ABSTRACT

The recent crisis of microfinance in several southern states especially of Andhra Pradesh had a tremendous negative impact on microfinance sector. In this context the issue raised to argue that, Is Micro Finance Institutions have deviated from their sole objective of helping poor people? In fact during the period of this crisis, question marks were put on many microfinance institution practices. Keeping a side the outstanding effort done by microfinance sector, media highlighted the stories of extremely high profits, instances of over-lending and inappropriate collection practices adopted by some microfinance institutions. All this have negatively impacted the public image of the sector and created a sudden need to develop instrument for all stakeholders to judge ethical and client protection practices. There is an immediate need of improving the ethical practices which are important in fostering long term relationships between Micro Finance Institutions and clients. The study was conducted on 100 microfinance clients randomly belong to MFIs working in the Allahabad district of Uttar Pradesh, to comprehend the real situation in the field about the need, implementation, and redefinition of the client protection principals.

Key Words: Andhra Pradesh Crisis, Allahabad, Financial Literacy, Malegam Report, Customer Relationship, Code of Conduct, Ethical Practices, Client Protection

1. Introduction

The Indian banking sector is one of the world’s fastest growing markets for inclusive finance. As the financial services industry becomes more entrepreneurial and innovative, its risk and product diversification grow. This has posed significant challenges for Indian regulators, who strive to develop clear rules and fair regulations for both customers and banks. The recent crisis in several southern states especially in Andhra Pradesh had a tremendous impact on Indian microfinance sector. The issue led some to argue that Micro Finance Institutions have deviated from their sole mission of helping poor. During the course of this crisis, many microfinance institution practices that are not addressed by regulation were put into question. Following the 2006 crisis in Andhra Pradesh, where the government closed nearly 50 branches of local MFIs because it accused them of having usurious interest rates, regulators, private banks, and MFIs alike have been increasingly concerned with client protection policies. Although the Client Protection Principles are widely developed at global level we in this paper tried to find out policy loop holes in the Allahabad district of Uttar Pradesh, following the suggestion’s to improve the situation.

2. About Allahabad

The city of Allahabad is among the largest cities of Uttar Pradesh. Spread in the area of 5482 Sq. Km. the district has eight Tehsil and twenty development blocks. The total Population as per the 2011 census is 59,59,798 which is 2.99 percent of the total population of Uttar Pradesh with literacy rate of 74.41 percent. Presently there are 195 Nationalised bank branches, 73 rural bank branches and 34 branches of cooperative banks. Apart from it there is strong presence of MFIs namely SONATA Finance Private Ltd, Share and SKS. From the past one year Utkarsh and Moral has also begun there operations in Allahabad district.

3. Research Methodology of the Study

Study Area This study has been conducted on hundred respondents belongs to micro finance institutions working in the Allahabad district. Research Design Although the Client Protection
Principles are widely developed at global level we in this paper tried to gauze its status in the Allahabad district of Uttar Pradesh. Hence the study is descriptive in nature. **Data Collection** We have used primary as well as secondary data for the purpose of this research. The main sources of secondary data are MFIs manual, annual general reports, journals, newspapers and concerned websites. Primary data has been collected through interview with the hundred clients of MFIs, top management officials, branch managers belong to the MFIs working in the Allahabad district. **Data Analysis** The paper tries to comprehend the real situation in the field about the need, implementation, and redefinition of the client protection principals. The study was conducted on hundred microfinance clients randomly belong to MFIs working in the Allahabad district of Uttar Pradesh. The results were further verified and explained on the basis of conversation with staff members of the MFIs.

### 4. What Are the Client Protection Principles?

Client protection is a key ideology of microfinance. The client protection principles are a set of global principles aimed at ensuring microfinance clients are treated fairly and responsibly and do not become over-indebted. The client protection principles promote ways for microfinance providers to take practical steps to treat clients fairly and respectfully while avoiding practices that might harm them. These Principles are distilled from the path-breaking work of providers, international networks, and national microfinance associations to develop pro-consumer codes of conduct and practices. While the Principles are universal, meaningful and effective implementation requires careful attention to the diversity within the provider community and conditions in different markets and country contexts. The CGAP in year 2007 has defined the six widely accepted client protection principles namely; Avoidance of Over-indebtedness, Transparent Pricing, Appropriate Collections Practices, Ethical Staff Behavior, Mechanisms for Redress of Grievances and Privacy of Client Data.

