APRIL 2015

IFC
International Finance Corporation
WORLD BANK GROUP

SmartLessons
real experiences, real development

ABOUT THE AUTHORS

GIRISH NAIR
is the regional lead for Microfinance Advisory in South Asia. He spearheads IFC's Responsible Finance initiatives in the region.

FARZANA BIJUR
is a consultant with the Access to Finance department in South Asia.

POORNA BHATTACHARJEE
is an Operations Analyst with the Access to Finance Advisory Services in South Asia.

SAKSHI VARMA
is an Operations Officer in the Access to Finance department in South Asia.

APPROVING MANAGER
Jennifer Isern,
Regional Business Line Manager, Access to Finance, South Asia, Advisory Services.

The India Microfinance Story: Putting the Focus on Borrowers

IFC has worked on client-protection issues since the first microfinance investment in the early 2000s. These activities took on a more defined shape when seeds of the Responsible Finance program were sown with the Microfinance Credit Reporting Initiative in 2009, which aimed at reducing the significant information asymmetry between microfinance borrowers and lenders by supporting increased links between microfinance institutions and credit bureaus. This SmartLesson shares the lessons learned during the implementation of components of the Responsible Finance program of IFC's Advisory Services—and how that program is having a clear and defined impact on India's microfinance industry.

BACKGROUND

In Andhra Pradesh, high growth in the microfinance industry led to an overemphasis on the supply side, ignoring the impact on the end clients, and brought the sector under scrutiny with the onset of the microfinance crisis in August 2010. The state government's restrictions on new lending and recovery led to huge nonperforming loans in microfinance portfolios, and consequently bank lending to microfinance institutions plummeted across India, falling to almost zero for those with exposure in Andhra Pradesh. Microfinance operations reached a standstill, and only $835 million is estimated to have been lent to the sector in fiscal year 2012, compared to $2.38 billion during FY11.

Given the changed circumstances, with microfinance portfolios having deteriorated across Andhra Pradesh, IFC expanded the scope of the Responsible Finance program by promoting initiatives that incorporate greater customer-centricity into operations and raising decision makers' and stakeholders' awareness of the need to effectively address the reputational issues facing the sector. The program focused on multidimensional yet interlinked interventions, pitched at different stakeholder levels, that would address the multiple challenges the industry faced. The following key project components of the program (Box 1) span sector, institutional, and end-client levels:

- The ***Microfinance Credit Reporting project*** promotes use of credit bureaus for decision making and links credit bureaus to microfinance institutions, the key to reducing multiple borrowing and over-indebtedness. The project design incorporates increasing awareness of end borrowers as well as a study of the impact of credit bureaus on microfinance institution borrowers' behavior and dissemination of results. The project has a database of more than 100 million client records and has received 45 million incremental inquiries in credit bureaus.

- The ***Responsible Finance Sectoral project*** works with the stakeholders at the sectoral level and aims at building the capacity of industry associations, facilitating adoption of a common code of conduct, supporting policy

Box 1: Some Responsible Finance Program Milestones

- Under the Responsible Finance Sectoral initiative, IFC worked with the World Bank to bring together a core group of stakeholders to form the "Responsible Finance Forum" in 2011. One outcome was the adoption of a common approach to responsible finance through a harmonized India Microfinance Code of Conduct.

- The SMART project contributed to the development of global standards for client protection in India and completed 20 client-protection assessments covering about 20 million Indian microfinance clients. IFC also helped five partners receive global Client Protection Certification, carried out eight trainings on CPPs for microfinance institutions, and conducted 10 assessor-training workshops to create a pool of regional resources.

- The Risk Management project team conducted risk-management diagnostics of eight microfinance institutions and formulated a customized risk-management strategy for each one. Phase 2 should reach 20 smaller microfinance institutions in low-income states. The team also conducted a series of five workshops/trainings with 210 participants from microfinance institutions, covering more than 70 percent of the Indian microfinance sector.

- IFC-supported credit bureaus, High Mark and Equifax, have a combined database of more than 100 million micro-client records, the world's largest repository of such data.

advocacy measures, carrying out benchmarking studies, and creating forums for stakeholders to arrive at consensus on key issues facing the sector and potential solutions. The project, with its work with the industry associations covers more than 90 percent of the microfinance sector.

IFC also worked with SMART Campaign[1] India—at the institutional level—for the adoption of global client protection principles (CPPs) by Indian microfinance institutions. The project supports training on CPPs for microfinance institution staff and onsite assessment of the institutions, as well as guidance on appropriate product design and delivery, enhancing transparency, responsible pricing, fair and respectful treatment of clients, privacy of client data, and mechanisms for complaint resolution.

- The ***Financial Awareness program*** works on the demand side and aims to roll out an effective and sustainable financial-awareness program for low-income households so that the end clients make informed choices about financial services—and microfinance institutions and financial institutions experience better business outcomes.

