PARAMETRIC ASSESSMENT OF GOVERNANCE PRACTICES OF MICRO FINANCE INSTITUTIONS IN KARNATAKA – AN EMPIRICAL ANALYSIS

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ABSTRACT

The micro finance institutions are primarily meant for providing financial assistance to the rural poor. Micro finance is viewed as a major tool for inclusive development over the years. But in the recent years MFI's (Micro Finance Institutions) are prone into unethical practices affecting the interest of stakeholders. Lack of accountability, disclosure mechanisms, transparency in operations, regulatory norms prevailing in the MFI's are the reasons for diversified developments in the field of micro finance. In this backdrop, this study looks into the governance aspects which are very much essential for the success of any MFI in the present day context and tries to highlight the importance of regulatory frameworks to protect the interest of stake holders by large. The Micro Finance Institutions located in the districts of Dakshina Kannada, Bengaluru, Tumkur, Kolar and Bidar of North Karnataka are chosen for the current research work.

Key Words – Micro Finance, Governance, Transparency, Regulatory bodies, Donor resources

INTRODUCTION

Over the last one decade Inclusive growth has received a special emphasis in the Indian policy making. The objective of expanding credit facilities to rural poor has been partially achieved by the Government of India and Reserve Bank of India through several initiatives inclined in the financial system. Some of the futuristic measures are nationalization of banks, prescription of priority sector lending, differential interest rate schemes for the weaker sections, development of credit institutions such as Regional Rural Banks, etc.

Despite these policy efforts, gap remains in the availability of financial services in rural areas and the dependency of the rural poor on money lenders continues as their capacity of saving is too small.

This adverse phenomenon has led to the emergence of Micro Finance in India. The Self-Help Group (SHG)-Bank Linkage Program (SBLP) which was launched in 1992 on a pilot basis soon grew significantly. As per the latest estimates, SHGs enable 97 million poor households' access to sustainable financial services from the banking system and have an outstanding institutional credit exceeding Rs. 31,200 crore as at the end March 2011.

Over the years, the role of microfinance institutions in terms of inclusive development, poverty reduction and economic empowerment is phenomenal and it also attracted the attention of UN. MFIs were primarily promoted by voluntary agencies, popularly known as NGOs with a prime purpose of community services and liberate the poor from poverty.

At present microfinance has global attention and promotion of MFIs, servicing the poor is a greater business opportunity and has became a business goal of such institutions.

There is a huge unmet demand for financial services in the microfinance sector. Despite some success stories, MFIs probably reach fewer than 5 percent of the potential clients. Serving this market will require access to funding far beyond what donors and governments can provide[12].

Thus, many MFIs want to expand their services by raising funds from commercial sources, including deposits. According to government data, over 5000 *farmers* committed *suicide* in 2005-2009 in Maharashtra. About 3,000 farmers in Andhra Pradesh committed suicide in the past five years owing to debt trap, drought and crop failure. In many cases extreme step of suicide was taken as a course of action due to heavy pressure and humiliation from the private moneylenders and MFI's.

Despite the measures undertaken by government and RBI, the intention of regulating the MFI's is not reaching the desired goal. Until and unless, proper mechanisms are developed and implemented to monitor the activities of Micro Finance Institutions there is a danger awaiting for those who access to these services. So the relevance of this study is to ascertain the degree of governance prevailing and the degree of governance to be established in order to ensure that the interest of MFI stakeholders is protected by and large. This study probes on the issues related to the determinant, influencing factors and independent factors that ultimately decide why a particular institution is a successful one and others or not. This study is restricted to the selected micro finance institutions of Karnataka.

OBJECTIVES OF THE STUDY

The study was undertaken with the following objectives.

1. To asses and analyze the governance issues of microfinance institutions in Karnataka.
2. To ascertain the factors that influences governance in MFIs.
3. To ascertain the importance of regulatory boards in establishing governance in Micro Finance Institutions.

LITERATURE REVIEW

Prof Zohra Bi and Dr. ShyamLalDev Pandey(2011)[1] highlight that, Micro finance in India has been viewed as a developmental tool which would alleviate poverty and enhance growth of the country through financial inclusion. **Roy Mersland& R. Oystein Storm(2007)**[2] highlight that, non-profit organizations are quite common in traditional microfinance and a non-profit firm needs return on its capital in order to lend again. **Sri Ramesh S Arunachalam(2007)**[3] identifie that, granting of loans to internal members of the NBFC MFI's should be taken care of and be monitored properly. The NBFC and their practice of lending to rural poor should be encouraged and it should be properly governed by well established regulatory norms of the government. **David Hulme, ThankomArun (2011)**[4] identifie that, recent events in south Asia have led to an expected reversal in the narrative of micro finance, long presented as a development success.

