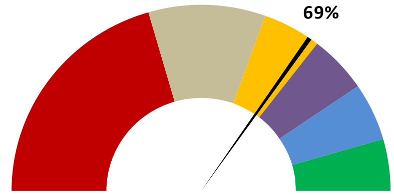
Microfinance Code of Conduct Compliance Assessment

M2i Consulting
Microfinance Management and Investment Advisory

Assessment done by: Deepak Alok and Atul

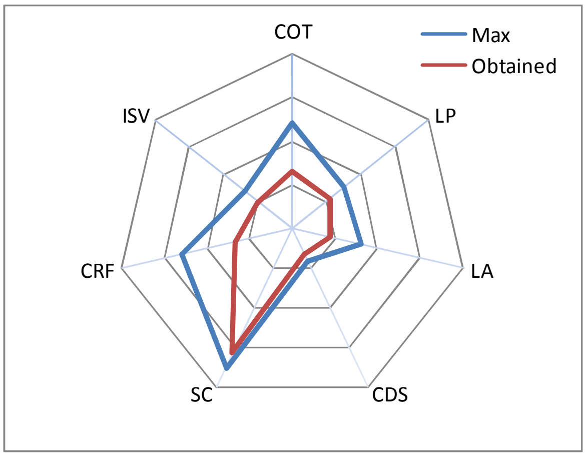
Sahayog Microfinance Limited (Sahayog)

December 2012



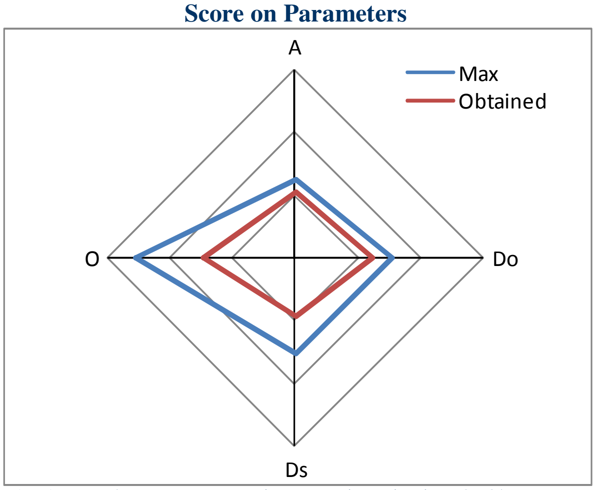
Composite COCA Score: 69%, Reasonable level of adherence

Score on Dimensions



COT=Client Origination and Training, LP=Loan Pricing, LA = Loan Appraisal, CDS=Client Data Security, SC=Staff Conduct, CRF=Client Relationship and Feedback, ISV=Integrating Social Values into Operations

Score on Parameters



A= Approval, Do=Documentation, Ds=Dissemination, O=Observance

Rationale

Sahayog has reasonable level of compliance with the code of conduct. While the organization's board has been actively pursuing important aspects of the code of conduct, there are weaknesses in dissemination of guidelines as well as internal controls which have adversely affected the organization's compliance. Particularly, these weaknesses have prevented Sahayog from developing a fool-proof system to comply with RBI's directions related to preventing over-indebtedness among clients. However, the organization has recently initiated several steps to improve its overall compliance with the code of conduct.

Highlights

- Sahayog's employees maintain high standards of conduct during their interactions with clients.
- There is a system of storing documents collected from clients in a secure manner at Sahayog.
- Sahayog charges interest rates on reducing balance basis and makes efforts to communicate this to its clients.

Areas of improvement

- Sahayog needs to put in place a functional and effective system to collect and resolve the grievances and feedback of its clients.
- Sahayog needs to considerably improve its process of loan appraisals so that information regarding the indebtedness levels of its clients are correctly recorded and utilized for decision making.
- Sahayog needs to ensure that loans are originated as per the policies of the organization.
- Sahayog needs to orient its staff members on all the aspects of the code of conduct.