### 5. Why need to regulate MFI’s

All NBFCs are currently regulated by Reserve Bank of India under Chapters III-B, III-C and V of the Reserve Bank of India Act. There is, however, no separate category created for NBFCs operating in the Microfinance sector. The reason which calls for urgent need to regulate the NBFC’ operating in the Microfinance sector includes the following:-

#### 5.1 Save vulnerable from being cheated

The borrowers in the Microfinance sector represent a particularly vulnerable section of society. They lack individual bargaining power, have inadequate financial literacy and live in an environment which is fragile and exposed to external shocks which they are ill-equipped to absorb. They can, therefore, be easily exploited.

#### 5.2 Splitting lead to multiple lending

NBFCs operating in the Microfinance sector not only compete amongst themselves but also directly compete with the SHG-Bank Linkage Programme. The practices they adopt could have an adverse impact on the programme. In a representation made to the Sub-Committee by the Government of Andhra Pradesh, it has been argued, that the MFIs are riding “piggy-back” on the SHG infrastructure created by the programme and that JLGs are being formed by poaching members from existing SHGs. About 30% of MFI loans are purportedly in Andhra Pradesh. The Microfinance in India- A State of Sector Report 2010 also says that there are many reports of SHGs splitting and becoming JLGs to avail of loans from MFIs. The A.P. Government has also stated that as the loans given by MFIs are of shorter duration than the loans given under the programme, recoveries by SHGs are adversely affected and loans given by the SHGs are being used to repay loans given by MFIs.

#### 5.3 To boost trust on the scheme

Credit to the Microfinance sector is an important plank in the scheme for financial inclusion. A fair and adequate regulation of NBFCs will encourage the growth of this sector while adequately protecting the interests of the borrowers.

#### 5.4 Freedom to operate

Given the need to encourage the growth of the Microfinance sector and the vulnerable nature of the borrowers in the sector, there is a need to give special facilities or dispensation to NBFCs operating in this sector, alongside an appropriate regulatory framework. This will be facilitated if a separate category of NBFCs is created.
Presently there are strong presence of SONATA Finance Private Ltd, Share, SKS and Utkarsh in the Allahabad district. All the MFIs operating in the region have adopted JLG model of microfinance. The group of five members is formed. Three to four such groups are formed to make group centre. Thus each centre comprises of 215-20 members. All the MFIs have slight variation in their products offered to urban and rural clients. As compare to urban area the initial loan size and duration of loan period is smaller for rural clients. The smallest loan in rural Allahabad begins at 2000-3000 rupees for 25 weeks while in urban area the duration is 50 weeks. The MFIs also have the provision of Individual loan which ranges rupee twenty thousand to fifty thousand. The effective rate of interest charged is twenty nine percent which becomes almost fifteen percent (flat). The results of the research are discussed as follows:-

6.1 Size of loan It was found that most MFIs consider a low-income borrower as a borrower who belongs to a household whose annual income does not exceed rupee fifty thousand. As mentioned above JLG (Joint Liability Group) of five members are formed, where each member after initial screening will be issued loan as per their requirement. All the group members take the joint responsibly for repayment of installments. However, some large NBFCs like SONATA Finance Private Ltd also give larger loans, even in excess of Rs.50,000 for special purposes like micro-enterprises, housing and education.

6.2 Term of Loan MFIs normally give loans which are repayable within 12 months irrespective of the amount of the loan. MFIs in Allahabad adopted 50 week repayment plan in urban areas and 25 weeks in rural areas. There are few MFIs which does not issue the next loan before the one year even if the group members repay the entire loan amount with interest prior to deadlines. This lead the client to approach other micro finance institutions resulted in overburden of the clients.

6.3 Collateral free Low-income borrowers often do not have assets which they can offer as collateral, and it is important to ensure that in the event of default, the borrower does not lose possession of assets which s/he may need for her/his continued existence. It was found that many times the staff members create nuisance when the client not able to meet its repayment schedule. It was also reported by many clients that the MFIs take the assets they hold to create pressure on them to repay the dues.

6.4 Leniency at Staff Side It was also found due to the leniency from the staff side at the time of screening and further follow up, many clients committed fraud. One case was reported where the one old regular client, which was having a good track record formed a fake group of dummy women’s and used to take all amounts issued to them by making a small payment to them for being acting as a dummy member of the group. Earlier the women used to repay all installments on time but once due to serious illness at home, she was found unable to meet repayment schedule. When the MFI enquired the reason of default, the story got revealed.

6.5 Multiple Loaning It was also found most of the NBFC extending micro finance to the clients does not bother multiple loaning. This happens especially in case of new entry in the industry. Initially rather than to work on making new groups they prefer to identify old groups developed and sustained by some existing institution and disburse loans to them. Generally MFI’s does not discourage clients to join other MFIs. They do not take any action till the number of institution exceed to three or they found client irregular in meeting its repayment schedule.

