performance- mission, strategy, systems, products & services, outcome etc, the results are presented under each element of the Social Performance Pathway.

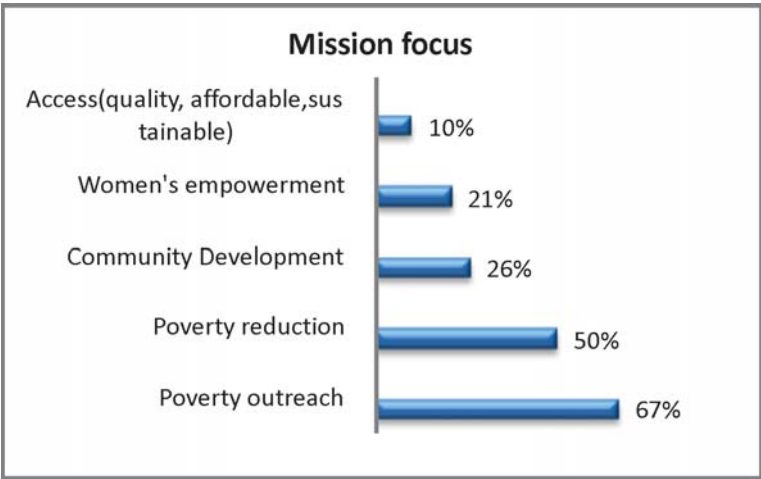
The conclusions drawn from the analysis would largely depend on the validity of the self reported data, which the Sa-Dhan-EDA team could not cross-verify.



MISSION

Mission statements of MFIs indicate what social goal the MFIs endeavour to achieve. The analysis of the mission statements of reporting MFIs shows the mix of social goals. The key words in MFI mission statements show that the majority of MFIs aim to work directly with the poor; around half aim for poverty reduction; others aim to improve quality of life, or to increase employment. (Figure 17)

Figure 17 MFI Mission focus

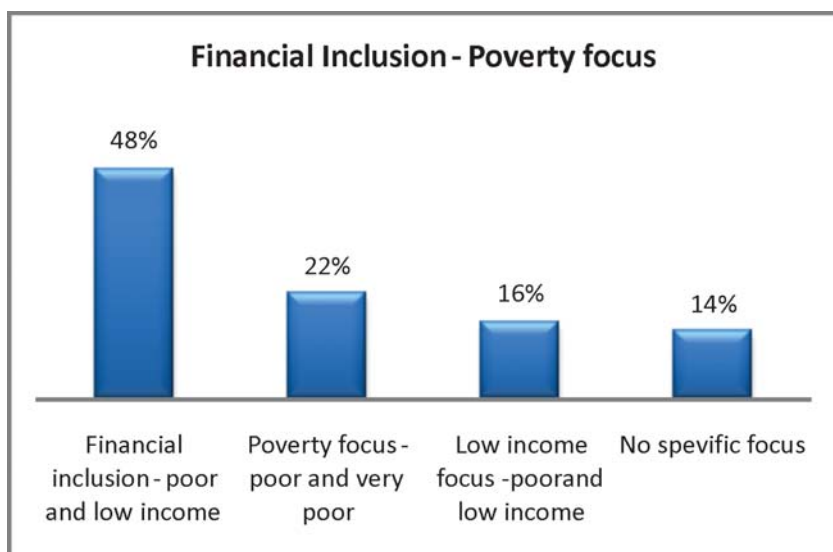


One fourth of MFIs include community development in their mission statements, either in terms of broader development programmes, or in terms of institutional structures that engage with wider communities. Ten percent of the organisations surveyed state their mission in terms of access to quality financial services. One in 5 also mention women's empowerment.

The missions of poverty outreach and poverty reduction are interrelated but different. Poverty outreach would perhaps connote that the MFIs aim at delivering service to low income clients without mentioning the impact they want to create over the lives of the poor. The mission of poverty reduction spells out the impact the MFIs want to create - reducing the client's poverty.

Financial Inclusion and Poverty Focus

Figure 18 Poverty focus



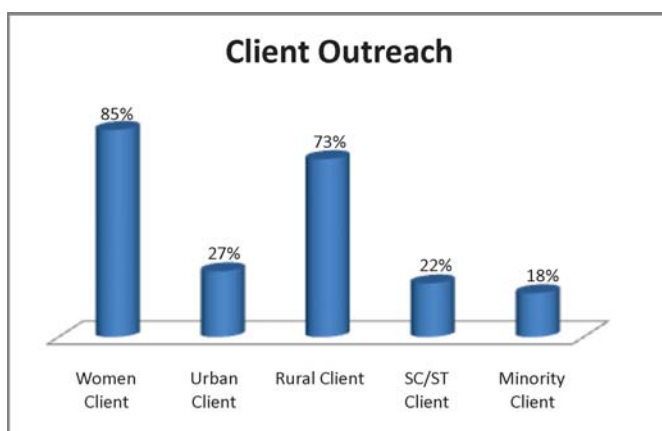
Around half of MFIs state that their intent is financial inclusion covering low income and poor households. One in five MFIs focuses on reaching the poor and very poor - below \$1.25/day at purchasing power parity (as per All India National Statistical Survey Organization (NSSO), 2005-6 Round 62) (Figure 18).

Some MFIs are targeting poorest of the poor with specialized products. Some NBFC MFIs for example target hardcore poor, identifying the target group through community participation.

Though the absolute number of poor clients reached by MFIs is not available, depth of microfinance reach is gauged using average loan size as surrogate indicator. Accordingly, the average loan size of NGO-MFIs is Rs. 4648 while that of NBFC -MFIs 6986. The data suggests that poverty outreach is deeper for the NGO-MFIs.

Community Focus

Figure 19 Outreach to community

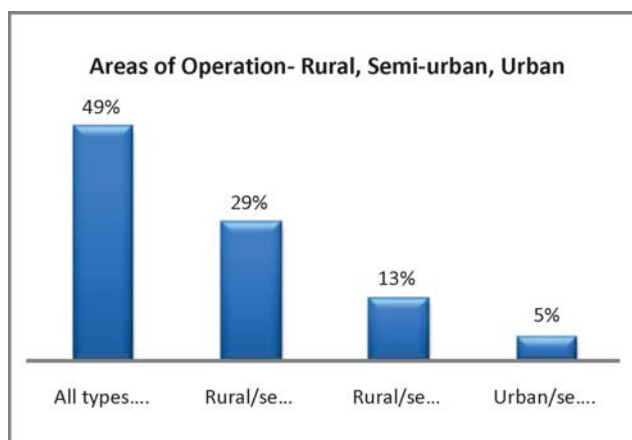


MFIs aim to be inclusive in terms of community outreach. Sa-Dhan Quick data for 2010 showed that MFIs consistently reach out to different socially important communities, see figure 19.

Women are the main partners of Indian microfinance. Around 85 % of MFI reach out to women clients. Also, the rural community participates in a larger way. One fifth of MFIs reach out to weaker/minority sections viz., Scheduled Caste/Scheduled Tribes and Muslim / Christian communities.

Coverage: Rural-urban

Figure 20 Areas of operation⁴



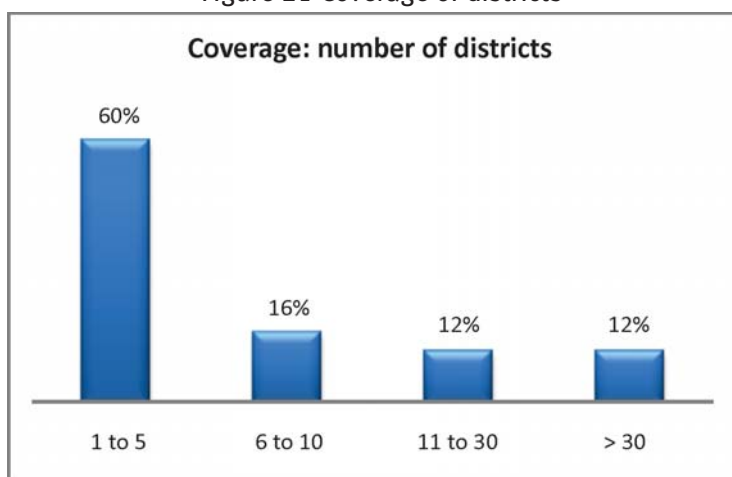
⁴ Numbers not adding up due to overlap in reporting.

Many MFIs work in all types of area – rural, semi-urban and urban, figure 20 shows that half of MFIs do so. One third of the surveyed organisations operate in rural and semi-urban areas and 13% only in rural areas. Five percent work only in urban areas.