Code of Conduct Assessment Compliance Assessment Tool

This tool requires scores to be assigned on the seven Code of Conduct dimensions – **Client Origination, Loan Pricing, Loan Appraisal, Client Data Security, Staff Conduct, Client Relationship and Feedback and Integrating Social Values into Operations**, across the four parameters – **Approval, Documentation, Dissemination and Observance.** The seven dimensions have been drawn from a review of the norms prescribed for MFIs including industry's code of conduct, fair practices' code of RBI and CGAP's client protection principles (Smart Campaign). The COCA tool also specifically assesses the MFI for compliance against the RBI's guidelines and scores it as well. The scores on the COCA indicators are then scaled down in proportion to the score received in Regulatory Compliance. The methodology followed for this assessment is presented in Annexure 2 and the framework of the tool is presented in Annexure 3.

Disclosure

M2i has not been engaged in any assignment of advisory, capacity building or of consulting nature with Sahayog in the last one year. Further, none of M2i's employees or their relatives are represented in the Board of Directors of Sahayog or related institutions.

Section 1: Scores[1] and facts

Code of Conduct dimensions[2]	Maximum	Obtained	%
Client Origination and Targeting	24	13.1	55%
Loan Pricing	15	11.0	73%
Loan Appraisal	16	9.0	56%
Client Data Security	8	6.3	79%
Staff Conduct	35	31.4	90%
Client Relationship and Feedback	26	14.1	54%
Integrating Social Values into Operations	14	9.7	69%
Total	**138**	**94.6**	**69%**
RBI's Directions	**12**	**11**	**92%**

Compliance parameters	Maximum	Obtained	%
Approval	25	20.8	83%
Documentation	31	24.5	79%
Dissemination	31	19.0	61%
Observance	51	30.3	59%
Total	**138**	**94.6**	**69%**

MFI's profile – September 2012	
Name of the MFI	Sahayog Microfinance Limited
Legal form	Non Banking Financial Company (NBFC)
Operational Head	Mr Anand Patidar
Year of starting microfinance	2010
Branches (30 Sep 12)	30
Operational area	Madhya Pradesh and Maharashtra
Total number of staff involved in microfinance	213
Visit of the Assessment team	18 December 2012 to 22 December 2012
Correspondence address	Sahayog Microfinance Limited, E-7/88, Lala Lajpatrai society, Arera Colony, Bhopal

[1]The scores have been colour coded as follows. = Less than 41% (Very Weak); 41-60% (Weak); = 61-70% (Reasonable); 71-80% (Good); 81-90% (Very Good); >90% (Excellent).
[2] Scores have been reduced by a factor of 0.92 to reflect overall achievement on regulatory compliance.

Microfinance Methodology
Sahayog primarily follows the Joint Liability Group (JLG) model of microfinance. Clients are required to organize themselves in groups of five or ten (most often five). These groups are called centers. Loans are given simultaneously to every member in the center. All members are required to jointly and severally guarantee each member in the center. An undertaking regarding the joint liability as well as declarations from the members regarding their borrowings and indebtedness from other sources is obtained on a Stamp Paper of Rs 100. Members are required to purchase the Stamp Paper on their own. Loans are disbursed during center meetings in the presence of the Branch Manager. Collections also take place in the center meetings on a weekly, fortnightly or monthly basis, depending on the preference of the members who constitute the center. Sahayog's individual loans (which constitute less than 1% of its portfolio) are given for microenterprise activities to entrepreneurs who require loans greater than Rs 50,000.

Details of the loan products - 30 Sep 2012					
Product	**Description**	**Loan size***	**Interest Rate**	**APR (Interest Rate and Processing fees)**	**% in portfolio**
Income Generation Loan	Loans given for livelihood enhancement to clients organized in centers of 5 to 10 members. Centers can choose to repay on a weekly, fortnightly or monthly basis. Loan term of loans over Rs 15,000 is 24 months.	Rs 5,000 to Rs 50,000	26% pa, reducing & 1% processing fees charged upfront	28.01%	99.8%
Business Loan	These loans are given to individuals for microenterprise related needs.	Greater than Rs 50,000	26% pa, reducing & 1% processing fees charged upfront	28.01%	0.2%

Notes:

1. APR has been calculated by taking the actual cash flow for each loan including principal, interest and processing fee.
2. EIR calculated through compounding interest on monthly rests comes to 32.17% for both the loan products. EIR has been calculated as: EIR = $(1+r)^n-1$, where r = APR/12 and n=12 (for 12 months to annualize).