Sri M.S Sriram (2011)[5] highlight that, Micro finance institutions need not be treated as holy cows and there need not be any soft regulations on MFI's. MFI should be treated on par with Non-Banking companies. **R Vijaykumar (2009)**[6] attempts to conflate the activities of self-help groups and their federations, the Grameen bank replicators and commercial micro finance institutions, leading to the belief that in empowering the poor the positive attributes shared by one are the others. **Anu Muhammad (2009)**[7] highlighting the successful organized model of the Grameen Bank's micro credit programme which has become an integral part of development thinking and has earned global attention as a new form of banking. **Nilakanth Rath (2008)**[8], expresses his concern on farmer's suicide and debt burden by various reasons influencing on the life of the poor. Poor farmer's death due to the unbearable burden of debt is the matter of concern. **Sri Debadutta K Panda (2010)**[9] reckons micro finance is not only for social and rural development, but also for business and profit making, based on the organizational missions. **Drew Tulchin and Jerry Grossman (2006)**[10] notices that Government actors can make important contributions to the micro finance industry, but they must act carefully to ensure that their efforts result in positive impact. **M. Rajashekar(2010)**[11] expresses that India's booming microfinance segment is under the scanner, with the Reserve Bank of India(RBI) issuing a veiled warning that it could be taken off the priority sector lending list of banks if the industry fails to improve its governance standard.

There are no much literatures and works which are available related to the governance issues of Micro financial institutions. Therefore this study is taken up to through light on governance issues of Micro financial institutions in Karnataka.

METHODOLOGY

The study is based on both primary and secondary data collected. The primary data is collected through the structured questionnaire and the secondary data is collected through the annual reports, publications, online journals, books and monthly magazines of MFI's.

Systematic Random Sampling Technique was used for collection of data. 30 leading Micro Finance Institutions of Karnataka were selected on the basis of their turn-over, outreach, and years' of service in the field of finance serving the poor and either the Chairman/Director/ Managers of these institutions have responded being part of Policy Makers and these responses are considered to test the hypothesis.

.The data collected was tabulated, analyzed and interpreted to draw suitable conclusions and to analyze the governance practiced in Micro Finance Institutions of Karnataka, tools like **Arithmetic Mean, Standard Deviation, Percentage, Test for proportions tool (Z test statistic)** are used in order to prove the hypothesis.Statistical analysis has been done using SPSS.

The following hypotheses were formulated and tested

Hypotheses

Ho_1 : The governance practices of Micro Finance Institutions are not in line with the guidelines of governance.

Ho_2 : Regulatory boards play a major role in establishing governance in MFIs

DATA ANALYSIS AND INTERPRETATION

As part of data collection, responses were taken from the directors and chairmen's of selected MFIs. As it is an empirical study, the importance is given on the significant factors of governance while analyzing the data collected through questionnaire. The questions asked and responses collected are presented in the form of following tables and graphs.

Table 1: Practices of Transparency

Sl. no	Particulars	No of Respondents			Hypothesis	Calculated z value	Critical value Zα	level of Significance	Result
		Yes	No	Total					
a.	Disclosure of Loan Pricing	12	18	30	H0:p ≥ 0.50, H1: p <0.50	1.095	-1.645	0.05	accept null hypothesis
b.	Terms and Conditions of Repayment	27	3	30	H0:p ≥ 0.95, H1: p <0.05	-12.56	-1.645	0.05	rejected null hypothesis
c.	Communicating to Beneficiaries	27	3	30	H0:p ≥ 0.95, H1: p <0.06	-12.56	-1.645	0.05	rejected null hypothesis

Source: Primary data

Table1 is used to denote the various transparency tools used by the MFI's. The table explains how hypothesis which are framed are tested by using the Z test.

A) In case of disclosing loan price information:

Null hypothesis: H0: $p \geq 0.50$ (50 and above % of MFIs are not disclosing the loan price information)

Alternative hypothesis: H1: $p < 0.50$ (less than 50% of MFIs are disclosing the loan price information)

Result: Since Z_{cal} value is 1.095 less than Zα is -1.645 at the 5 percent significance level. Therefore null hypothesis is accepted against alternative hypothesis saying that more than 50% of MFIs are not disclosing their loan price information in brochures.

B) In case of Term and Conditions of repayment of loan:

Null hypothesis: H0: $p \geq 0.95$ (95 % and above of MFIs are not disclosing the terms and conditions of repayment of loan)

Alternative hypothesis: H1: $p < 0.95$ (less than 95 % of MFIs are disclosing the terms and conditions of repayment of loan)

Result: Since Z_{cal} value (Calculated value) is 12.56 more than Zα (Critical value) is -1.645 at the 5 percent significance level. Therefore null hypothesis is rejected against alternative hypothesis saying that less than 95 percent of MFIs are disclosing their terms and conditions of repayment of loan in their brochures.

C) In case of communicating to beneficiaries:

Null hypothesis: H0: $p \geq 0.95$ (95 and above % of MFIs are not communicating to their beneficiaries)

Alternative hypothesis: H1: $p < 0.95$ (less than 95% of MFIs are communicating to their beneficiaries)

Result: Since Z_{cal} value (Calculated value) is 12.56 more than Zα (Critical value) is -1.645 at the 5 percent significance level. Therefore null hypothesis is rejected against alternative hypothesis saying that less than 95% of MFIs are communicating to their beneficiaries.