Coverage of districts

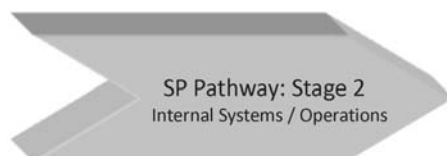
Three quarters of MFIs cover up to ten districts, while only 12% cover more than 30 districts (figure 21). Legal forms possibly dictate outreach: NGOs generally have more limited resources which affects their outreach. Also laws under which they are registered prevent their spread beyond state borders.

Figure 21 Coverage of districts



As per the data reported to Sa-Dhan (Quick report 2010), number of poorest Indian districts covered by MFIs went from 200 in 2008 to 418 in 2010. The number of poorest district covered was arrived at using the classification of poorest districts by the Government of India under the NREGA scheme.

It is very important to note that social intent is not an end in itself. The degree of social performance depends on the efficiency with which the process, systems and products are orchestrated to achieve the social mission. A closer look at mission statements of MFIs assumes importance in the light of increased public opinion that MFIs have allowed mission drift. The analysis has shown MFIs to have social mission to reach out to the poor and vulnerable.



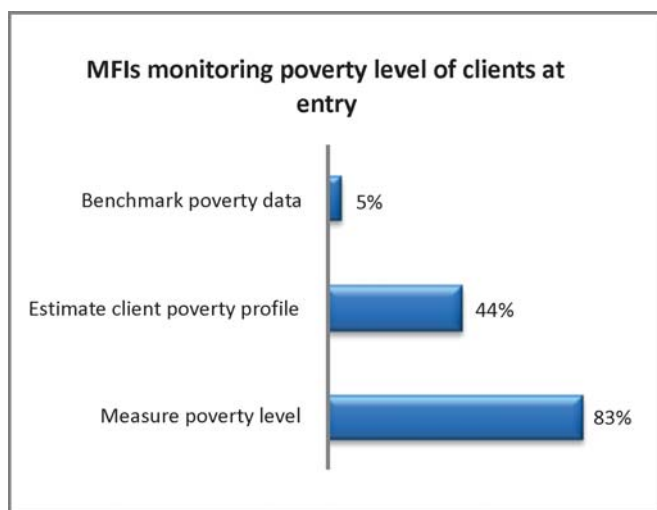
Poverty monitoring

Tracking the poverty level of clientele helps MFIs to monitor the progress of their operation towards achieving their mission. This also helps them to take mid-course correction if the progress is not in line with the intended mission.

The majority of MFIs report that they are measuring information related to poverty status of clients at entry (figure 22). This refers to information collected as part of the membership or loan application form, which may include quick estimates of household income, or records of other indicators related to quality of life, sometimes using a poverty score card or housing index. However, MFIs do not usually collate this information, or report it; nor do they benchmark it to a poverty line. Without systematic monitoring of poverty related data, under half of MFIs are able to provide only a rough estimate of the poverty profile of their clients.

Four MFIs reported on benchmarked data from application of the Progress out of Poverty Index (PPI), as part of their own pilot of this poverty assessment tool or from an M-CRIL social rating. Another three MFIs reported that they are applying the PPI⁵ to assess the poverty level of their clients.

Figure 22 Client poverty level at entry



Twenty MFIs report that they have information about the poverty level of their clients after some time – through routine collection at every loan cycle (though again this is not collated). In some cases this is done through sample surveys – after 2-3 years or more. This data may be explored in future.

⁵ www.progressoutofpoverty.org

To understand progress in achieving the stated poverty goals of MFIs, reliable and actionable data on poverty must be collected or collated by institutions. Data gaps, especially in terms of tracking client poverty, are significant. Although historically it has been accepted that poverty measurement and quantification is a challenging task, there are tools available today that can assist MFIs in collecting and analyzing meaningful data on poverty.

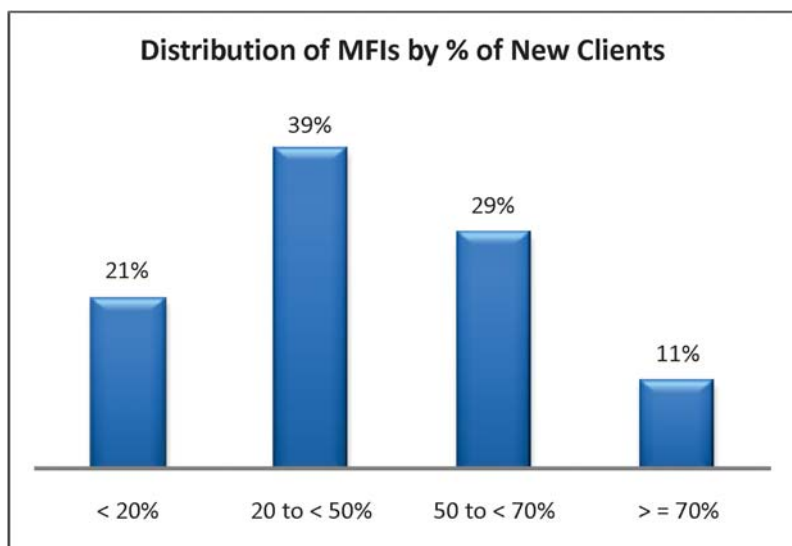
Client retention

Client retention is one of the indicators of the quality and appropriateness of service of MFIs. In addition, an MFI can expect to cause impact over the clients only when that section of clients stays with the MFI for considerable period of time, say over several loan cycles.

In this report, we asked MFIs to provide a profile of their total clients: how many were new (had joined in the previous year), how many had been with the MFI for three years or more? Not all MFIs were able to report this information, since it requires a unique client ID in the MIS. Not all MFIs have this. Even if they do, clients who rejoin after a gap in borrowing may be counted as new clients.

The distribution of total clients as of March 2010 for the reporting MFIs (Quick data 2010) reveals that MFIs report a high percentage of new clients, particularly for NBFCs (a few of who started operations within the previous two to three years). Figure 23 indicates the distribution of MFIs by percentage of new clients.

Figure 23 Distribution of MFIs by percentage of new clients

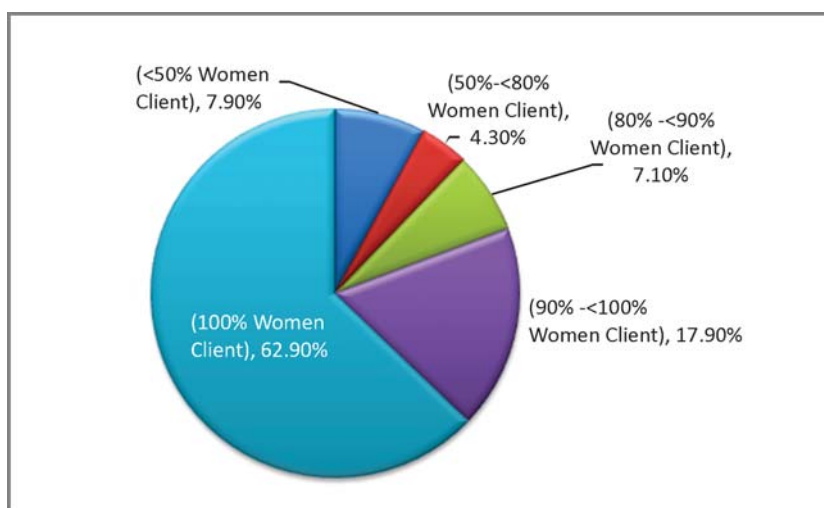


The data portrays that most of the clients are new. The corollary indicator for measuring client loyalty / satisfaction is client dropout rate. The median drop rate, as per the Sa-Dhan analysis (Quick Data 2010) on 140 MFIs, was 13.5 % drop out rate at the end of March 2010. Though benchmark of acceptable dropout rate is yet to be evolved, the rate appears to be lower for Indian MFIs as compared to the global average of 24 % (as reported by MiX).

Gender

Predominantly, the Indian microfinance sector has always targeted women as its clients. As of March 2010 (Quick Data 2010), the women clients constitute an overwhelming majority of the total clients reached by all MFIs together (Figure 24).

Figure 24 Women as share of total clients



It shows that Indian MFIs still prefer to work with women clients. It has also been observed that many of the MFIs have either started working with male clients. Some of the financial institutions, who have forayed into microfinance as an alternative market, were earlier working with mainly male clients but their microfinance clients are mainly women. Some of the matured MFIs have also started small enterprise loans targeting male clients. In the coming years, the proportion of male clients is likely to increase further.