Key facts and figures			
Parameters	**Mar-11**	**Mar-12**	**Sep-12**
Total Groups	16,409	52,109	64,849
Members	3,303	10,422	12,756
Active borrowers	15,027	40,773	45,547
Branches	16	25	30
States	1	1	2
Number of districts	3	7	10
Total staff	102	146	159
Number of loans disbursed for the FY ending	11,194	40,680	12,520**
Amount of loan disbursed for the FY ending (Rs Mn)	158.7	542.2	114.90**
Loan portfolio outstanding (Rs Mn)	105.1	362.7	278.5
PAR-60	0.12%	0.16%	0.20%
PAR-30	0.54%	0.12%	0.03%
Interest Yield on portfolio*	32%	25.4%	24%***
OSS	103%	107%	109%
RoA	0.4%	0.7%	0.6%

**Interest income as percentage of average loans outstanding*
*** Half year ending 30 Sep 12*
****Annualized*

Sahayog's Equity Structure (Sep 2012)		
S No.	**Shareholders**	**% stake in the company**
1	Mr. Khushi Lal Patidar	12.5
2	BDP Holdings Pvt Ltd	12.5
3	Synergy Megaventure Pvt Ltd	8.2
4	Mr. Kanhaiya Lal Patidar	6.5
5	Mr. Anand Patidar	6.5
6	Mrs. Purnima Urdhwareshe	5.8
7	Mr. Yogesh Patidar	5.7
8	Kasturi Megaventures Pvt Ltd	3.3
9	Mr. Jitendra Prasad Tiwari	2.6
10	Mr. Prashant Patidar	2.2
11	Gem Management India Pvt Ltd	1.9
12	Mr. Aseem Singhal	1.9
13	Dr. YSP Thorat	1.9
14	Cypress Investments Pvt Ltd	1.8
15	JPT Enterprises Pvt Ltd	1.3
16	Mr. Dinesh Raach	1.3
17	Others	24.1
	Total	100.0

Sahayog's Board of Directors – Sep 2012	
Name	**Profile**
Dr. Y S P Thorat	Dr Thorat is the Chairman of the board. He does not hold any executive position in the organization. Former MD and CEO of NABARD, Dr Thorat is member of the board of several organizations such as Tata Chemicals and Enam Infrastructure Trustee Company.
Shri Vinay Jha	Shri Jha is an Independent Director at Sahayog. He serves as the Executive Board Member and Vice President of the International Council of the Societies of Industrial Design, Helsinki. He is also the Chairman of the Expert Committee for establishing Quality and Design Standards for Engineering Exports, Engineering Exports Promotion Council.
Shri Vijay Joshi	Shri Joshi is an Independent Director at Sahayog. He is also the Director, Business Development at DM Corporation Pvt Ltd. In the past he has worked as Zonal Manager at ICICI Prudential Life Insurance Company.
Shri. Sushil Bhagat	Shri Bhagat is an Independent Director at Sahayog. He is the CFO of the Coastal Group – which has presence in the Power Sector.
Shri Yogesh Patidar	Promoter Director and ED Business Development at Sahayog.
Shri Anand Patidar	Promoter Director and ED Operations at Sahayog.
Shri Jitendra Prasad Tiwari	Promoter Director and ED Finance and Accounts at Sahayog.
Shri Khushilal Patidar	Promoter Director.
Smt. Purnima Urdhwareshe	Promoter Director.

Section 2: Status of Regulatory Compliance

2.1 Compliance with regulations

Sahayog complies with most of the critical RBI directions regarding NBFC-MFIs and priority sector classification of microfinance assets, and has obtained CA certificates regarding its compliance every quarter since June 2011. However, in M2i's opinion the organization's weaknesses in internal control and dissemination aspects makes it non-compliant in ensuring that all borrowers whose loan accounts have been classified as qualifying assets have an indebtedness level of less than Rs 50,000.

Sahayog's compliance with RBI guidelines for MFIs is presented below.

Capital requirement
As per Sahayog's audited financial statements for the year ending 31 March 2012, it had Net Equity of Rs87.3 million as of 31st March 2012. This is more than the required Rs50.0mn of Net Owned Fund (NOF) prescribed by RBI for NBFC-MFIs.

