THE GROWTH OF MICRO FINANCE AND NEED FOR EFFECTIVE GOVERNANCE - A COMPREHENSIVE REVIEW

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Abstract*— the institutional crisis experienced during the year 2010 has been a nightmare for many service providers. The risk involved and the obvious negative atmosphere created during such crisis times overshadowed the capacity of the MFIs in bringing transformation in the community. The micro finance sector has seen a tremendous growth since then and recorded a 45% Compounded Annual Growth Rate (CAGR) growth. The growth in the micro finance sector can be highlighted by considering the various increments in the customer base and financial activities carried out. The share of rural customers was 69% in fiscal year 2012. That dropped marginally to 67% in 2013. In the following two years, the share of rural customers has declined drastically. In 2014, rural customers constituted 56% of the total. It dropped further to 33% in the following year. This busts the myth that Indian microfinance is predominantly a rural phenomenon, very different from what we see in Latin America and large parts of Africa and Asia. The current research paper attempt to provide a comprehensive review of the growth of microfinance and need for the governance in the changed scenario of doing business.

***Index Terms*— Micro Finance, SHGs, Regulations, RBI, Stakeholders**

I. INTRODUCTION:

The significant growth in the field of microfinance and the major changes which have taken place in the form of conversion of MFIs into small finance banks is there for everyone to see. The industry’s outreach to urban clients was increasing every year and it has now outstripped that of rural customers. Why has this happened? Before we look for an answer, let’s look at the broader picture. The industry had a customer base of 37.1 million in March 2015, up from 33 million a year ago. It included 6.5 million customers of Bandhan Financial Services Ltd, the largest MFI that turned into a bank in August. The percentage of women customers remained unchanged at 97%, while the share of Scheduled Caste and Scheduled Tribe customers rose from 19% to 28%. The loan portfolio was close to Rs.40,000 crore and 80% of it was for income-generating activities. The average loan per borrower in the year ended 31 March rose to Rs.13,162 from Rs.10,079 in at the end of the previous fiscal.

The year 2016 promised to be full of developments that could propel India’s microfinance sector past the heights that it touched in 2010. In 2010, Indian MFI’s had to face a backlash from loan borrowers and politicians. There was large scale default on loans because of non-repayment by clients which caused the top 5 MFI’s to incur heavy losses. Since then MFI’s have reigned in their growth and have adopted practices that ensure there is no multiple lending. They have also constituted a self-regulatory organization called MFIN (Microfinance Institutions Network) which addresses grievances of microfinance clients and ensures the MFI’s are sticking to their code of conduct.

The government of India’s focus on financial inclusion through Jan Dhan Yojana has also benefited MFI’s enormously as they can now directly disburse money into bank accounts. Though it is too early to pass judgment on the scheme, most observers believe the real benefits will accrue over the entire decade.

It becomes necessary to analyze the reasons for this changeover in the field of micro finance, the exponential growth of MFIs over the years, the outreach of the MFI services, the impact of MFI services and the need for effective governance to keep the MFIs in the right path so that they don’t get deviated from the objectives to which they were operationalized.