6.6 Purpose of Loan It was found in the survey the money so issued is not hundred percent consumed by the client on income generating activities. Sometimes due to the nature of work they hold certain
money to stocking the goods. Moreover only 60-70 percent loan amount is get utilized in their occupation and rest they spend to meet their other expenses which include education, illness, and personal consumption and even to pay prior loan installments taken from other informal sources.

6.7 Repayment schedule In almost all MFIs the installments were collected on weekly basis and to apply for next big loan it is the responsibility of the group leader to see all the installments should reach the day allotted at the collection centre. The members remain at great tension to meet the weekly deadlines. The stress increases when they have to spent amount to commute to the collection centre. They also have to sometimes close their shop for that many hours which affect their business also. Moreover it becomes anxiety for those clients whose earnings are quite irregular due to the nature of occupation they involved. It was also found that in certain MFIs which gives the facility to clients to pay installments to the staff who responsible for weekly meeting. It leads to at times chances of fraud at staff side. It was reported few staff members used to make fake theft story of money so collected. Many times it was reported they charge late fee and other such charges and do favorers among the group members.

6.8 Lack of financial literacy While interview it was found that the clients does not know the rate of interest charged from them. They just could able to communicate that their weekly installment is two fifty rupees over ten thousand rupee loan issued for 50 weeks. The MFIs deduct rupee hundred in the name of file maintenance and administration charges. They also charge one percent of loan amount as life insurance of the client and her spouse. Even seven days financial literacy program is conducted by the MFIs, still very few clients (10 percent) were found aware of the interest rates and other fees charged from them. The most common reason includes their illiteracy and lack of financial literacy.

6.9 Micro credit in spite of Micro finance It was found that nearly all the institutions were found providing only micro credit and no other services to the client. In the absence of risk cover for loss of cattle, business, or accident, leads to over burden and result in worse condition of the clients. At most thirty percent clients reported they are at worse position after they joined micro finance institutions. It was so because the cattle (Goat, pig, buffalo) they purchased to supplement their income died due to certain reason and in the absence of cattle insurance there expenses increased rather than any enhancement in their earnings. Moreover, the life insurance which the institutions claim is just a scheme to cover risk of loan so issued.

6.10 Skill Development, Entrepreneurial activities It was found in the study that the institutions are not involved in providing any type of skill development activity. Thus due to lack of entrepreneurial skills, market knowledge, new trends, the clients were not found taking benefits of the opportunities available. It was revealed that seventy percent of the respondent clients has just smoothen their business cycle and not lifted up out of the poverty. They are still at the same financial status even after they have been taken loan for 3-4 cycles. The most important reasons responsible for their stagnant financial position include, increase in the expenditure as compare to earnings, chronic illness, involved in paternal occupation (as they do not have any other skill), not proper utilization of loan money, poorly managed savings schedules etc.

6.11 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. It was found that 37 percent staff says there is no written guidelines how to handle difficulties in repayment. While 61 percent says they have written norms of debt collection practices. Almost 94 percent staff admitted they opt peer pressure for debt collection. 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. It was clearly observed those neighbors who hesitate to lend even ten rupee once grouped together in JLG model found came forward to repay their friends installment. Due to fear if any one
among group member default in paying installment, the loan will not be sanctioned to the other group members. 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.

6.12 Fair Practices In our survey it was found that except sharing profits of the firm, generally all the MFIs do not take any physical collateral, speedy loaning and reimbursement of loan, wherever collateral is taken for individual loans above 50,000, the collateral is released within 10 days. It was found that the caste discrimination takes place in few of the MFIs on the ground to balance the group and maintain its credit worthiness. For instances not all Muslim women were allowed to form group few other religion women were also being involved in the same group. It is so done because from experience it was found that mostly all the Muslim women stay in a colony are either directly or indirectly relatives of each other which may create chances of delinquency. Thus we can say the majority of the MFIs validated follow fair practices. This is very encouraging. Their practice on non-discrimination among clients, collateral requirement, etc. is noteworthy. This will enhance the client confidence and trust resulting in enhanced outreach.

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7. Solution to Improve Implementation of Client Protection Policy

7.1 Restrict the loan size It is important to restrict the size of individual loans as larger loans can lead to over-borrowing, diversion of funds and size of repayment installments which are beyond the repayment capacity of the borrower. It is, therefore, suggested that the size of an individual loan should be restricted to rupee thirty thousand in spite of rupee fifty thousand. Further, to prevent over-borrowing, the aggregate value of all outstanding loans of an individual borrower should also be restricted to thirty thousand rupees. However, the larger the loan, the larger the amount of the repayment installment, and a large installment may strain the repayment capacity of the borrower and result in ever greening or multiple borrowing. At the same time, if the repayment installment is too small, it would leave cash with the borrower which could be directed to other uses and not be available for repayment when repayment is due. Thus the size of the loan should be adequate.