Proportion of qualifying assets and income generation loans
As per the CA certificate obtained by Sahayog dated 1 November 2012, it had qualifying assets greater than 85% of its total assets excluding cash and bank balances. The CA has also certified that over 75% of Sahayog's total loans have been given for income generation purposes. This is in compliance with the RBI guidelines for NBFC-MFIs on qualifying assets and income generating loans.

However, M2i's assessment suggests that Sahayog's weaknesses in internal control and dissemination aspects makes it non-compliant in ensuring that all borrowers whose loan accounts have been classified as qualifying assets have an indebtedness level of less than Rs 50,000.

M2i's observations on critical compliances by Sahayog are presented below:

- Loan size verification

Sahayog's first cycle loans are less than Rs 35,000 and its maximum loan size is Rs 50,000. Physical verification of over 100 loan documents corroborated this.

- Collateral verification

Sahayog does not take any collateral on group loans. This is in accordance with RBI's guidelines. M2i's check of loan documents and direct verification with clients did not reveal any deviation on this guideline.

- Loan duration verification

Sahayog's loans carry a repayment period of 12 months for loan sizes upto Rs 15,000 and 24 months for loans sizes over Rs 15,000, which is in accordance with directions issued by RBI. However, we observed that Sahayog's operational staff had made their own interpretations as illustrated in the caselet below:

Caselet: Disbursement of loan of over Rs 15,000 with 12 months repayment term

On 20 January 2012, Rs110,000 was disbursed to 5 clients of Ektanagar center in Chandangaon area under Chhindwara Branch. Each client was provided between Rs25,000 and Rs30,000 structured in such a manner that each client received two loans of Rs15,000 each or one loan of Rs15,000 and another loan of Rs10,000. These loans had the same duration (12 months) and the same repayment frequency (fortnightly). The concerned staff member had the understanding that by opening separate loan accounts, compliance with the direction had been ensured. This indicates weakness in internal control and dissemination aspects within the organization.

Based on the findings of this assessment, the company has initiated steps to convert all loans over Rs 15,000 which were given for duration of less than 24 months to duration of 24 months. The company has also initiated a comprehensive training of all the field staff members to ensure sound comprehension of RBI's guidelines.

- Household income

Sahayog takes self-declaration from the client on their household income. In a check of randomly selected 100 loan documents across 12 branches it was observed that all members had declared their income within the RBI stipulated annual households income limit of Rs60,000 in rural areas and Rs120,000 in urban areas.

Multiple Lending and Indebtedness

As per the existing policy of the organization, total indebtedness of a client under microfinance loans cannot be more than Rs50,000. Further, Sahayog has a policy of not extending loan to any client who has existing borrowing outstanding from two other institutions. As per policy, Sahayog does not provide loans to a client if her total indebtedness exceeds Rs50,000. However, this condition is often not checked by the field staff. Sahayog has not started using credit bureau records for checking indebtedness of the clients. During the assessment M2i came across several instances where the total indebtedness of Sahayog's client was more than Rs 50,000 (See caselet in the section on loan appraisal).

Pricing of credit

Sahayog charges interest rate of 26% per annum on reducing balance basis. In addition the clients are charged 1% processing fee upfront. Loan insurance is charged on actual premium paid basis. All these prices are revealed to clients during compulsory group training are mentioned on loan card of clients. These are also mentioned on loan passbook of clients. The passbook is used to record all the transactions made by clients and Sahayog's loan officers duly put their signature in the relevant place in the passbook to acknowledge payments made by the clients.

For the year 2011-12 Sahayog's average cost of borrowing came to 14.6%. The interest yield on average portfolio of Sahayog for the year 2011-12 was 25.4%, with a margin of 10.8%. Thus, Sahayog was in compliance with RBI's directions on pricing and margin.

Capital adequacy

The CRAR of Sahayog was 19% as of 31st March 2012 which complies with the required CRAR of 15% for NBFC-MFIs. Sahayog does not have any exposure in Andhra Pradesh.

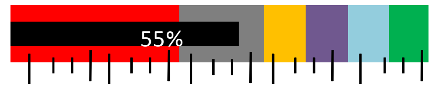
Diversification
Sahayog's operations are concentrated in the state of Madhya Pradesh, although the organization has recently started disbursing loans in Maharashtra.

