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Transparency and Client Protection in Micro Finance

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Abstract

Micro finance has been in practice in India for the last two decades or so after drawing inspirations from Prof Muhammad Yunus, the brain child of micro credit and micro finance and the founder of the Grameen Bank, Bangladesh whose model has been replicated almost all over the world. However, one serious issue that needs to be addressed is whether the practitioners of micro finance really take care of the transparency and the client protection part. Micro Finance as a developmental tool for inclusive growth has been promoted by many institutions in the country including Banks, NGOs, SHGs, JLGs etc. Apex Institutions like RBI and NABARD have been instrumental in spreading promotion and linkage of SHGs to the banking system through refinance support and other initiative measures of proactive policies and systems thus making the same an important component in the poverty reduction strategy. Micro Finance also promotes micro and small enterprises development. This article attempts to discuss an overview of Client Protection and Transparency one aspect to building a self sufficient Micro Finance Institution.

Keywords: Credit, Client, Transparency, Financial Security, Management

Introduction:

The Micro credit or micro finance programme is understood to have started way back in 1976 when an experiment was conducted by Professor Muhammad Yunus in Jobra Village in Bangladesh near Chittagong University. The experiment provides loans to the poor who do not have anything to mortgage as collateral security. The Grameen bank's model has a lending guidelines and procedures in favour of women clients wherein about 97% of the borrowers belong to women. This model has been replicated in a number of countries and is doing very well in terms of clients and

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repayment of loan. To make the micro finance practices successful, the micro finance practitioners should make a serious effort in assuring and ascertaining transparency and client protection in the operation so as to meet the goals and objectives.

A thought on a statement:

I would like you to reflect upon a statement given by Prof. Muhammad Yunus, the brain child of Micro Credit & Micro Finance who said, ***"Poverty is not created by poor people. They are very hard working and intelligent people. Poverty is created by the system that we built, the system that we learnt in our University classes. If we change the system, poverty will be gone because it is not the fault of the person. It is externally imposed phenomenon and not internally generated phenomenon"***. This statement clearly tells us that the poor have the potential to excel in life if opportunities are given to them. They can really come out of poverty if resources are provided to them at appropriate time and place. Micro finance cherishes the activeness of the clients however poor they may be. The micro finance practitioners must be upfront about what they do to their clients and be straight forward in their dealings. In order to execute the micro finance schemes in the right perspective, the Micro Finance Institutions (MFIs) are to properly understand the very basic objectives of micro finance and its sustainability for consistent growth and expansion in terms of breadth of outreach (No. of clients) and depth of outreach (levels of poverty reached) which can be achieved only if transparency and client protection principles are well placed. Micro finance service is not the end in itself but is an enabling act to impact upon the life of the industrious poor.

Transparency in Micro Finance:

Micro finance is a very beautiful concept having its own frame of glory provided the principles are adhered to in letter and spirit by the Micro Finance practitioners operating across the globe. The un-banked section of the society – the poor, the down trodden and most neglected section who are in the base of the pyramid in reality have difficulties in accessing the formal banking systems for finance or for any other financial products as they have no collateral to mortgage to the bank and as they are thought to be not bankable. It goes beyond doubt that the poor are considered to be potential NPA's (non performing assets) by the banks even before the lending takes place. The one platform that is easily accessible by the poor undoubtedly is the micro finance programmes and the Institutions dealing in micro finance activities. However, as trust remains the dominant and main vehicle for sustainability of the micro finance programmes, the need to maintain transparency and client protection arises in the organisation. If transparency in the MFI's dealings is truly advocated by the practitioners, certain transformational effect on the lives of the disadvantaged section of the population served can definitely be observed. The practitioners in the field of micro finance activities need to be upfront in whatever they do and people particularly the clients should not have negative attitude towards what the Micro Finance Institutions are doing. Some people may be induced to say interest rate is abnormally high as most of the MFIs are charging rates much higher than what the commercial banks charge. In fact the MFIs do charge higher rate of interest but unlike scheduled commercial banks or organised Financial Institutions, they deliver credit and other financial services instantly and at the doorsteps of the clients though the same sounds impossible and impracticable for the commercial banks. The capital requirement in the case of micro finance is need based which is not encouraged by the commercial banks. The act of MFIs of charging higher interest rates than other organised players in the market on different counts can therefore be justified as mentioned above. The Micro Finance practitioners should also be upfront and transparent of what they do to their clients. Apart from fulfilling the social objectives, the MFIs also need to focus on the sustainability aspect and as such charging a little higher interest rate than the rest of the lenders in the market will enable the MFIs to take the good cause forward. The MFIs should also be transparent about Interest income being the only income of the MFIs and that the practitioners have to get margins sufficient to sustain their institutions. MFIs prominently feature in the minds of the poor borrowers when it comes to accessibility of financial services by the people who are outside the banking fold. It is strongly believed that poverty is not institutionalised but is pathological which can be done away with if opportunities are given to the poor and helpless people. They can definitely turn around in life as they have the potentials. The MFIs should be transparent about a system they create to address the hardship faced by the people, particularly the poor clients and the have-nots. All the policy makers and every right thinking citizen must address this issue very seriously to enable each and every person to live a meaningful life. MFIs are doing their bids in this area to lessen the pains of the society. The message here is to reflect upon the realities in life by creating opportunities and avenues for the poor clients and undeserving people who will in turn show amazing results in life which is indeed transformational.