In the social performance reporting, MFIs report on additional services they provide for women clients, as well as the ratio of men and women staff within their organization.

Services to women clients

Women empowerment has been one of the prime objectives of Indian MFIs. The majority of MFIs report various services particularly for women, including leadership training in the group based models as well as training related to women's enterprise opportunities (Figure 26). These services would go a very long way in building capacity of women.

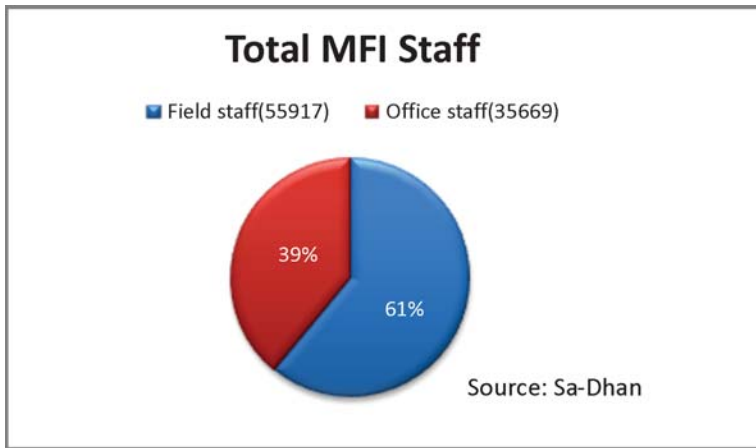
Figure 25 Non- financial services for women in training



Women employees

Proportion of women staff in MFIs is perhaps an important indicator of the organizations commitment to provide opportunities to women, a social goal in itself. Higher number of women staff would also heighten the organizations' competency to gauge the needs of the women clients and acceptability of MFIs product and process. The shares of field and office staff are given in Figure 26.

Figure 26 Total MFI staff



Nearly all MFIs were able to report on staff numbers and the ratio of women staff at different levels.

Figure 27 Distribution of MFIs by share of women managers

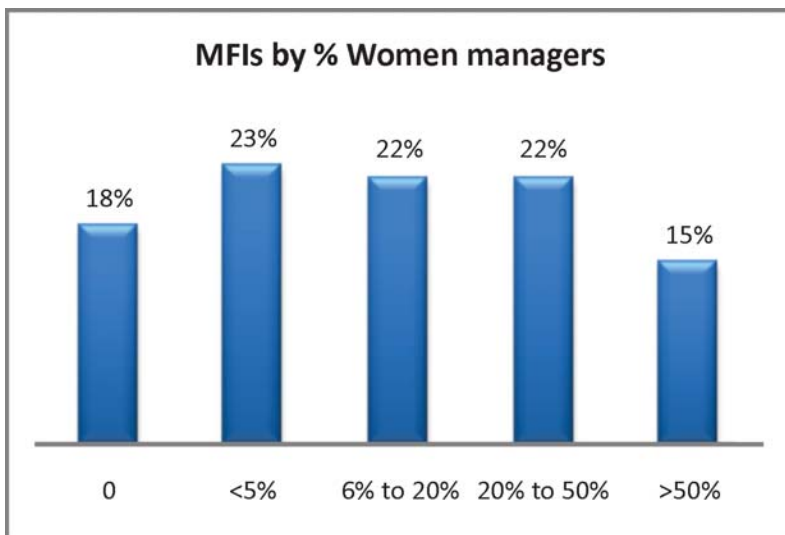
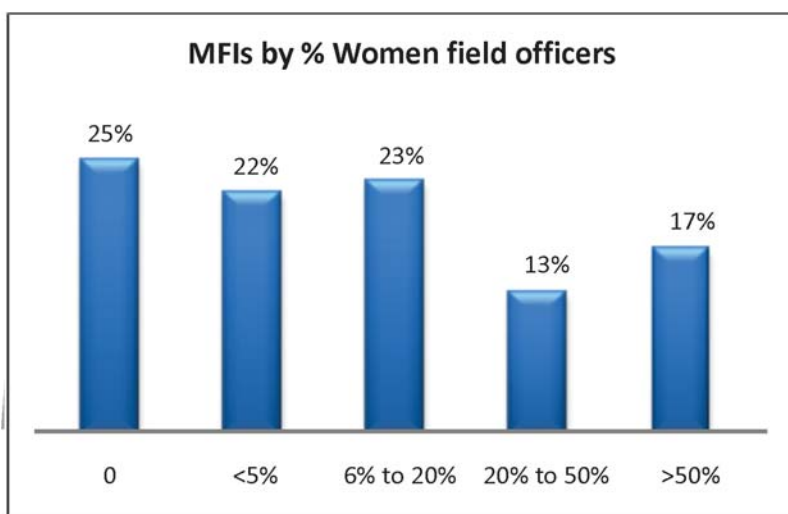


Figure 28 Distribution of MFIs by share of women field officers

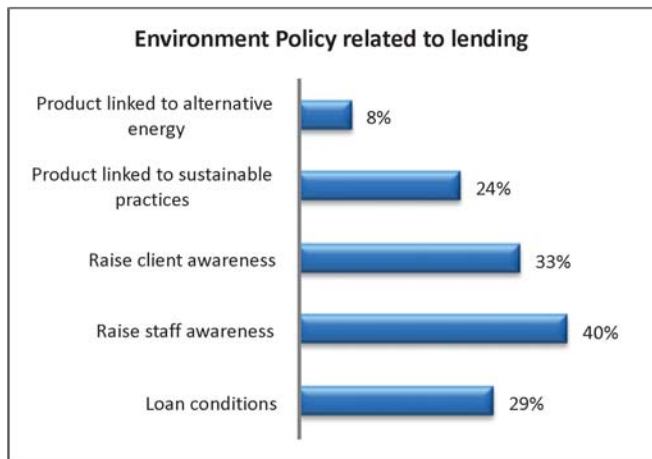


The distribution of MFIs by gender ratio of staff shows that women employment is neither high for field staff or managers. The analysis (figures 27 and 28) reveals that the scope for enhancing the women staff is wide, especially when we foresee the requirement in the light of preponderant women clients that MFIs reach out.

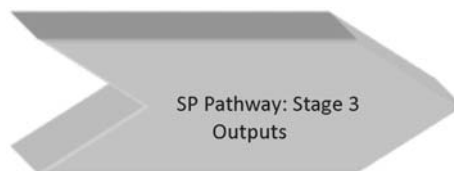
Environmental policies

While financing economic activity, climate change and its drivers have to be taken into account. Environmental dimensions are also emphasized now for the sector making it triple bottom-line industry. Lending to solar lighting system would be an ('eco-friendly') example. Thus, PPP (People, Profit and Planet) would be the target of MFIs at least in the long term. A small proportion of MFIs have formal written policies related to lending; over one-third have informal policies guiding operations. The environmental policies related to lending can be found in figure 29.

Figure 29 Environmental policies related to lending



The analysis does indicate that MFIs are conscious of the eco-friendly lending and eco-way of running their organizations, though very wide scope is ahead in this front.



Products and services: financial services

The Malegam Committee set up to study microfinance in India, has recommended to the effect that the MFIs to lend in a targeted way to constitute 75% of their loan assets to be under income generation activities. This reiterates the importance of responsible lending to show social performance.

All MFIs offer credit – usually general loans which are intended for general enterprise use, or may also be used for other purposes. As per the analysis done by Sa-Dhan, as of 31 March 2010, the major loan amount goes to income generating purposes (figure 31). This supports the mission objective of poverty reduction as seen from the data above.