Customer Protection Initiatives
Sahayog has regularly discussed customer protection initiatives in its board meetings and has adopted RBI's fair practices code as per RBI's circular dated 26 March 2012 in its Board meeting on 9 June 2012.

Membership with SRO and credit bureau
Sahayog is a member of MFIN as well as High Mark Credit Information Services Limited and shares client data with them.

Section 3: Observations

3.1 Client Origination and Targeting (COT)



Sahayog's score on client origination is poor because of weaknesses in its control systems to ensure that client origination is consistent with the policies of the organization.

Approval (A)	Documentation (D)
✓ Sahayog has a board approved policy of targeting low income clients in a manner that allows them to improve their livelihoods.	✓ The organization has documented the processes of area selection, training of clients and group recognition test in its operations manual. ✗ The manual has not been translated in local language
Dissemination (D)	**Observance (O)**
✓ Sahayog has a system of providing various trainings to its staff members. ✗ Staff members display variable understanding of client origination guidelines of the organization. ✗ The Operations manual has not been made available to the branches.	✓ The organization has been providing services in remote areas of Betul and Chindwara districts where no other MFI has an operational presence. ✗ We came across instances where client origination guidelines had not been followed by Sahayog's field staff. ✗ Sahayog needs to significantly improve its operational monitoring system so that there is a higher compliance with its policies and guidelines.

As per its policy and guidelines, Sahayog originates clients in areas which are under served. It also has the policy of not providing loans to any client who has loans from two other MFIs. While the client origination guidelines have been documented in the operations manual, the manual has not been translated into the local language and has also not been made widely available in the branches. Senior staff members (Area Managers) were found to be aware of not involving outsiders in the group formation process.

Sahayog has so far not placed an upper limit on the incentive that a loan officer can derive by enrolling new clients. The understanding regarding sound client selection among the loan officers was also not found to be uniform. While the organization has a system of training staff members on client origination guidelines, the effectiveness of the trainings needs to improve considerably.

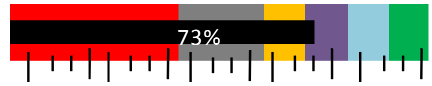
Many of Sahayog's center leaders were found to be the group/center leaders of other MFIs. And the center meetings of the other MFIs were also being conducted at the same place (at the house of the center leader). This exposes the organization to significant risks. One of the measures taken by Sahayog to address this risk has been to limit the center sizes to 10 (most of the centers have 5 members) so that any single client does not become too influential. In M2i's opinion this needs to be supplemented by improved monitoring.

Sahayog has so far not started using information from credit bureau to ascertain the level of indebtedness of its potential clients. While the loan officers are expected to collect this information from the clients, and clients also need to provide an undertaking regarding their borrowings, we observed that in many cases the indebtedness of the clients had not been appropriately recorded. In one of the visited branches (Bairasia), where several MFIs have operations, we found that there was no mention of any other borrowing by clients in any of the loan files in the branch. However, during our interactions, several clients revealed that they had taken loans from other MFIs as well, with some having loans from two other MFIs.

On the positive side, Sahayog has recently undertaken a survey to explore the feasibility of expanding branches in villages where no other MFI is present. In Chindwara and Betul districts, most of the places where the MFI works are quite remote and other MFIs are not present. Some of the villages where the MFI works are up to 30 KMs from the branches.

Based on the observations made during this assessment, the organization has initiated steps to make the operations manual available in local language in all the branches. The organization has also initiated trainings for its field staff members on the directions and guidelines issued by the RBI.

3.2 Loan Pricing (LP)



Sahayog's score on loan pricing is good as the organization has made efforts to comply with RBI directions issued in this regard. Sahayog charges interest rate on reducing balance basis and discloses all its charges to its clients in its communications.

Approval (A)	Documentation (D)
✓ Sahayog's board has discussed loan pricing during the previous one year and issued guidelines to ensure that these are in line with RBI's directions regarding interest rates, processing fees and margins.	✓ Sahayog's pricing guidelines have been documented in circulars issued by the organization.
Dissemination (D)	**Observance (O)**
✓ All the staff interviewed had received training and communications on Sahayog's pricing principles. ✗ Despite the training, there is a lack of uniform understanding among the field staff regarding the rates to be communicated to the clients.	✓ The interest rates, processing fees and insurance charges are printed prominently in the loan cards provided to clients. ✓ Clients are informed about insurance terms and conditions during group trainings ✗ Awareness regarding interest rate was low among illiterate clients. ✗ While the insurance premium collected is mentioned in the loan passbooks, insurance terms and conditions are not mentioned on them or any other document provided to the clients.