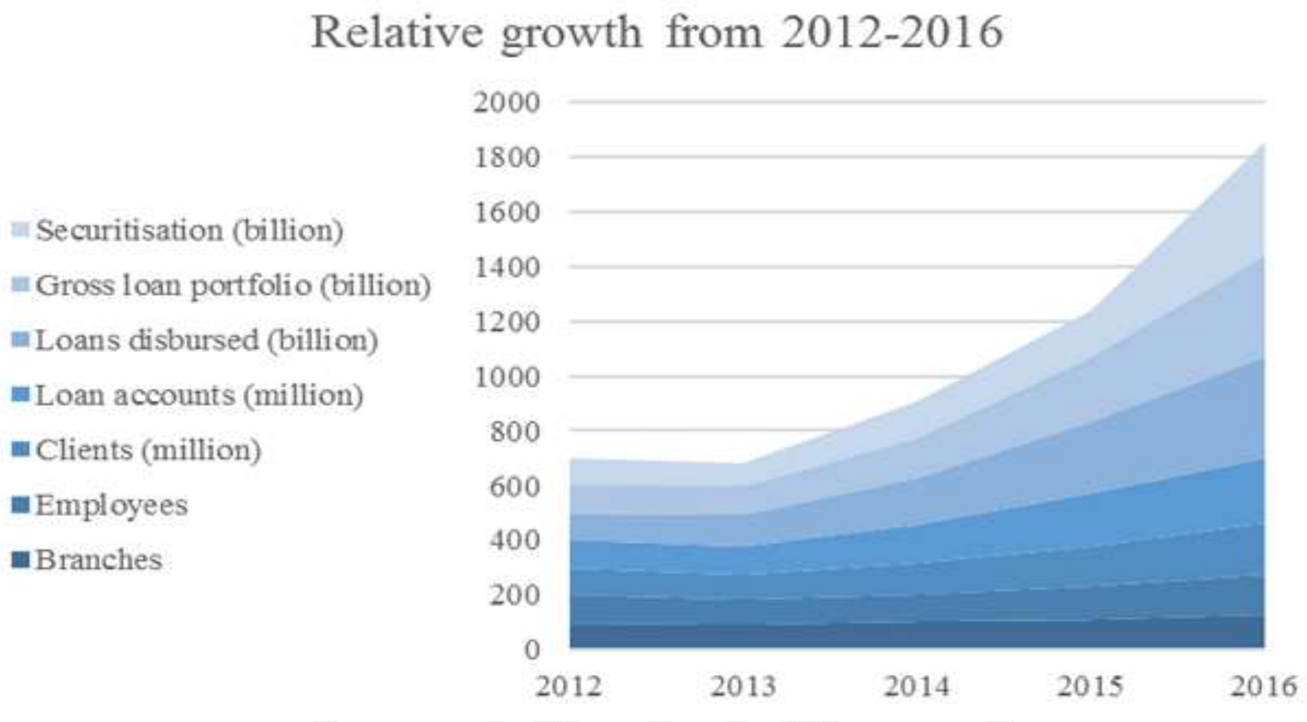
II. GROWTH OF MICRO FINANCE IN INIDA:

The institutional crisis experienced during the year 2010 has been a nightmare for many service providers. The risk involved and the obvious negative atmosphere created during such crisis times overshadowed the capacity of the MFIs in bringing transformation in the community. With demonetization, this proved to be an Achilles heel for the sector. Lack of availability of new notes hit the informal cash intensive economy of the low income groups served by microfinance in the weeks following the old Rs. 500 and Rs. 1000 notes being declared illegal tender. Microfinance institutions were forced to ask customers to get new notes or repay their loan amounts in other denominations (Nambiyar M K, 2017).

The micro finance sector has seen a tremendous growth over the last 5 years, which is recorded at 45% Compounded Annual Growth Rate (CAGR). The growth has been remarkable after overcoming the debacle the sector faced in 2010, which is marked as a dark scene of the micro finance industry. Now, with the combined efforts of Government and RBI, with the help of small regulatory techniques, methods like Adhar Based lending have been instrumental in bringing back the lost glory of MFI services. As a result now the MFI outreach stands with over 45 million end clients with a loan outstanding of Rs. 1 Lakh Crore across all the MFI programmes in India.

The relative growth of MFIs including loan portfolio, clients reach, employability and increased number of branches etc., can be understood with the help of information depicted in the following graph.

Figure no.1: Relative Growth of MFIs from 2012-16



Source: Inclusive Finance India Report 2016

The loan portfolio has increased by 84% and loan disbursement increased by 45%. There is growth by 22% in branches, 38% growth in staff strength, 44% increase in number of clients and 45% growth in the number of loan (Sriram M S, 2016). But it is also evident from the facts that MFIs are moving from service model to business model, which may be necessary as they have reached the people who need mainstreaming.