Therefore it can be concluded that overall practices of transparency in MFIs is not visible or maintained at 100 percent.

Table 2: Disclosure Mechanisms Used

Particulars	Brochures		Orientation Sessions		Meetings		Annual Reports	
	Nos	%	Nos	%	Nos	%	Nos	%
Yes	27	90	24	80	27	90	30	100
No	3	10	6	20	3	10	0	0
Total	30	100	30	100	30	100	30	100

Source: Primary data

The table 2 represents, the disclosure mechanisms followed by MFIs as part of their governance. Various disclosure mechanisms are used by these institutions like brochures, orientation sessions, Meetings, annual reports etc.

Out of the total institutions taken for study, 90% are using brochures as one disclosure mechanism, 80% of them use orientation sessions, 90% of them use Meetings, and all the ten institutions use annual reports resulting in 100% as part of disclosure mechanism. This data reveals that, the institutions are rightly ahead in terms of disclosure and governance practices contributing to the welfare of the poor.

Table 3: Need for Regulatory Bodies

Particulars	Frequency	Percentage
Yes	18	60
No	12	40
Total	30	100

Source: Primary data

Table 3 is used to represent the opinion of the MFIs on formulating regulatory bodies. The majority of the selected MFIs are of the opinion to set up an exclusive regulatory body to monitor the operations of the MFIs as it has got increased importance in the present day context.

The above chart shows, 60% of the MFIs expressing their willingness for formulating of the regulatory bodies and the rest 40% are not in favour of formulation of regulatory bodies. The leading MFIs have identified the role of regulatory bodies in ensuring the quality of service of these institutions and those institutions which are not in favour of regulatory bodies still think that the formation of regulatory bodies will restrict their free fly in this field of finance.

While concluding it can be rightly said, for the current day Micro Finance Industry, there is a definite need of regulatory body to govern and control the operations of MFIs to ensure the interest of the stakeholders are protected.

Testing of Proportions

Our objective is to test whether the MFIs require exclusive regulatory bodies or not i.e., to test whether proportion of MFIs who says exclusive regulatory bodies is required. Accordingly Null Hypothesis and Alternative Hypothesis are framed as follows:

Null Hypothesis (H_0): $P \geq 0.50$ (50% and above percent of MFIs says exclusive regulatory body is required)

Alternative Hypothesis (H_1): $P < 0.50$ (Less than 50% of MFIs says exclusive regulatory body is required)

Where, P is the population proportion

From the collected data it was apparent that out of 100 percent, 60% Micro Finance Institutions say that, there is need for separate regulatory bodies. i.e., $p = \frac{x}{n} = \frac{18}{30} = 0.60$, where p is sample proportion.

The test statistics is given by Z=$\frac{p-P_o}{\sqrt{\frac{P_o \quad Q_o}{n}}}$ = $\frac{0.60-0.50}{\sqrt{\frac{0.50*0.50}{30}}}$ =1.095

Applying the two-tailed test for determining the rejection regions at 5 percent level which come to as under, using normal curve area table: R : |z| > 1.96

The observed value of z is 1.095 which comes in the acceptance region since R: |Z| > 1.96 and thus, H_0 is not rejected in favour of H_1. Accordingly, we conclude that the more than 50% of MFIs says that there is need for an exclusive regulatory body.

CONCLUSION

As MFIs are suffering from the conceptual clarity of the Micro Finance service they have to render, they should be clear with what they have to do actually to uplift the rural poor from poverty. Most of the MFIs suffer from late payment problems and they should come up with new mechanisms to overcome this problem in contrary to the existing techniques.

MFIs should encourage the rural poor to take up self employment from the financial service they receive. MFIs need to be more clients friendly when people approach them for finance. MFIs have to be softer in debt collection mechanisms because, the existing methods are not so encouraging and it's demoralizing the applicants. It is being observed that the percentages of interest charged by the institutions are reasonable and rural friendly. Effective Governance in MFIs should be widely practiced in view of efficient performance and increased transparency.Though governance is practiced, it is not effectively implemented in all the institutions. So, MFIs should be properly educated by making them to know the benefits of transparency and governance in the financial market.

As MFIs are criticized for trying to deceive the poor people by charging higher rate of interest, they must be controlled by establishing proper regulatory mechanisms. As MFIs fail in effective implementation of governance there is a need of establishing regulatory body to monitor and govern the MFIs in the long run. It is advisable to majority of the institutions to follow the service delivery and operational methods adopted by the leading institutions like, SKDRDP, IDF, NavodayaGrama Vikasa Trust, Samastha Micro Finance and Bharathiya Swamukthi Samsthe. Finally, MFIs are operating in increasingly competitive markets, and maintaining or increasing market share has become an important component of their strategic objective.

Therefore, a clear articulation of the function of microfinance boards is essential for their effective governance. After analyzing the basic issues in Micro Finance Institutions and types services offered and existing governance prevailing in these institutions, the researcher proposes to establish the environment which will strengthen the micro finance sector and the conditions that must exist to achieve effective governance.

In terms of significance, the study can be extended to any part of the nation or even to other countries.

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