Figure 30 Credit products of MFIs

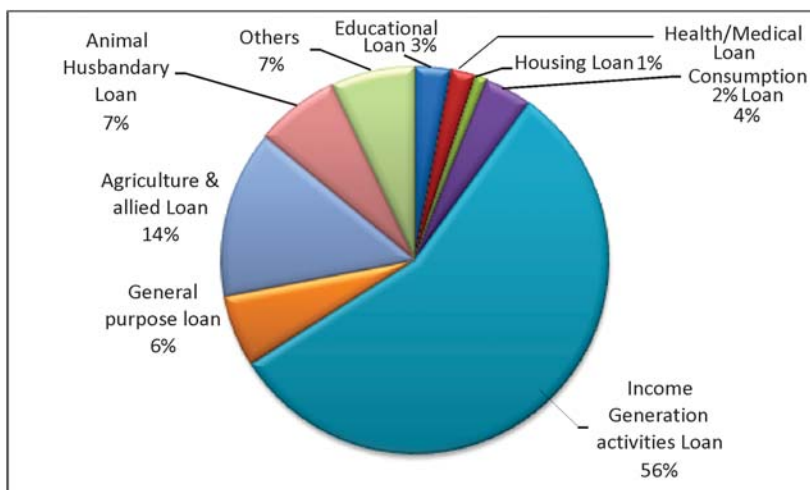
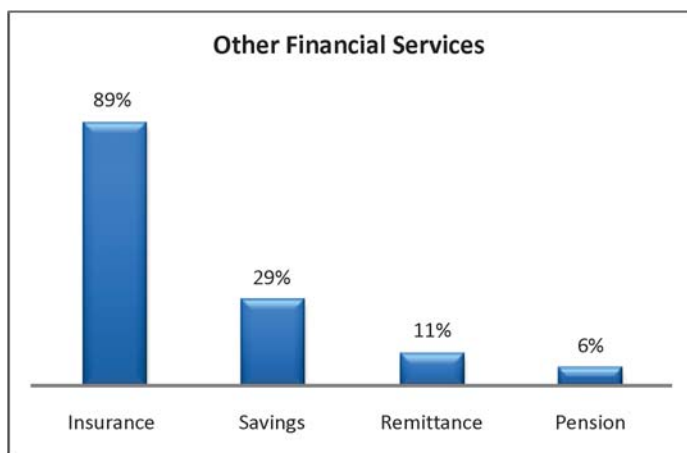


Figure 31 Other financial services of contributing MFIs



The social performance data shows (figure 32) that under non- credit products, the majority of MFIs are providing insurance. Nearly one-third are facilitating savings, largely through the SHG bank linkage model. A number of them are beginning to offer remittance facilities and pensions.

Non-financial services

A number of MFIs are reporting non-financial services to clients including:

- Enterprise skills training and other livelihood support
- Education – in basic health and nutrition
- Linkages to medical services.

Indian microfinance, in essence, is a single product - credit- industry making it imperative to find ways to design basket of products and services to create 'real' financial inclusion.

CONCLUSION

Most MFIs have a social mission. They seek to reach out to the poor, reduce poverty, undertake community development, encourage women empowerment and promote socio-economic development in general. Social performance refers to the success of MFIs in meeting these goals.

This chapter is the result of the attempt on the part of Sa-Dhan to collect data and report on social performance of Indian MFIs. This self-reported data based analysis is providing the first evidence of the achievement of the social goals the MFIs set for themselves. The analysis has revealed that the MFIs have a clear social mission and have reached out to very large number of women clientele, most of them poor, illiterate, vulnerable, operating predominantly in rural areas and poorest districts untouched by mainstream banks. This itself is the pointer to the fact that the MFIs are socially geared to embrace at least the double bottom-line. The stakeholders' expectation from MFIs is clear. They need to - have socially relevant mission, introduce customer friendly products, adopt appropriate process, invest in client education, and exercise restraint in pricing and offer services beyond finance. These will help MFIs navigate through the social performance path way in an accelerated way to cause community development.

4. PROGNOSIS AND WAY FORWARD

Microfinance is social enterprise and the financial performance is only a means to social performance. In fact, there is growing evidence that social performance enhances overall performance⁶. The relationship between social performance and financial performance of MFI is not difficult to comprehend. In any financial industry or for that matter any other industry; it is a well established fact that that customers need to be central to the service-, so to say 'The customer is the king'. Similarly other recognized principles like 'marketing' builds customer loyalty rather than 'selling', 'satisfied customer is the best advertisement' etc underline the importance of customer service, in any business.

We can extend these principles to microfinance. Microfinance is a social sector where financial sustainability is important for continued service to the clients, and the financial performance in turn depends on the performance to safeguard the client households' interest, an important aspect of social performance. The socially responsible initiatives like staff training for better client service, client education and entrepreneurship training, etc build loyalty among the clients leading to improved volume / quality of portfolio resulting in better financial performance. Similarly, better financial performance results in surplus resources that could be used by MFIs for deepening the social performance.

At present, Sa-Dhan has a limited set of social performance data. To perform analysis to establish the link between the social and financial performance would be premature. Certain global studies conducted with larger volumes of data have confirmed the positive relationship between the social performance and financial performance. The findings are reproduced below:

In a study of the Microfinance Information Exchange (MIX)⁷ the relationships between three financial performance indicators (productivity, portfolio quality, efficiency) and social performance indicators (targeting of poverty level, non financial services, training on social performance, client retention, social responsibility to clients, and social responsibility to staff) were tested. The data analysis was done with ordinary least squares regressions using data of 208 MFIs reporting to the MIX. The main results from the paper confirmed several expected trade-offs and synergies between social performance and financial performance, (FP), including: efficiency trade-offs

⁶ Orlitzky et al. (2003)

⁷ Adrian Gonzales (2008)

for targeting the poorest, SP training and social responsibility (SR) to staff, productivity synergies for SP training and SR to staff, and productivity and efficiency synergies for client retention.

1. The results confirm that investments in human capital (social performance training and social responsibility) go hand-in-hand with higher staff productivity and better portfolio quality, but lower efficiency. This seems to be supported by the study above.
2. Social performance training and human resource (HR) policies have stronger synergies and weaker tradeoffs with financial performance; and that serving the very poor and poor comes at a cost in terms of efficiency, but not in terms of risk or productivity, even after considering differences in loan sizes.
3. An interesting finding in the present context is the negative relation of consumer protection policies with portfolio at risk measured by PAR30.

Implication of the social performance analysis

The analysis in this report has shown that Indian MFIs had been focusing on financial sustainability as part of a growing industry to establish institutions to serve the client in a sustainable way while making all out efforts to follow client protection measures. The lesson that could be learnt from the results of this analysis, interpreted in light of the present microfinance crisis, is that the client protection measures and social performance need to be given emphasis right from day one of the organizations' coming into existence. The implications that could be drawn for better social performance of MFIs would include, among other things:

1. Avoiding over lending and multiple lending
3. Financial literacy to enable the clients to take informed decision
4. Proper feedback and grievance redressal mechanism
5. Avoiding unhealthy competition through sharing of information among MFIs working within the same geography
6. Widening the choice on products and services
7. Understanding the livelihood context of the clients and complementing the efforts of other stakeholders in strengthening their livelihoods
8. Appropriate loan recovery practices and staff behavior with clients

The MFIs, however, could not shoulder the entire responsibility of poverty alleviation despite their social mission and attempts for social performance. There are

significant other stakeholders whose facilitation and intervention are critical for the effective social performance of MFIs.

The Way Forward

The sector requires certain broader interventions for ensuring social performance. The contributions anticipated from such stakeholders are described hereunder. The Code of Conduct as a critical tool for ensuring ethical practices assumes highest importance for all stakeholders.

i Clients & MFIs:

Awareness building has a long way to go in the sector. The clients have to become aware of their rights and responsibilities as well as the limitation of MFIs and the financial system as a whole. They also need to know the complementary nature of credit and the financial products and the need for responsible borrowing for managing their livelihoods better.

The MFIs need to become increasingly aware of the sensitivity of the type of clients being served and the need to synchronize/match their service to the needs and other development factors playing on the day to day lives of the poor. The importance of governance and the critical nature of the staff incentive system in the overall service delivery and social performance are other aspects the MFIs need to internalize.

ii Investors & Banks

The investors and banks could appreciate the unique nature of financing the poor and the differential treatment required by MFIs for valuation and evaluation before investing. The necessity to embrace commercially oriented legal form, for example, is not borne out of the NGO-MFIs desire, but because of the handicap to attract resource for their transformation from being an NGO- *avatar*.

iii Service Providers

The other service agencies like rating agencies, audit firms have the responsibility to alter their tools and methods of analyzing, monitoring MFIs to gauge the indicators of social performance rather than those of financial performance alone. Most importantly, they need to examine and recognize true costs in the promotion and provision of the service, either through the group channel or the direct route.

The capacity building institutions have a spectrum of subject matters to deal with apart from financial, investment and valuation related ones. Client protection, building people's institutions, entrepreneurship development etc are other areas for skilling interventions.

The international agencies and donors would need to channelize their resources in such a way the social capacities of the stakeholders are built.

The researchers would need to look for new relationships existing between social, economic, cultural, financial factors and the performance of MFIs, clients and others and suggest new theories and standards for the practitioners to adopt.

iv Regulators, Government Agencies & People's Institutions

The regulators could better appreciate the constraints under which the constituents are operating and the fact that it is always the 'bad apple', not peculiar to microfinance sector alone, which brings bad standing and reputation to even genuine operators who would be majority. Any regulatory move could ideally discourage erring players and would avoid inadvertently bogging down the genuine ones.