- The ***Risk Management project*** contributes to strengthening risk-management systems and practices in the microfinance sector in India. It aims to promote global risk-management practices in Indian microfinance institutions and integrate them with responsible finance practices. On completion, it is expected to cover 28 microfinance institutions.

LESSONS LEARNED

Lesson 1: The microfinance crisis demanded a rapid and multipronged response.

Post-crisis, the need to reinforce responsible lending practices in microfinance institutions increased multifold, and it was critical for the sector to come together and propose concrete next steps to ensure adherence to responsible finance. IFC immediately took a leadership role by initiating a comprehensive effort through the Responsible Finance program. With its different project components focusing on stakeholders at sectoral, institutional, and end-client levels, the program quickly began to address the sector's multiple challenges.

IFC's neutral role was critical in bringing the sectoral stakeholders together to address differences and harmonize their efforts, such as in the negotiation of the Unified Code of Conduct for the sector. The individual project components, with their focused deliverables, helped address such sectorwide concerns as multiple lending and client over-indebtedness. IFC's credibility in the sector, ability to mobilize strong links with stakeholders, and expertise in project delivery helped microfinance institutions develop the necessary partnerships with clients and adhere to client protection principles and codes of conduct.

Lesson 2: In project design, propose holistic solutions.

For a project to have a sustainable impact on the sector and to be appreciated by the clients, it needs to shift from a piecemeal approach to providing solutions. IFC's recognition of the need for an integrated approach to address challenges in the Indian microfinance sector guided all its interventions.

Identifying a lack of consensus in the sector on the direction to be taken post-crisis, IFC reached out first to the important stakeholders. The result was the Responsible Finance Forum,[2] formed in 2011, and the Unified Code of Conduct for the Indian microfinance sector. To ensure integration of Code of Conduct principles into microfinance institutions' systems and processes, IFC then worked stra-

1 The SMART Campaign is a global effort to unite microfinance leaders around a common goal "to keep clients as the driving force of the industry." Committed to embedding client protection practices into the institutional culture and operations of the microfinance industry, the SMART Campaign encompasses the following client protection principles: appropriate product design and delivery, prevention of over-indebtedness, transparency, responsible pricing, fair and respectful treatment of clients, mechanism for complaint resolution, and privacy of client data. SMART Campaign India is housed under Accion International.

2 Founding members were representatives from IFC, the World Bank, DFID, Small Industries Development Bank of India (SIDBI), Sa-Dhan, Microfinance Institutions Network, Michael and Susan Dell Foundation, ACCESS Development Services, and individual senior microfinance practitioners Brij Mohan and N Srinivasan.

tegically with SIDBI to carry out Code of Conduct assessments, which analyzed existing systems and processes of a microfinance institution, rated its compliance with the Code of Conduct, and identified gaps in adherence to Code principles. Then the team worked with each institution to integrate CPPs into its operations. This holistic approach of working at the sectoral, institutional, and end-client levels has increased the success rate and pace of institutionalizing responsible-finance practices in the Indian microfinance institutions.

One of our clients, Cashpor Microcredit (based in Uttar Pradesh) underwent CPP assessment and worked with IFC on institutionalizing client protection principles. Cashpor Microcredit is among the first microfinance institutions in the country to be certified by the SMART Campaign.

Lesson 3: Engage with key stakeholders for maximum sectoral outreach.

A multistakeholder approach is critical for a large sectoral project where it is important to holistically address the underlying gaps. The project's credibility and acceptability is heavily influenced by how successfully the team can mobilize strong links with stakeholders—to clearly gauge the stakeholders' expectations and willingness to participate in the project and take collective responsibility.

As the primary strategy, IFC successfully engaged with sectoral stakeholders such as development institutions, lenders, investors, credit bureaus, and network associations, thus ensuring that everyone was on the same platform—and lending more credibility to IFC's efforts. This stakeholder engagement resulted in a high level of participation by microfinance institutions, technical vendors, and consultants in credit bureau workshops and risk-management workshops/trainings across the country. This approach generated buzz about the IFC project and made it easier to get buy-in for the project's implementation. Similarly, reaching out to key stakeholders can lead to further expansion of the project to a large number of microfinance institutions, as with SIDBI, which has seen value in the risk-management initiative and will support the rollout of the risk-management framework for another 15 microfinance institutions.

Lesson 4: Master the balancing act: customize content and standardize quality.

Differences in regulatory framework, operating models, and political environments make it important to customize a project to suit the local context. The key is to identify the optimal level of customization without undermining the quality of the project. This balancing act requires close collaboration with clients, consultants, and other stakeholders to determine the optimal level.

An example of the effectiveness of this approach was the customization of IFC's Global Risk Management Assessment toolkit to suit the Indian microfinance context. Recognizing that direct application of global tools and frameworks might not be effective, the project team put in extra effort through stakeholder workshops and onsite experience to customize the toolkit to include, for example, 1) measures to identify hidden group delinquency, because group lending is the common model; and 2) social performance management, considering its importance in the risk-management context in India.