7.2 Multi Purpose Loan It was revealed that the clients of microfinance institutions does not requires loan just for income generating activities but also for the other purposes too. It includes education, asset building, housing, shop building, medical expenses, and even to pay prior loans taken from informal sources. A recent study by Centre for Microfinance of borrowers in Hyderabad indicates that Microfinance is useful in smoothening consumption and relieving seasonal liquidity crises that visit poor families and that it obviates the need for high-cost borrowing from informal sources. The loans should not be restricted to income generating activities but should also be given for other purposes
such as repayment of high-cost loans to moneylenders, education, medical expenses, consumption smoothing, acquisition of household assets, housing, emergencies, etc. Hence it is suggested that the need for loans for the above purposes cannot be denied. The certain provisions are made by MFIs and they should at least provide loans to meet prior loan repayment, excessive medical bills, and housing and education loans after evaluating the repaying capacity of the client up to a certain limits.

7.3 **Utilization Record** as earlier mentioned the loan money issued is not hundred percent consumed by the clients on their business. In our study it was revealed that seventy three percent clients utilized their loan money for the same purpose they informed to the MFI, while the rest of twenty seven percent diverted their funds to the other income generating activities. Moreover only twenty four percent of the total respondents were found utilized hundred percent of the loan money on income generated activities. Rest seventy six percent respondents were found utilized only eighty percent on the purpose and twenty percent on consumption purpose. Thus it is important to keep a record of utilization status of the loan money sanctioned.

<table>
<thead>
<tr>
<th>Utilization Status</th>
<th>Number of clients</th>
</tr>
</thead>
<tbody>
<tr>
<td>100% Utilization</td>
<td>24</td>
</tr>
<tr>
<td>80% Utilization</td>
<td>76</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
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</tbody>
</table>

7.3 **Avoiding over indebtedness** It was found that in the JLG model the 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 analyze the repayment capacity of clients. This principle requires that the MFI should carefully analyze 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. The MFIs should prepare structured Progress of Poverty Index (PPI) form to analyze the credit worthiness of the client. It was found all MFIs in the study have such forms but no regular financial progress of the clients was recorded in the form. Thus it is strongly recommended that after every three months the staff should record the progress of the clients and the reason of no improvement if any.
7.4 Moderate Collection Policy some argue that installment repaid weekly reduces chances of misuse of surplus cash, while other argue it leads to hardship and due to nature of work it should be monthly installments. But here we suggest the repayment schedule should be decided according to the conveyance of the client keeping in mind the nature of activity client involved. The MFIs should be given freedom to vary the repayment schedule from weekly, fortnightly to monthly basis according to the repaying capacity of the client and their willingness. But it should be checked that whatever be the repayment schedule all loans so taken should be fully repaid within a period of 12 months. 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.

7.5 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 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. 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.

7.6 Customer Care Management It is suggested that MFIs must appoint customer care executives in each branch to address queries of the clients. The MFIs may also have a centralized 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.

7.7 Flexile repayment schedule While in interview with clients it was found that many clients showed their preference towards the fortnightly repayment schedule in spite of weekly. It helps them to save the money which they have to spend to commute from their house to collection centre. It was also argued that the weekly spending 2-3 hours in paying installments lead to wastage of their precious time as they have to leave their work place for that much time. Hence it is suggested that MFIs should go for flexile repayment schedule considering the clients requirement and nature of business they hold.

7.8 Withdraw in Multi Loan Cases To avoid the southern crisis, the MFIs should immediately withdraw from the clients who have been involved with many MFIs at one time to avoid situation of overburdens. It is required that the MFIs strictly check and withdraw.

Conclusion Keeping a side the outstanding effort done by microfinance sector, media highlighted the stories of extremely high profits, instances of over-lending and inappropriate collection practices adopted by some microfinance institutions. All this have negatively impacted the public image of the sector and created a sudden need to develop instrument for all stakeholders to judge ethical and client protection practices. There is an immediate need of improving the ethical practices which are important in fostering long term relationships between Micro Finance Institutions and clients.
The study 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. While acceptable collection practices are defined, some MFIs do not have guidelines on dealing with individual and mass difficulties in repaying loans. Financial literacy to help clients to take informed decisions should receive more attention among MFIs. Feedback and grievance mechanism to address clients' complaints is an important component to better serve the customers. Further a balance has to be struck between the benefits of restricting loans only for income-generating purposes and recognition of the needs of low-income groups for loans for other purposes. Thus it is suggests that the more integrated a MFI is in the community the better it will know its clients and their need for finance, which help to reduce the poverty from the nation.