As part of understanding the constraints of the players, the regulators could appreciate their ability/inability to mobilize local resources (like savings). This may be kept in view for making available resources for lending.

The government agencies have the right to intervene in the sector if the clients' interests are compromised. The distinction should always be made between the unorganized money lender and the MFIs as institutions. The agencies could appreciate the statutory acts governing the operation of MFIs and validate the critiques being brought to their notice by media and the local political cadres. The resources available at their disposal under different government schemes could be put to best use for enhancing the capacities of supply side players and the demand side beneficiaries

The broader political structure existing to represent the people to the government could appreciate the role played by MFIs in supporting the livelihood opportunities of their constituents.

v. Industry Body

Sa-Dhan being a voluntary body has limited resources to create awareness on the members' Code of Conduct brought in for ensuring client protection and initiate preventive action against aberrations. Its other initiatives on skilling its members

on credit plus products, livelihood promotion as well as building industry infrastructure encounter similar constraints.

The sector requires a growing data base and analysis to take informed decision. The system of financial performance data gathered and made available by Sa-Dhan to the stakeholders during the past six years deserves further investment for capturing increasingly complex data including social performance. Sa-Dhan is planning to build an internal infrastructure for knowledge building and systematic education and dissemination.

In essence the social performance is a function of investment on awareness creation, skill building, setting appropriate incentive structure, tools and functional systems of service providers, capacitating industry body's for self regulation and continual monitoring of players under conducive regulatory framework.

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ANNEXURES

ANNEXURE 1: SA-DHAN CODE OF CONDUCT

CORE VALUES, CODE OF CONDUCT AND COMPLIANCE MECHANISM

PREAMBLE

Microfinance institutions seek to create social benefits and promote financial inclusion by providing financial services to low income households. As these institutions build partnerships with their clients, it is getting increasingly important to define core values and fair practices, so as to ensure that Microfinance services are provided in a manner that benefits and respects clients. This document states core values for Microfinance (Part-I), a Code of Conduct for Microfinance institutions to abide by these values (Part-II) and a process of compliance (Part-III). We, (insert your MFI name) member of Sa-Dhan, unanimously and whole-heartedly agree to abide by the core values and the Code of Conduct as set out hereunder:

PART I CORE VALUES IN MICROFINANCE

INTEGRITY

Our mission is to service low-income clients—women and men—and their families, providing them access to financial services, that are client focused, designed to enhance their well being, and delivered in a manner that is ethical, dignified, transparent, equitable and cost effective.

QUALITY OF SERVICE

We are committed to ensure quality services to clients, appropriate to their needs and delivered efficiently in a convenient and timely manner. While doing so, we agree to maintain high standards of professionalism based on honesty, equality and dedication to serve the poor.

TRANSPARENCY

We shall provide our clients complete and accurate information and educate them about the terms of financial services offered by us such as interest rates and all

other charges as well as our policies and procedures in a manner that is understandable by them.

FAIR PRACTICES

We are committed to provide financial literacy to all our clients and ensure that our clients are protected against fraud and misrepresentation, deception or unethical practices. In providing Microfinance services including lending and collection of dues, we are committed to fair practices, which balance respect for client's dignity and an understanding of a client's vulnerable situation, with reasonable pursuit of recovery of loans.

PRIVACY OF CLIENT INFORMATION

We will safeguard personal information of clients, only allowing disclosures and exchange of such information to others who are authorized to see it, with the knowledge and consent of clients.

INTEGRATING SOCIAL VALUES INTO OPERATIONS

We believe that high standards of governance, participative management and reporting- that include social as well as financial data- are critical to our mission to serve our clients and to uphold core social values.

FEEDBACK MECHANISM

We shall provide our clients formal and informal channels for their feedback and suggestions and consistently assess the impact of our services with the object of building our competencies to serve our clients better.

PART II CODE OF CONDUCT

To ensure that all our activities and dealings with clients are in compliance with the above core values, we (insert your MFI name) agree to adopt and practice the Code of Conduct as elaborated hereunder in letter and spirit:

2.0 APPLICATION OF THE CODE:

This Code applies to following activities undertaken by us:

- a) Providing credit services to clients individually or in groups.
- b) Recovery of credit provided to clients.

- c) Collection of thrift from clients, where ever applicable.
- d) Providing insurance and pension services, remittance services or any other products and services that will reduce vulnerability of our clients.
- e) Formation of any type of community collectives including self-help groups, joint liability groups and their federations.
- f) Business development services including marketing of products or services made or extended by the eligible clients or for any other purpose for the welfare and benefit of clients.

2.1 We agree to—

- i. Promote and strengthen the Microfinance movement in the country by bringing the low-income clients to the mainstream financial sector.
- ii. Build progressive, sustainable and client-centric Microfinance institutions in the country to provide integrated financial services to our clients.
- iii. Promote cooperation and coordination among Microfinance institutions and other agencies to achieve higher operating standards and avoid unethical competition in order to serve our clients better.
- iv. Integrate this code into the operating guidelines & processes of our institution.

2.2 In order to achieve the aforesaid, we agree to follow the practices mentioned below:

2.2.1 INTEGRITY AND ETHICAL BEHAVIOUR

- i. Design appropriate policies and operating guidelines to treat our clients and employees with dignity.
- ii. Incorporate transparent and professional governance system to ensure that our staff and persons acting for us or on our behalf are oriented and trained to put this Code into practice.
- iii. Educate our clients of this Code of Conduct and its implementation.

2.2.2 TRANSPARENCY

- i. Disclose to clients all the terms and conditions (including changes if any) of our financial services offered in the language understood by the client.
- ii. Provide loan sanction letter or any other document clearly indicating the rate of interest, mode of charging interest, levy of any other charges, terms of repayment to the client against his/her acknowledgement.
- iii. Provide information to clients on the rate of interest offered on the thrift services, wherever applicable.
- iv. Provide information to clients related to the premium and other fees being charged on insurance and pension services.
- v. Provide periodical statements of their accounts by means of a passbook or any other mechanism to the clients.

2.2.3 CLIENT PROTECTION

a) Fair practices

- i. Committed to follow fair practices built on dignity, respect, fair treatment, persuasion and courtesy to clients.
- ii. Provide micro finance services to low income clients irrespective of caste or religion.
- iii. Provide services using efficient and cost effective methods.
- iv. Obtain no documents other than what are required as per KYC norms from clients.
- v. Obtain no tangible collateral security-except for housing loans under Microfinance- while granting loans under microfinance.

b) Avoiding Overindebtedness

- i. Take reasonable steps to ensure that credit services are based on the need and repayment capacity of the client and that this service will not put borrowers at significant risk of over-indebtedness.
- ii. Ensure that non-credit, financial products extended to low-income clients are appropriate and the terms are made known to the client.

c) Appropriate interaction and collection practices

- i. Interact with the clients in an acceptable language and dignified manner and spare no efforts in fostering clients' confidence and long-term relationship.
- ii. Have a clearly defined and phased procedure in case of client default.
- iii. Maintain decency and decorum during the visit to the clients' place for collection of dues.
- iv. Avoid inappropriate occasions such as bereavement in the family or such other calamitous occasions for making calls/visits to collect dues.
- v. Avoid any demeanor that would suggest any kind of threat or violence.
- vi. Emphasize using social collateral which includes various forms of peer assurance such as lending through groups and group guarantees at the village, hamlet or neighborhood level, or guarantees by relatives, friends, neighbors or business associates; and explain clearly to clients what the obligations of social collateral are.

d) Privacy of client information

- i. Keep personal client information strictly confidential except in the following circumstances:
 - a. Client has been informed about such disclosure and permission has been obtained.
 - b. It is legally required to do so.
 - c. The party in question has been authorized by the client.
 - d. This practice is customary amongst financial institutions and available for a close group on reciprocal basis (such as a credit bureau).

2.2.4 GOVERNANCE

- i. Observe high standards of governance, ensuring fairness, integrity and transparency by inducting persons with good and sound reputation and understanding of Microfinance as members of Board of Directors. Ensure that at least 1/3 members of the board of directors are independent directors and the board is actively involved in all policy formulations and other important decisions.
- ii. Ensure transparency in the maintenance of books of accounts and reporting/ presentation and disclosure of financial statements by qualified auditor/s.
- iii. Put in best efforts to follow the Audit and Assurance Standards issued by the Institute of Chartered Accountants of India (ICAI).
- iv. Place before the Board of Directors, a compliance report indicating the extent of compliance with this Code of Conduct , specifically indicating any deviations and reasons therefore, at the end of every financial year.