So it becomes important in a country where one in two people still do not have a bank account and only 15% have access to formal credit lines, to seriously think of the right to financial inclusion as a fundamental right.

III. THE NEED FOR GOVERNANCE IN MFIS:

The governance is required to uphold the organization's goals and mission and see that they are implemented. It is needed to guide the organization's major strategic directions. Governance has assumed increasing importance for microfinance institutions (MFIs). The infant micro-finance industry has achieved a degree of success, and now it must institutionalize that success. This raises challenges that are common to all small businesses as they expand: issues of power, control, and transparency, as well as problems of cash flow, a perceived lack of legitimacy and a short track record. Since these challenges are faced by emerging industries all over the world, it is useful to review the typical pattern as industries mature. (CGAP)

In the emerging micro-finance industry, micro-finance institutions (MFIs) have large pools of financial assets. The increased MFI operations, changed institutional norms, commercialised notion of the institutions, lack of ethical and legal framework on the institutions and need for the protection of stakeholders interest necessitates importance of governance in MFIs in India.

The microfinance sector should now be very careful and pause to ensure that it observes the transformations taking place and doesn't end up in crisis again. Slowing down the phase, little pauses, and taking stock of the negatives is important to proceed further. Otherwise, the uncontrolled developments or activities in the sector could have a far-reaching effect.

IV. REGULATIONS ON MFIS:

The regulation of MFIs is the legal registration by the government to perform as a MFI. An MFI will be subjected to regulation when it is mobilizing the savings from the clients. As the individual clients cannot monitor their savings, so there should be a legal framework in which the legal authority will monitor the MFI.

Prudential regulation is aimed specifically at protecting the financial system as a whole as well as protecting the safety of small deposits in individual institutions. When a deposit taking institution becomes insolvent, it cannot repay its depositors, and, if it is a large institution, its failure can undermine confidence enough so that the banking system suffers a run on deposits. Prudential regulation mandates such things as capital adequacy requirements and rules for provisioning loan losses, which almost always require a specialized financial authority for their implementation. (Debadutta K. Panda, 2009)

V. LITERATURE REVIEW

(Mersland & Strøm, 2009). Governance is about achieving corporate goals. The first goal of MFIs is to reach more clients in the poorer strata of the population, and the second goal is financial sustainability. We analyze the relationship between governance mechanisms and both outreach and financial performance and financial performance is assessed in terms of overall profitability.

(Arun & Annim, 2010). In lieu of the inconclusive empirical evidence in support of MFIs' ability to achieve the win win objective of poverty reduction and financial sustainability, the wider positive effect of the microfinance paradigm is revealing and diverse. Hence it is important to identify both internal and external factors that will further contribute to the success of MFIs. The investigation shows the the effect of external governance on the poverty and financial objectives of MFIs. The study rationalizes a case for external governance in achieving poverty reduction and other social objectives of microfinance.

(Nasir, 2013). With all the said and done, presently, there is no distinctive regulatory framework for MFIs in India. Regulation of the MFIs largely is in the purview of the state governments. So there is a need of an exclusive regulation to regulate MFIs in India

The study of literature influences one to believe that there is a definite need of regulations over the MFIs across India and it must be made possible at the earliest in order to ensure the protection of the stakeholders and integrity of the MFIs.

(Chakrabarty & Bass, 2014). A recent trend in microfinance research is to examine the rol e of corporate governance in MFIs. Corporate governance is a key mechanism to strengthen MFIs' financial and social performance. In typical financial institutions, the purpose of corporate governance – and specifically boards – is to monitor the actions of managers and increase transparency by reducing information asymmetry. Boards strive to ensure that managers act in the interests of owners (rather than the managers' self-interests). In comparison, the purpose of the boards in MFIs is not only to monitor the actions of managers but also to ensure that the organization is achieving social and economic goals simultaneously.