Client Protection:

While the positive aspects of the micro finance programmes and policies are focussed, it also stands prudent to internalise the negative aspects that might harm the clients as well as the resource providers. The cause of micro finance crisis that occurred in Andhra Pradesh way back in the year 2010 which affected the whole micro finance industry in the country including the states of North Eastern Region may be looked into here. The crisis is understood to have started after some borrowers of micro finance Institutions committed suicide as they were unable to service the debt. Another fact that was established was that the micro finance lenders used coercive methods to recover the loans from the clients. One of the reasons for being unable to repay the loan could be because of over-indebtedness. There has been a tremendous growth in the micro finance industry in recent times which was also believed to have fuelled many players entering into the field. As per a study conducted by Sa Dhan, there is a demand of micro finance services of about Rs. 26 billion in the North Eastern Region alone providing business opportunities to the individual promoters as well as to the Corporate houses. It is obvious that entry of many players in the sector would increase the competition thereby proliferating the chances of over-indebtedness to the borrowers which means micro finance borrowers will be availing loans from many lenders at any opportunity available to them without actually having the capacity to repay the loan. The then will be having too many accounts to service without having sufficient cash inflows to their favour. Therefore, it is desirable for the micro finance practitioners to put in place a system to protect the clients by providing them a cushion to fall back in times of financial crisis.

Client protection Principles: The following client protection principles may be considered effective while safeguarding the interest of the clients.

1. **Avoidance of over – indebtedness** – Over indebtedness in fact is very obvious in micro finance as the number of players in the market increase. It means giving too large a loan to a person with too modest a means to pay it back. Many borrowers today are borrowing from more than one MFI or borrowing from one MFI to repay the loans of another which has become a real problem for the micro finance industry. If the industry fails to figure out a way to deal with it, there could be potentially high levels of loan default. Over-indebtedness in one way occurs because there are too many MFIs (players) in the market and proper identification of clients is not done. Cases are there where one client has two to three IDs in different names and addresses etc. The issue here is how do we operationalise or prevent over indebtedness is important.
2. **Transparent and Responsible Pricing** – Being transparent in one's dealings is a doable thing. The MFIs can at the least be very upfront about what it is doing and be open to scrutiny and audit as the MFIs are not committing anything illegal or unlawful. However, being responsible about pricing depends on - from where the money is coming, the source of fund for running the micro finance programmes. If the money comes from high risk investor looking to make 40-45% return on equity, then can the MFI execute responsible pricing? It is not very certain. The one who gives MFIs the money is the one who holds the purse string and is the master. And in this case the lenders are not purely driven by social benefits wherein it would be difficult to give the money to the clients just at the cost of fund. And this is not going to happen because organization has to grow to survive and have to earn money. If MFIs want to lend at very low rate of interest, then they will have to find out a social investor or low risk investor. In the case where low risk investors are not available, MFIs will either sell off the organization or go to high risk investors who are looking to make huge return on equity. Once money comes from them, they would start dictating terms.

3. **Appropriate Collection Practices** : Appropriate collection practices other than coercive way of recovering money from the borrowers should be put in place to enable free and fair transactions. The MFIs in such case can go extra mile in tracking the portfolios and checking the delinquent loans. From day one of default, the MFIs can approach the defaulting clients and find out the reasons of default and in the case of genuine defaults ways and means can be worked out to extend revival package.

Conclusion :

In spite of all the ills confronting the micro finance industry and the backgrounds why the entire crisis are blown out of proportions, the micro finance practitioners should still be proud of having the moral high ground of saying that they are helping the poor by strictly adhering to the micro finance principles of transparency and also the client protection principles in letter and spirit to enable the good cause of micro finance to continue for generations to come. The moral high ground of micro finance should be protected and cherished by winning the trust of the people across the board. If the MFIs say that they are helping the poor, people should not say that they are making huge personal wealth and not passing the benefits to the clients. This has become a reality wherein the MFIs will come under the scanner and will have to be scrutinized almost on daily basis as to what and how the MFIs are doing and what rate of interest they are charging? In the light of this backdrop Micro Finance Institutions after becoming financially self sufficient can contribute to solving the myriad problems faced by the poor clients.

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