2.2.5 CLIENT EDUCATION AND FINANCIAL LITERACY

Raise the client's awareness of the options, choices and responsibilities in the financial relations with us.

- i. Adequately inform clients about our policies and procedures in order to enable them to make informed choices and decisions.
- ii. Ensure regular checks on client awareness and understanding (as part of internal audit systems or through some other regular monitoring).

2.2.6 COMPETITION

- i. Develop regular interaction with other MFIs operating within the same area or in new areas where expansion is planned.
- ii. Follow fair and ethical practices while lending to clients of other MFIs and recruiting employees of other MFIs.
- iii. Explore other unserved and underserved areas for expansion, avoiding areas that are already adequately served.

2.2.7 FEEDBACK/ GRIEVANCE MECHANISM

- i. Establish effective and efficient feedback mechanisms.
- ii. Inform clients about the existence and purpose of these mechanisms and how to access them.
- iii. Designate an official to handle complaints and/ or note any suggestions from the clients and make his/ her contact numbers easily accessible to clients.
- iv. Set up complaint handling systems which will take steps to correct any error and handle/receive complaints speedily and efficiently.
- v. Where complainants are not satisfied with the outcome of the investigation into their complaint, they shall be notified

of their right to refer the matter to the Ethics & Grievance Redressal Committee constituted by Sa-Dhan.

- vi. Conduct an annual client survey in order to gauge the effectiveness of our practices and client satisfaction levels.
- vii. Monitor client exit rate and conduct regular exit surveys to understand reasons for leaving MFI program.

PART III

COMPLIANCE MECHANISM

- 3.1 The Board of Directors of Sa-Dhan shall nominate an independent Ethics and Grievance Redressal Committee to facilitate compliance with this Code. The committee shall be constituted of two experts from the sector and three other independent persons nominated by the board of directors of Sa-Dhan. They should be respected and trusted persons from the Microfinance sector and other social development sectors, providing guidance and help in resolving disputes.
- 3.2 The Board of the member Microfinance institutions should adopt the core values and the Code of Conduct on an annual basis.
- 3.3 Disclosure: Independent of any complaints, all members of Sa-Dhan will report regularly on indicators derived from this Code. The analysis of this report will be published on the Sa-Dhan website and the Annual Microfinance Report of Sa-Dhan.
- 3.4 In case of a written complaint received by the Ethics and Grievance Redressal Committee regarding non-compliance with the Code of any member Microfinance institution, the committee shall take the following steps:
 - (i) Assist in compliance by giving an opportunity to the member to explain its position by way documents and/or a presentation before the committee. The committee thereafter shall pass its observation and advise corrective measures in case the member is found deficient.
 - (ii) In case the member does not respond to the complaint or does not take corrective measures advised by the committee as per step (i) above, shall proceed as follows:

- a. Formally write to the Chief Executive of that member Microfinance institution to respond to the complaint within 15 days.
- b. If the Chief Executive of that member Microfinance institution fails to respond or on failure to respond satisfactorily within 15 days of the receipt of the communication, the matter will be formally communicated to the board of that Microfinance institution in writing to seek a response.
- c. If the board does not respond or on failure to respond satisfactorily within the 15 days of the receipt of the communication, the membership of that Microfinance institution shall be suspended till further decision of the committee.
- d. If the committee decides after scrutiny it is necessary to expel the Microfinance institution from the membership of Sa-Dhan, it shall recommend the expulsion to the Board of Directors of Sa-Dhan.
- e. The Board of Directors of Sa-Dhan shall then take appropriate action and if they decide to expel the member, the name of the expelled member will be published on the website of Sa-Dhan and shall take any other appropriate step/steps deemed fit to inform such expulsion to other stakeholders.

ANNEXURE

Clients refers to those served by the microfinance institutions - women and men from socially, economically and politically disadvantaged sections of society, including small and marginal farmers, oral lessees, tenants, sharecroppers, disadvantaged social groups, artisans, and persons engaged in small and tiny economic activities.

Independent director means, that apart from receiving director's remuneration, the individual does not have any material pecuniary relationships or transactions with the company/organization, its promoters, its senior management or its holding company, its subsidiaries and associated companies:

- is not related to promoters or management at the board level.
- has not been an executive of the company/ organization in the preceding three financial years;
- is not a substantial shareholder of the company, i.e. owning two percent or more of the block of voting shares.

Documents under Know Your Customer (KYC) norms:

Features	Documents
Accounts of individuals Legal name and any other names used Correct permanent address	(i) Passport (ii) PAN card (iii) Voter's Identity Card (iv) Driving license (v) Identity card (subject to the MFI's satisfaction) (vi) Letter from a recognized public authority or public servant verifying the identity and residence of the customer to the satisfaction of the MFI (i) Telephone bill (ii) Bank account statement (iii) Letter from any recognized public authority (iv) Electricity bill (v) Ration card (vi) Letter from employer (subject to satisfaction of the MFI) (any one document which provides customer information to the satisfaction of the MFI will suffice)

ANNEXURE 2: CODE OF CONDUCT IMPLEMENTATION STRATEGY

Sa-Dhan's implementation strategy comprises of steps for MFIs to implement the Conduct of Conduct as well as a roadmap for Sa-Dhan's own role as an enabler and supervisor of the Conduct of Conduct implementation. These are discussed below.

1. Implementation by Sa-Dhan members

The essential components for the implementation of the Code by MFIs involve the following broad steps.

Adoption of the Conduct of Conduct

The adoption of the Code consists of understanding the implication of Code, adopting the Code in overall operations and the designation of a compliance official.

Internalization through policies and guidelines

MFIs need to incorporate the Conduct of Conduct in their mission, vision and objectives. These need to be widely disseminated – on the websites, in all the offices, during training programmes and public meetings and all major publications. Internalising the Code also requires evolving policies, guidelines and operating instructions as well as modifications of existing rules and procedures. Other aspects are the introduction of new forms and making necessary changes to software and accounting practices. An example for internalisation is given below as a feature of capacity building of Sa-Dhan.

The guidelines should include principles to spell out organizational values and the standards of professional ethics expected of all staff as well as acceptable staff behaviour, grievance handling procedures and staff accountability for quality of loans.

Examples for internalisation: Code integration into organisational structures

Loan documentation: Provision for adequate disclosures should be made in loan application forms, sanction letters and loan agreements. Loan documentation can be drafted in the local language and in a manner which is understandable to the clients. Details of various terms and conditions must be explicitly told to the clients during their trainings. Sa-Dhan's Conduct of Conduct and CGAP's client protection principles further imply that prices, terms and conditions of financial products are fully disclosed to the customer, including interest charges, insurance premiums, minimum balances required on savings and transaction accounts, all fees, penalties, and whether those can change over time.

Lending policies: Lending policies should be made in such a manner that clients are not overburdened with the loans. These should not rely only on guarantee mechanisms, but should include an assessment of repayment capacity of the borrowers. The guidelines regarding debt threshold and acceptable level of loans from other sources should be precise. MFIs should avoid increasing debt levels of borrowers who are already indebted beyond their repayment capacity, avoid re-financing the loan at a higher amount, and follow standard procedures in case there is a need for re-structuring debt.

An example: Client appraisal is supposed to minimize the risk of overindebtedness, which is – as a result of multiple lending – the root of many crisis situations the microfinance sector has witnessed.

The Conduct of Conduct; subsection: 2.2.3bi says:

(MFIs should) take reasonable steps to ensure that credit services are based on the need and repayment capacity of the client and that this service will not put borrowers at significant risk of over-indebtedness.

This Code component must be integrated in the credit policy. The policy should contain among other things a guide to assess repayment capacity of clients and should prescribe a mechanism for avoidance of multiple lending. The policy should then be translated accordingly into operational manuals. Here the process of calculating repayment capacity must be stated clearly including income/expense analysis, asset- liability analysis. The process has to be transformed into formats and sheets for use by the credit officer in the field. Additionally the software and audit formats have to be enhanced to capture the different aspects of compliance to this Code component. Every component of the Code should find its mentioning in the relevant policy.

Collection Practices: MFIs should evolve collection practices that require all clients to be treated with dignity and respect, even when they fail to meet their contractual commitments. The following should be strictly avoided:

- Abusive language or threats
- Harassing borrowers at odd hours
- Forcible entry into dwelling and forced seizure of property without the legal orders

Specific step-by-step procedures and time frames can be outlined for late payment recovery and how to proceed when borrowers are in default.