(Nawaz A & Iqbal S. 2015). Greater operating expenses do lead to better governance mechanism in MFIs which shows the negative impact of financial performance on corporate governance of MFIs indicating as the day to day expenses of MFIs increases, likelihood of better governance in those MFIs also increases as these could lead to more strict and rigorous control of resources by top management. However, contrasting effects are seen in the results of portfolio quality of MFIs which are positively linked with the corporate governance mechanism. These results are surprising as good governance is not affected by the profitability status of MFIs.

VI. RELEVANCE OF THE STUDY:

The studies conducted on the issues of microfinance over the years have ignored to highlight the importance of effective governance of MFIs. The lack of regulations, regulatory frameworks and governance practices or self-regulations among the institutions is hurting the stakeholders and even the long term sustainability of the MFIs. The earlier studies have focused more on MFIs role in SHG promotion, performance of MFIs in poverty reduction etc. The number of studies undertaken on the governance of MFIs in Karnataka is significantly less rather than nil. It is the high time to draw the attention of government to ensure the effective governance so that the micro finance institutions render services to the rural poor with increased accountability, integrity, transparency and responsibility. To ensure the operational responsibility of the institutions towards the stakeholder and to impose regulations over the institutions, there is a need of setting up of regulatory body at the national level. The present research work is an attempt to create awareness at the highest level to ensure that the government takes necessary steps to regulate the micro finance institutions through setting up of a regulatory body with proper regulatory frameworks.

VII. OBJECTIVES OF THE STUDY

The role of MFIs in increasing the livelihood for the poor households is phenomenal. The growth of the MFIs in this regard is also significantly visible. But at the same time calls for taking some precautionary steps to ensure the sector doesn't face the same crisis what it experienced during 2010. This study is undertaken to propose the importance of governance to ensure the stakeholders interests are always protected. In this regard the objectives of the study are

1. To understand the practice of RBI guidelines in Micro Finance Institutions.
2. To examine the impact of governance practices of microfinance institutions in Karnataka.
3. To suggest the need for regulatory frameworks for better governance of Micro Finance Institutions.

VIII. HYPOTHESES OF THE STUDY

The following null and alternative hypotheses were formulated based on the objectives.

Ho - the RBI guidelines are not significantly practiced by the MFIs

H_1 - the RBI guidelines are significantly practiced by the MFIs

The study has made an attempt to find the answers to the objectives set with the help of above hypotheses and testing of the same.

IX. METHODOLOGY OF THE STUDY:

The study was conducted by taking respondents of 3 MFIs working in Dakshina Kannada District. The respondents are members of SHGs and general clients. These MFIs are originated and located in Belthangady and Bantwal Taluk of Dakshina Kannada. For the purpose of data collection 100 respondents were chosen being the beneficiaries of these MFIs in the Belthangady Taluk. These MFIs are doing a responsible job in this region by providing micro finance, micro insurance, training, SHG promotion, pension and other financial and non-financial services. The data so collected has been tested and suitable conclusions are drawn through testing of Hypotheses.

To assess the RBI guidelines followed by these Micro Finance Institutions and the impact of the same, basic tools like percentage and frequencies to get the results and t-test has been used in order to prove the hypothesis. Statistical analysis has been done using SPSS. The tested results have been presented with the help of simple tables.

XI. Data analysis and Interpretation:

The present research work is done to analyze the growth of MFIs in Karnataka and the need for effective governance to administer the MFIs to ensure fair and equitable practice of service delivery by these MFIs. As of now, there are no standard regulatory frameworks apart from the one which is given by the RBI. So it is necessary for the MFIs to at least practice the same which may curb some of the wrong practices of the MFIs. The study has also attempted to analyze whether RBI guidelines are followed by the MFIs or not. So any research study is effective only after knowing the practical issues prevailing or developments taking place in the field. The study has been conducted by taking into account both primary and secondary data. The responses have been carefully classified and presented in tables to find out the results.