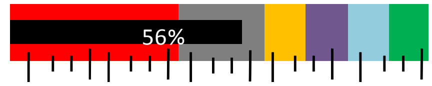
Sahayog charges interest on reducing balance basis. Life insurance for the clients availing loan is compulsory and premium is charged on actual basis. Loan Processing fee is 1% which is charged upfront to JLG clients. There are no prepayment penalties or any extra charges on overdue loans. In case of prepayment, interest for the unexpired period is not charged. Sahayog does not have a system of providing acknowledgement of loan applications received or loans sanctioned to its clients. The insurance premium collected is mentioned in the loan passbooks and clients are informed about the insurance terms and conditions during the group trainings. However, insurance terms and conditions are not mentioned on the passbooks or any other document provided to the clients.

The loan installment is mentioned on the loan cards given to the clients. The loan passbook also contains information regarding the reducing balance rate of interest on the loans. The clients are also made aware of the interest rate during the CGT process. During client interviews we found that nearly 40% of the clients were aware of the interest rates. We found that in a few instances the interest rates mentioned in the loan passbooks of the clients was

13.7% per annum on a reducing balance basis, which points to a lack of uniform understanding among the field staff regarding the rates to be communicated to the clients.

Based on the observations of this assessment, the organization has initiated steps to distribute insurance terms and conditions to all its clients in Hindi.

3.3 Loan Appraisal (LA)



There is considerable scope for Sahayog to improve its performance on Loan Appraisal by improving the compliance of its loan officers with its policies and guidelines.

Approval (A)	Documentation (D)
✓ Sahayog has a board approved policy of appraising loans as per the directions of the RBI to prevent over-indebtedness of its clients.	✓ Sahayog has evolved forms and formats that can lead to effective loan appraisal.
Dissemination (D)	**Observance (O)**
× Staff members did not have uniform understanding of how loan appraisal had to be performed.	× In many instances, we observed that the indebtedness of clients on account of borrowings from other MFIs had not been accurately reported. × In significant number of cases, we found that the household surplus was not sufficient to service all their debts.

Sahayog's policy is to ensure that loans are given to borrowers in accordance to their capacity to repay as well as to comply with the directions issued by RBI. The organization has evolved appraisal formats that take into account the borrowers incomes, expenditures as well as other borrowings. Before loan disbursements clients are provided training on the loan product and its terms and conditions. The Credit Officers and Branch Manager make visits to the household of the loan applicants to ensure that they are eligible for Sahayog's loans, and that the information they have provided is valid.

However, during the assessment we found that the field staff had filled up these formats after interpreting them in a manner that suited them. As a result, the appraisal formats did not reflect the real status of clients' household level cashflows. This has been illustrated in the caselet below.

Caselet: Incorrect Appraisal

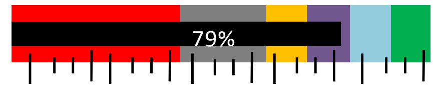
Five members of Center no 42 in Umaranala Branch were issued loans of Rs45,000 each in February 2012. At the time of disbursement all the clients had loans from Spandana (Rs 10,000 to Rs 15,000). Some of these clients also said that they had loans from BASIX as well, at the time of disbursement of loans from Sahayog. It is likely that total indebtedness of clients was in excess of Rs 50,000 after disbursement of loan from Sahayog. Review of loan documents of the group revealed that loan amount from Spandana was mentioned. The concerned Branch Manager had the understanding that since Rs 45,000 loans was to be repaid in 24 months, they will consider only 50% of the loan amount towards computation of overall indebtedness. (Another branch manager with whom the assessment team interacted also had the same understanding).

Subsequent to the disbursement of loan from Sahayog, the group members also availed loans from HDFC Bank (Rs10,000 each). Total loan installment for most of the group members for all the MFIs taken together is about Rs 4,000. Monthly household income recorded by the MFI for the clients is only Rs 5,000 for each household.