Communication with the clients: Specific guidelines should be formulated for communication with the clients at all levels – loan officers, supervisors and administrative staff. Principles have to be evolved for dealing with specific situations – normal group meetings, and repayment problems. These should ensure that customers with low levels of financial literacy understand the product, the terms of the contract, and their rights and responsibilities. Clients should also be aware of the debt recovery practices of the MFI. They should be aware of what to expect in case there is a delayed payment or a default. Clients should be encouraged to ask questions regarding the product and policies.

Incentive systems: Incentive systems particularly for the field staff can be designed in a manner which does not encourage indiscriminate lending. The incentive system should rather focus on the creation of a sound portfolio quality and strong client relationship.

Sharing information with other MFIs: MFIs should form regional networks where they can exchange information on level of indebtedness in specific areas. They can also share information specific problems like fraudulent staff members and unauthorized agents. They can commit to each other in the forum not to adhere to unfair practices at the time of recruitment of staff or enrolment of clients.

Dissemination and training

Dissemination and training consist of internal publicity to mark the idea of self regulation and the display of the Conduct of Conduct in prominent places, in the local language, in the MFI branches. The Conduct of Conduct needs to be made part of all manuals and training programs for staff and clients. MFIs can provide regular training to their staff members on the Conduct of Conduct. Loan officers and staff responsible for collections should receive training on acceptable debt collections practices and loan recovery procedures. Clients need to be made aware about the existence of grievance mechanism with the organisation and at Sa-Dhan.

Implementation at ground level

Implementation at the ground level needs to be driven by an assigned compliance officer by the MFIs. To assure all efforts are working out for implementation of the Code in letter and spirit, incentive structures need to be modified to support the client focussed approach of the Code. Simultaneously the loan officers need to be motivated to spend sufficient time with the clients in order to ensure that the principles implied in the Code are followed from the time of client origination.

Feedback mechanism

The feedback mechanism includes feedback from clients to MFI and Sa-Dhan and from MFI to Sa-Dhan. Formal mechanism must be developed to get feedback and complaints from the clients. Customer complaints have to be taken seriously, investigated and resolved in a timely manner. MFIs must have a formal mechanism to handle customer complaints, problems, and feedback is in place and accessible to customers. Specialized personnel should be designated to handle customer complaints and problem solving. Complaints should be fully investigated and decisions be made consistently and without bias. The reporting on code compliance to Sa-Dhan serves as a feedback from the MFI to Sa-Dhan.

Tracking of compliance to the Code

Tracking of Code implementation is primary responsibility of the board of the MFI. The organisations should evolve a structure and mechanism to track the compliance on all levels. Sa-Dhan suggests a designated person, operational supervisors, the internal audit team as well as client feedback to be involved.

Adherence to Conduct of Conduct and stated policies and procedures should also be thoroughly checked during internal audits. Specifically, internal audits checks should include household debt exposure, lending practices that violate procedures including unauthorized re-financing, multiple borrowers per household, and other practices that could increase indebtedness. The collection practices as well as complaint handling should also be brought under the purview of internal audit.

There will be review and validation by Sa-Dhan and the publication of industry-wise reports annually on level of implementation. Sa-Dhan is planning to include on-site validations and assessments in order to provide rigorous monitoring to Conduct of Conduct compliance.

The integration of the Conduct of Conduct into the different components of the organisational structure is the centre piece of the capacity building workshops conducted by Sa-Dhan for its membership. These capacity building workshops form the heart of the roadmap of Code implementation for Sa-Dhan's.

2. Implementation by Sa-Dhan

Sa-Dhan as the association for development finance institutions in India has put the framework and structure for self regulation in place. It aims to support the members in implementing the Code and to allow smooth functioning of Microfinance in India by taking steps against members who do not follow the Conduct of Conduct.

Within Sa-Dhan, a team is coordinating the implementation of the Code. The team is linked with various other departments within Sa-Dhan. The strategy comprises of four components:

Data collection

Sa-Dhan will track the Conduct of Conduct compliance among its members and take corrective actions wherever necessary. This necessitates collection of data on Code compliance of MFIs at different points in time to enable Sa-Dhan to analyse and compare individual performance against benchmarks.

Monitoring of Code compliance consists of offsite and on site surveillance. Data on Code implementation will be collected and analyzed regularly. Results from data analysis will support capacity building and enforcement of the Code compliance. Off site surveillance is done through a self reporting sheet (the compliance report) and analysis of supporting documents.

On-site surveillance involves visits to MFIs for validations of the compliance report provided by the MFIs and assessment of the level of adherence with the Conduct of Conduct. Sa-Dhan has developed an assessment tool. This tool checks adherence of the MFI to the various Conduct of Conduct dimensions and looks at the Code from four perspectives¹⁰

- Approval: MFI must be aware of Conduct of Conduct issues and there should be willingness and express approval from the board that the Conduct of Conduct will be adhered to.
- Documentation: Policies and practices confirming to the Conduct of Conduct would need to be clearly and unambiguously documented in operational manuals etc.
- Dissemination: Policies and procedures adopted would need to be clearly disseminated across the organization through trainings, circulars and other communications.
- Observance: External assessment at client level to ensure that that the prescribed policies are being followed in practice.

Sa-Dhan's representatives visit the MFI and discuss the Conduct of Conduct compliance report with the management of the MFI. The validation team also visits an MFI branch and holds meetings with the staff and clients. The validation exercise serves the purpose of checking whether the MFI systems and processes are designed to ensure compliance with various Conduct of Conduct dimensions. The validation exercise also serves as a capacity building mechanism where the validation team discusses various issues with the management to clarify any difference in interpretations of the codes.

¹⁰ The assessment tool has been developed with the help of M2i consulting.

Capacity building

Capacity building efforts are being made to raise awareness regarding the Conduct of Conduct and its relevance and educating the members of Sa-Dhan about the integration of the Code rules into the systems of the MFIs. Capacity building aims to improve the practices of MFIs by providing practical help in developing client friendly systems and attitudes. This is being done by explaining the whole circle of flow of Code information in organizational systems: from policies to operational manuals to formats to MIS and internal audit to feedback to Sa-Dhan.

Sa-Dhan's capacity building initiatives include on site as well as off site efforts. Experience has shown that members value immediate discussion of findings of the onsite surveillance. The gaps identified between self reported data and the findings of the tool assessment are discussed with the management of MFIs. Off site capacity building is done through workshops with members. The workshops are structured to reflect the proper implementation of the code by MFIs.

Advocacy and capacity building

Sa-Dhan has conducted several meetings and workshops on Conduct of Conduct before and after the crisis in AP started. Two weeks after the ordinance was put in place by the government of AP, Sa-Dhan arranged for a meeting with government officials, banks/ funders and MFIs on November 2nd in 2010 in Hyderabad. After an elaborate round of stock taking the Sa-Dhan team presented the roadmaps for Code implementation. Confidence was built through the public endorsement of the members of the Conduct of Conduct. Meetings like this have been repeated in Bhubaneswar, Kolkata and Chennai.

Pure capacity building workshops have been held in Kurnool, Hyderabad and Rajahmundry. Focus was put on stock taking and a detailed description of the implementation strategy. These workshops will be increased significantly incorporating the insights from the data collection.

Enforcement

The salient principles for enforcing the Code among the members are:

- Transparent investigations in complaints
- Quick process of complaint redressal
- Avoidance of conflicts of interest
- Use of scientific methods in investigations
- Use of mediation and focus of cooperative strategies

The enforcement itself involves insisting on compliance to Conduct of Conduct rules, and action against organizations (including expulsion from membership) that display repeated non compliance despite the realistic possibility of compliance.

Upon a complaint received by Sa-Dhan against a member MFI the process of enforcing the Conduct of Conduct involves a review of the current state of compliance of the MFI, an agreement on areas and timeframe for improvement between the MFI and Sa-Dhan and evaluation after a period of time. This process is being coordinated by the Sa-Dhan Conduct of Conduct team and makes use of the Conduct of Conduct assessment tool described above. Advice and directions are given by the Ethics and grievance redressal committee (EGRC). The committee consists of 5 members (3 independent and 2 from the sector). It serves as the self regulator and has the power to suggest measures against erring members to the board of Sa-Dhan. An effective enforcement mechanism has been made possible by the Annual General Body meeting of Sa-Dhan in Bangalore on August 31st 2010. It has amended the memorandum of association by a clause prescribing that non compliance to the Code leads to exclusion from the Sa-Dhan membership.