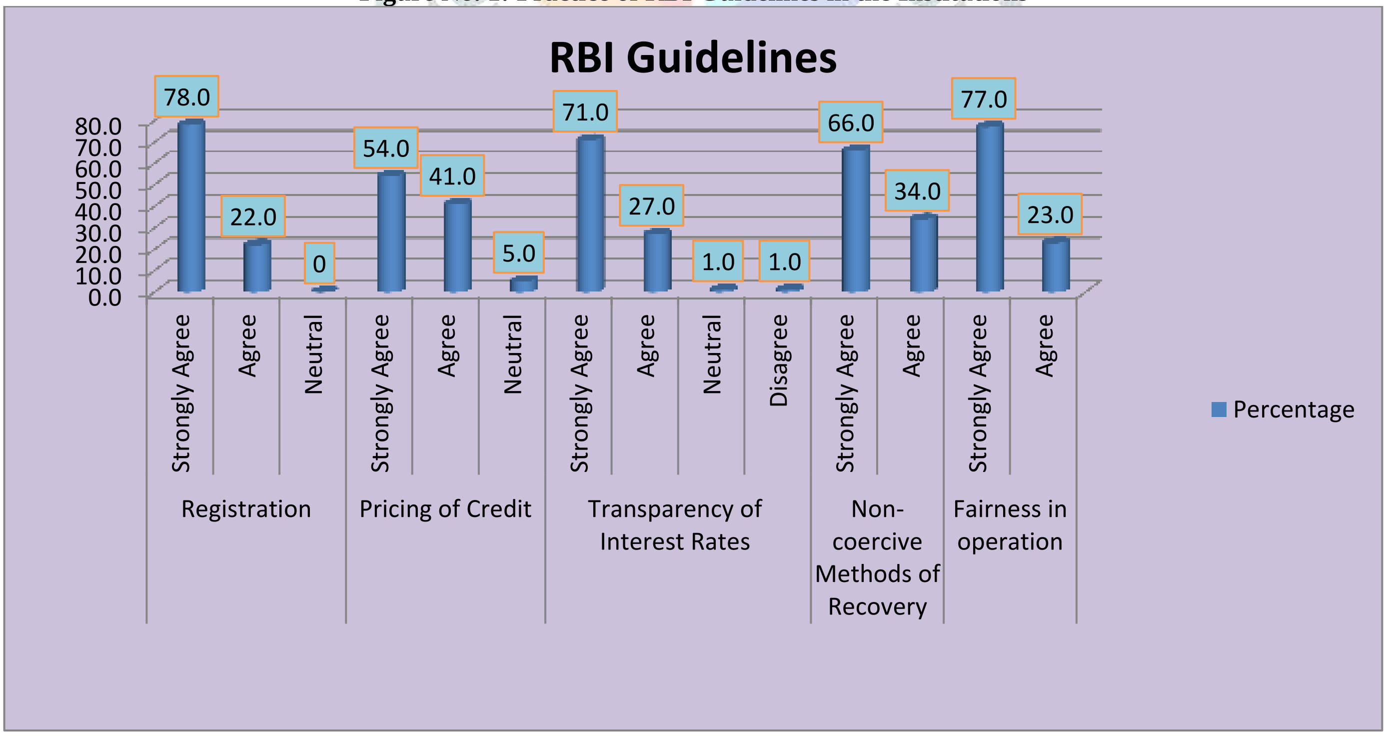
In order to test the hypotheses, 100 respondents from Dakshina Kannada have been selected and the responses taken from them through a structured questionnaire. The data so collected has been analysed with the help of SPSS and the results has been presented in the following table.

Table No. 1: Practice of RBI Guidelines in the Institutions

Sl. No	Factors	Responses	Frequency	Percentage
1	Registration	Strongly Agree	78	78.0
		Agree	22	22.0
		Neutral	0	0
		Total	100	100.0
2	Pricing of Credit	Strongly Agree	54	54.0
		Agree	41	41.0
		Neutral	5	5.0
		Total	100	100.0
3	Transparency of Interest Rates	Strongly Agree	71	71.0
		Agree	27	27.0
		Neutral	1	1.0
		Disagree	1	1.0
		Total	100	100.0
4	Non-coercive Methods of Recovery	Strongly Agree	66	66.0
		Agree	34	34.0
		Total	100	100.0
5	Fairness in operation	Strongly Agree	77	77.0
		Agree	23	23.0
		Total	100	100.0