In Sahayog's centers in Barkheri, (Bilkisganj branch), loans of Rs 40,000 had been given to Janki and her mother in law Kiran. The loans had been used to finance a single asset – Tata Magic. In order to fully finance the asset, the family had also borrowed from a finance company. Sahayog's field staff maintained that since the clients were part of different centres of Sahayog, loans could be given to both of them.

Sahayog maintains that errors in appraisal happen partly because clients tend to not disclose information in an accurate manner. In M2i's opinion Sahayog should try to overcome this constraint by initiating credit bureau checks and further strengthening its loan appraisal. *Based on M2i's observations, Sahayog is evolving a template which shall be used by the field staff to assess the repayment capacity of applicants before a loan is sanctioned. The Internal Audit process is also being amended to check and prevent instances of erroneous appraisal in future.*

3.4 Client Data Security (CDS)



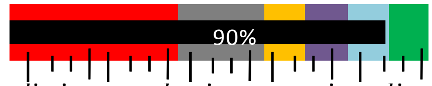
Sahayog's performance on CDS is good on account of sound policies and systems for keeping the client data secured.

Approval (A)	Documentation (D)
✓ Sahayog has a board approved policy regarding client data security.	✓ Sahayog has documented its policy of client data security.
Dissemination (D)	**Observance (O)**
✗ Interviewed employees displayed variable understanding of how the loan documents had to be stored.	✓ Physical documents are stored securely at the Branch Offices. ✗ Security of client documents has so far not been included in the Internal Audit guidelines.

Sahayog has formulated policies for protection of client data and preventing unauthorized access to client records. Most of the information pertaining to clients is maintained in the MIS software used by the organization. Designated protocols are required to be followed for editing. Required back-ups are taken to ensure business continuity. Loan files are kept in the steel almirahs under lock and key. These are under the command of Assistant Branch Manager/Branch Manager. Loan files are neatly arranged and properly numbered for identification and retrieval. Sahayog needs to include security of client data in its Internal Audit checklist. Also, the interviewed Branch Managers displayed variable understanding of whether the loan documents had to be kept in locked rooms.

Based on the observations made during this assessment Sahayog has introduced client data security in its internal audit checklist.

3.5 Staff Conduct (SC)



Sahayog's score on staff conduct is very good. There is a distinct emphasis on treating clients with respect and dignity. None of the clients interviewed made any adverse remark regarding staff conduct.

Approval (A)	Documentation (D)
✓ Sahayog has adopted the industry code and RBI fair practices code for staff behavior which includes policies regarding expected staff conduct with clients.	✓ Sahayog has documented a staff code of conduct for ensuring sound staff conduct.
Dissemination (D)	**Observance (O)**
✓ Sahayog has evolved a pledge for its employees, which places emphasis on maintaining high standards of staff conduct. ✓ The staff code of conduct is displayed in the branches. ✓ Employees have been trained on how they should address their clients even under stressful circumstances.	✓ Staff members were found to be aware of behavioral issues with clients. Staffs were following these staff conduct policies. ✓ Visited clients did not report any incidence of staff misconduct or coercion. ✓ Behavioral aspects form part of Internal Audit checklists.

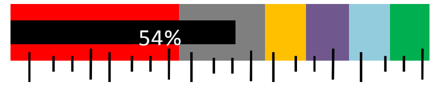
Sahayog has a policy of maintaining high standards of staff conduct particularly during interactions with clients. There is a staff code of conduct that has been displayed prominently across the branches. A printed copy is also provided to the clients. Most of these points are reiterated during the group training and during disbursements. Sahayog's pledge meant for its employees also emphasizes on maintaining high standards of staff conduct.

The salient aspects guiding staff conduct at Sahayog are as follows:

1. No distinction will be made by the staff on the basis of caste, religion or language.
2. Staff will not consume alcohol or smoke while on duty
3. Staff will refrain from indecent language and violent behaviour
4. They will not accept any gift from the clients
5. They will not do collection of instalments beyond 6.PM
6. They will not go for collections on inappropriate occasions like death in the family.
7. They will avoid all actions which may cause unpleasant situation for the clients.

During interviews by the assessment team, none of the clients reported any incidence of staff misconduct or coercion.