During implementation of the Risk Management project, the team identified the need to customize according to the scale of operations or size of clients. For instance, small institutions usually have nascent risk-management systems and find it easier to integrate the project's risk-management standard framework into organizational strategy and processes without huge modifications or cost implications. On the other hand, for larger microfinance institutions with better-developed systems already in place, we need to demonstrate value-addition through more nuanced and system-specific recommendations.

Lesson 5: Ensure client buy-in early on.

Any new process or system involving a considerable shift from the norm requires the institutions dealing with it to be willing to change and to be supportive of the efforts to do so. So it is important for the project team to be actively involved with the client right from the design phase—and at all levels. This implies a substantial investment in time by senior management and staff across the organization. Hence we emphasize a consultative approach, which helps in outlining priorities and concerns, thereby preventing unrealistic expectations on either side.

With one of our clients, Ujjivan Financial Services, we engaged right from the inception for the integration of client protection principles in its operations. This helped Ujjivan set up its service quality department in line with its decentralized operational structure by empowering the branch-level staff to handle client complaints and grievances. Engagement with the client from an early stage significantly improved IFC's understanding of operations and enabled us to consistently support and strengthen the organizations' efforts.

The project team also ensures the involvement of a microfinance institution's senior management right from the project design stage. For instance, under the Risk Management project, the team makes detailed presentations to the senior management on the proposed risk-management framework prior to the diagnostic to understand expectations and concerns. We also send the final list of recommendations from IFC as a letter to the board for its approval. Implementation does not begin until the board approves.

Lesson 6: Engage in global-regional collaboration for better outcomes.

Clients appreciate that a strong sectoral/institutional impact is always a focus of IFC projects. The team has strate-

gically collaborated with IFC's global team, which brings credibility and expertise, in the design and implementation of the regional projects. This strategic alignment ensures that there is greater awareness about the project and better buy-in among the stakeholders.

The ongoing Risk Management project exemplifies the effectiveness of the collaboration of the regional IFC team with the global team. Risk-management workshops, conducted jointly by the global and regional teams, succeeded in creating awareness and better buy-in for the product in Indian microfinance institutions, as it combined the global team's know-how on risk management with the regional team's in-depth understanding of the nuances of the Indian microfinance sector. The project team also successfully leveraged the global team's risk-management expertise in developing the project design at the regional level, selection of consultants, maintenance of quality standards in deliverables, and effective communication of IFC's branding as well as in customization of IFC's Risk Diagnostic Framework for Indian microfinance.

Ensuring alignment with this strategic collaboration, the team has also aimed for an integration of Investment Services and Advisory Services. During selection, the project gave priority to direct IFC microfinance investees or indirect IFC investees (through investee funds). This IS-AS link was a great help in showing the microfinance institutions the advantages of meeting the project standards.

Lesson 7: Leverage the IFC-World Bank link.

Greater strategic alignment between IFC and the World Bank and coordination of activities can bring effective and sustainable results. According to its mandate, the World Bank's project focused on government, public entities, and other sectoral institutions. IFC has successfully leveraged the credibility of its partnerships with the Bank to bring about better impact in its projects with private institutions.

An example of leveraging this link is implementation of IFC's Responsible Finance Advisory program in coordination with the World Bank's Scaling Up Sustainable and Responsible Microfinance project. IFC received a boost to its advisory services to credit bureaus for capacity enhancement and promoting the use of credit information in microlending decisions, when the World Bank used its influence with SIDBI and other lenders to make it mandatory for microfinance institutions to report to credit bureaus. The project team also successfully leveraged the Bank's relationship with the apex body, SIDBI, by collaborating with it in rolling out risk-management diagnostics for an additional 15 microfinance institutions, which could speed up the impact on institutionalizing adoption of customized risk-management frameworks by microfinance institutions in India.

CONCLUSION

Through its Responsible Finance program, IFC with its partners has helped microfinance institutions institutionalize client protection principles and codes of conduct. Across South Asia, the Access to Finance team is managing 16 microfinance institution projects with a built-in Responsible Finance component. The Indian microfinance institutions are nearly 60 percent of the banking sector's outreach to small lenders; therefore, the impact of these IFC initiatives may be felt by as many as 26 million clients.

Commitment to responsible finance requires participation from all stakeholders, and this program serves to bring them together on the same platform. It requires innovative and proactive approaches at the sectoral, institutional, and client levels. These collaborative efforts aim to build sustainable partnerships in Indian microfinance—partnerships that clearly demonstrate the social impact of the work being done and that do a better job of communicating the microfinance success story. The systematic approach this program follows has had a profound impact on the sector.

We hope these successes—and how the program addressed the challenges—can provide insights that will help those developing similar approaches in other regions. IFC's Responsible Finance advisory program can continue to be a key factor in building capacity and revamping the sector in fledgling and mature microfinance markets throughout the world. IFC is geared to play a critical role by replicating lessons learned from successful interventions globally.