Source: Compiled from Primary Data

Figure No. 1: Practice of RBI Guidelines in the Institutions



Source: Designed by the researcher

Table No.1 shows that, 78% of the respondents strongly agree that registration is done by the MFIs to which they are members and 22% agree the institutions are not registered. Regarding pricing of the credit, 54% strongly agree that the institution is following the RBI guideline and 41% agree and 5% remained neutral. 71% of the beneficiaries strongly agreed the transparency of the interest rates are practiced by the institutions. 27% agree and 1% each remained neutral and disagreed. With regards to use of non-coercive methods to recover the loans, 66% strongly agreed that the institutions are not practicing any such methods and 34% just agreed to the same which indicates they are not fully experiencing the same. 77% are of the view that the institution is acting fair in their operations towards the community and 23% agree with the same and acknowledge. The data representation in table can be understood so as to conclude the institutions which are working in

Dakshina Kannada District are fair enough in following the guidelines bestowed upon them by the RBI and they are practicing governance in their operations though not fully.

The role of MFIs is to provide the micro finance services to the poor and underprivileged population to come out of the hardships they are facing but lead a life full of respect and dignity. It is the responsibility of the MFIs to ensure the borrowers who approach these institutions are never mislead and exploited. It for this reason MFIs are expected to practice governance in their institutions as there is increased growth in the microfinance services over the years.

Table No.2: Descriptive Statistics on Practice of RBI guidelines

RBI Guidelines	N	Mean	Std. Deviation
Registration	100	1.22	.416
Pricing of the Credit	100	1.51	.595
Transparency in Interest Rates	100	1.32	.548
Non-coercive Methods of Recovery	100	1.34	.476
Fairness in Operation	100	1.23	.423
Valid N (list wise)	100		
Aggregate Mean and Standard Deviation		1.324	2.458

Test Statistics: 3.402

T-Test for testing the hypotheses

t_{cal} (Computed value) = $\frac{1.324-2.5}{2.458} = 0.31$

Table No.2 presents the one tail test @ 5% level of significance, critical value is 3.402. As computed value (0.31) is less than the critical value (3.402), the alternative hypothesis (H_1) is accepted and null hypothesis (H_0) is rejected. Therefore it can be concluded that, the MFIs in Dakshina Kannada district are practicing governance and are adhered to the RBI guidelines with regards to the governance of MFIs.

XII. FINDINGS AND SUGGESTIONS:

The present study reveals that the MFIs operating in Dakshina Kannada District are following the governance guidelines that are given by RBI to all the NBFCs operating in India. It is essential to uphold the regulatory norms imposed by the RBI, which will ensure the protection of all the stakeholders of MFIs. Majority of the MFIs in Karnataka are not abiding by the norms issued by the RBI and are moving towards profit making by charging higher interest, using coercive methods for recovery of loans and by not being transparent in their actions. It is the earnest opinion and suggestion from the researcher in this regard to the government of India to formulate the regulatory frameworks and establish an exclusive regulatory body for the governance of the MFIs as it will have impending impact on the micro finance sector thereby ensure the sustainability of the MFIs and safeguard of the borrowers that are dependent on these MFIs.

XIII. CONCLUSION:

The microfinance institutions have made a remarkable progress and impact on the people who are at the bottom of the pyramid. The progress and success of MFIs in the last one decade or so is attributed to the efforts of policy makers, service providers and the borrowers. Though the MFIs are significantly transforming the lives of many, they are yet under the scanner for certain wrong doings which is observed over the years and which may prove costly to the entire sector if not addressed properly. So to conclude researcher wishes to place on record the need for scrutinizing the existing governance practices in the MFIs, undue effects of not following regulatory norms and need for introducing new regulatory norms to strengthen the sector in view of long term sustainability.

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