Stakeholder engagement

The entire society is a stakeholder in the microfinance sector. This includes:

- Clients and their communities
- Funders (donors, banks, investors, bulk lenders)
- Government (union, state, local)
- Regulators
- MFIs
- Employees of MFIs
- Media and press
- Support organizations
- Political parties

Stakeholder engagement requires delivering information demanded by stakeholders and helping them in forming an unbiased and fair view of microfinance. Such engagements have to be characterized by transparency, honesty, proactive moves by Sa-Dhan and Integration and participation of large numbers of stakeholders. The MFIs themselves need to coordinate with Sa-Dhan for effective stakeholder engagement. Sa-Dhan on its part will continue to engage with the stakeholders through:

- Publication of reports for the public like the 'Quick report' with financial data issued by Sa-Dhan every year
- Events and workshops
- Individual discussions
- Media engagement through articles, comments, press conferences, press notes

ANNEXURE 3 CONTRIBUTING MFIs

S.No.	Name of the organization	Reported on Code of Conduct	Reported on Social Performance	Code of Conduct data validated on-site (in field)	Code of Conduct data validated off site (document analysis)
1	Adhikar Microfinance	✓		✓	
2	Agradut Polly Unnayan Samity	✓	✓		
3	Ajiwika Society	✓			
4	Arman Financial Services Ltd.	✓	✓		✓
5	Arman Financial Services Ltd.	✓			
6	Arohan Financial Services Ltd.	✓		✓	
7	Arth Microfinance Pvt. Ltd.	✓			✓
8	Ashajyothi Mahilabyudaya Society	✓		✓	
9	Asian Institute for Rural Regeneration	✓			
10	Bal Mahila Vikas Samiti	✓			
11	Bandhan Financial Services Pvt. Ltd.	✓			✓
12	Banki Anchalika Dibasi Harijan Kalyana Parishad		✓		
13	Belghoria Janakalyan Samity	✓	✓		
14	Bharat Integrated Social Welfare Agency	✓	✓		✓
15	Bhoruka Charitable Trust	✓	✓		
16	BWDA Finance Ltd.	✓	✓	✓	
17	CASHPOR Micro Credit	✓	✓		✓
18	CDC Microfinance Pvt.Ltd	✓	✓		✓
19	Cecoedecon Development Centre	✓			
20	Centre For Development Orientation & Traning	✓	✓		
21	Chaitanya Institute for Youth & Rural Development	✓			
22	Community Services Trust	✓	✓		✓
23	Coochbehar Khagrabari Relief Services	✓	✓		
24	CRESA Financial Services Pvt. Ltd.	✓		✓	
25	Darbar Saghitya Sansad	✓	✓		
26	Deepalaya	✓			
27	Development Organization for village Environment	✓			
28	Dhosa Chandaneswar Bratyajana Samity	✓			
29	Disha India Micro Credit	✓			✓
30	Drishtee Foundation	✓			
31	ESAF Microfinance & Investments Pvt. Ltd.	✓			

S.No.	Name of the organization	Reported on Code of Conduct	Reported on Social Performance	Code of Conduct data validated on-site (in field)	Code of Conduct data validated off site (document analysis)
32	Future Financial Services Ltd.	✓	✓		
33	Global Welfare Society	✓	✓		
34	Gram Utthan	✓			
35	Grama Vidiyal Microfinance Ltd.		✓		
36	Grameen Financial Services Pvt. Ltd	✓	✓	✓	
37	Grameen Sahara	✓	✓		
38	Haridanga Ramkrishna Vivekananda Sangha	✓	✓		
39	Hope Integrated Rural Development Society	✓			
40	HOPE Microcredit Fin Pvt. Ltd.	✓			
41	IDF Financial Services Pvt. Ltd.	✓	✓		
42	Indur Intideepam MACS Federation Ltd.	✓			
43	Innovative microfinance for poverty alleviation and Community transformation	✓			
44	Ishara Foundation	✓			
45	Jaago Samajik Arthik & Harit Vikas Sangathan	✓	✓		✓
46	Jan Chetna Sansthan	✓			
47	Kalighat Society for Development Facilitation	✓	✓		
48	Kaveri Credit India Pvt. Ltd.	✓			
49	Kotalipara Development Society	✓	✓		
50	Krishna Bhima Samruddhi Local-Area Bank Ltd.		✓		
51	Mahasemam	✓			
52	Mahila Vihas Prathamika Sanchaya Samabaya Ltd.	✓			
53	Manidham Grameen Savings cum Credit Services	✓	✓		
54	Margdarshak Development Services	✓	✓		✓
55	Mimoza Enterprises Fin. Pvt. Ltd	✓	✓		✓
56	MITR	✓	✓		
57	Nav Bharat Jagriti Kendra		✓		
58	Navachetana Microfin Ser Pvt Ltd.	✓			
59	Network of Entrepreneurship & Economic Development	✓	✓		✓
60	New Life	✓			
61	Nirantara Community Services	✓	✓		✓
62	Nirman Bharti Samajik & Arthik Vikas Sangathan	✓			✓
63	Opportunity Microfinance India Ltd.		✓		

S.No.	Name of the organization	Reported on Code of Conduct	Reported on Social Performance	Code of Conduct data validated on-site (in field)	Code of Conduct data validated off site (document analysis)
64	PAHEL Livelihood	✓	✓		✓
65	Parama Mahila Samity	✓	✓		
66	PARTNER	✓			
67	People's Action for Transformation	✓	✓		✓
68	Planned Social Concern	✓	✓		
69	Pragathi MAC Frderation Ltd.	✓			
70	Prakruthi Foundation	✓	✓		
71	PRAYAS	✓	✓		✓
72	Priyasakhi Mahila Sangh	✓			
73	Prochesta	✓			
74	Pushtikar Laghu Vyaparik Pratishthan Bachat & Sakh Sahakari Samiti Ltd.	✓	✓		
75	Rashtriya Seva Samithi	✓			
76	RORS Finanace Private Ltd.	✓	✓	✓	
77	Rural Education and Action Development	✓	✓		
78	Saadhana Microfin Society	✓	✓	✓	
79	Sahara Utsarga	✓	✓		
80	Sampada Trust	✓	✓		
81	Sanghamithra Rural Finanacial Services	✓	✓		
82	Sanginee Secondary Co-op. Ltd.	✓	✓		
83	Sarala Women Welfare Society		✓		
84	Satin Creditcare Network Ltd	✓	✓		
85	Seva Rahara	✓	✓		
86	Shalom Microfinance Ltd	✓			
87	Shikhar Development Foundation	✓	✓		✓
88	Shri Kshethra Dharmasthala Rural Development Project	✓			
89	Siri Microfin Society	✓		✓	
90	SKS Micro Finance Pvt. Ltd.	✓	✓		
91	SMILE Microfinance Ltd.	✓	✓	✓	
92	Societal Upliftment & Rural Action for job & Empowerment	✓			
93	Society for Model Gram Bikash Kendra	✓	✓		
94	Sonata Finance Pvt. Ltd.	✓	✓		
95	Sreema Mahila Samity	✓	✓		

S.No.	Name of the organization	Reported on Code of Conduct	Reported on Social Performance	Code of Conduct data validated on-site (in field)	Code of Conduct data validated off site (document analysis)
96	Support	✓			✓
97	S. V. Credit Line Pvt.Ltd.		✓		
98	Swadhaar FinServe Pvt. Ltd.	✓			
99	SWAWS Credit Corporation India Pvt. Ltd.	✓		✓	
100	Swayamshree Micro Credit Services	✓		✓	
101	The Payakaraopta Women's Mutually Aided Co-operative Thrift and Credit Society Ltd.	✓			
102	The Saath Savings and Credit Coop. Society Ltd.	✓			
103	Trident Microfin Pvt. Ltd.	✓	✓	✓	
104	Trust Microfin Network	✓			
105	Ujjivan Financial Services Pvt. Ltd.	✓		✓	
106	Ulkundra Tarun Seva Sangha	✓	✓		
107	UNACCO Fin Services Pvt. Ltd.	✓	✓		✓
108	Uttarakhand Micro-finance and Livelihood Promotion Cooperative Institution	✓	✓		
109	Vedika Credit Capital Ltd.	✓	✓		✓
110	Village Financial Services Pvt. Ltd.	✓	✓	✓	
111	Vivekananda Sevakendra-o-Sishu Uddyan	✓	✓		
112	We the People	✓	✓		✓
113	Welfare Services Ernakulam	✓			
114	WSDS- Institute of Innovative	✓			
115	Youth Council for Development Alternatives	✓			
116	Yuva Chetna Kendra	✓			



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