3.6 Client Relationship and Feedback (CRF)



Sahayog's performance on client relationship and feedback needs to improve significantly. The organization needs to put in place an effective system to collect and address client feedback and grievances.

Approval (A)	Documentation (D)
✓ The organization is in the process of evolving a sound policy for grievance redressal.	✓ Sahayog provides the phone number of its head office on the loan passbooks of clients. ✗ Clear policies on grievance redressal have not been documented. ✗ While the new passbooks being introduced by the organization carries details of the grievance redressal mechanism, the existing passbooks do not carry these details.
Dissemination (D)	**Observance (O)**
✗ The organization needs to better train employees who are responsible for collecting and classifying feedbacks and grievances from clients.	✓ Sahayog's internal auditors visit all cases where insurance payments have been made out to clients. ✗ Interviewed clients were not found to have sufficient understanding of the grievance redressal processes. ✗ Sahayog needs to include the resolution of all kinds of client complaints in its monitoring and internal audit systems.

While Sahayog's board has given adequate emphasis on putting in place a robust system for grievance redressal, this has still not been implemented adequately. So far the Business Coordinator-Operations has himself tried to receive and address complaints voiced by clients. However, given his other involvements in the operations of the organization, grievance redressal has not received adequate attention. The guidelines regarding how client grievances will be received and classified have still not been documented.

Caselet: Umaranala Branch – grievance redressal

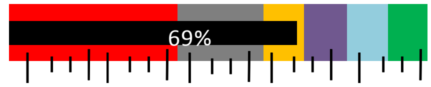
At about 10.45 am on 20 December a client from Mohkhed area in Umranala Branch called the branch requesting some information. The person answering the call said that he will call back to the client and provide necessary information. No call was made by the Sahayog official to answer the query. (The call was made using the phone of one of the members of the assessment team).

Many of the clients interviewed were not aware that in case of grievance they can call the Head Office. Branches have complaint registers but no entries were found in these registers. Branch address/phone number is not mentioned on the loan cards. Since disbursements happen in the field most clients have not visited the branch and many are not even aware of the branch location.

While the loan passbooks have phone numbers of the organization's head office, they do not contain the grievance redressal mechanism in adequate detail. Sahayog has initiated the process of pasting details of the grievance redressal mechanism in the group registers which are maintained by the center leader. Also, this has been pre-printed in the new passbooks, which are however, still to be given to clients.

An aspect where the organization has proactively tried to address client concerns is settlement of insurance claims. Inappropriately settled insurance claims are an important factor that can adversely impact client relationships. The internal auditors visit every case where an insurance claim has been made so that the possibility of fraud and client dissatisfaction can be ruled out. However, Sahayog needs to include all serious grievances in its internal audit to make this function more effective.

3.7 Integrating Social Values into Operations (ISV)



Sahayog's score on ISV is reasonable as the organization actively seeks to have a positive impact in the lives of its clients. Sahayog's sister concern Sahayog Micromanagement – a not for profit company, has been created with the objective of making interventions in the area of livelihoods.

Approval (A)	Documentation (D)
✓ Sahayog's board is actively involved in planning interventions that can positively impact the livelihoods of its clients. This issue has been discussed frequently by the board in its meetings. × While a decision to form an Audit committee of the board has been taken, it has still not been formally constituted.	✓ Sahayog's vision, mission and values are well-documented and displayed in all its branches. ✓ The policy for identifying the target clients is also documented.

Dissemination (D)	Observance (O)
✓ Sahayog's staffs are aware of the target clients who are mainly from low income category.	✓ Sahayog has produced an impact assessment report of its microfinance activities. ✓ Sahayog Micromanagement has been created to specifically intervene in the area of livelihoods × Sahayog does not offer any product that can provide relief to its clients during periods of stress.

Sahayog's board has seven directors of whom three are independent directors who neither have any executive role nor any significant ownership stake in the organization. The organization in its board meeting of 7 Aug 12 has resolved to create an Audit Committee. However, so far the committee has not been constituted. Sahayog's vision is to "a society with equal opportunities and sustainable livelihood for all". The vision statement has been widely disseminated across the organization to sensitize all staff members. The staff members were found to be aware about the impact the organization desires in the lives of its clients.

Sahayog Micromanagement (SM) has been created as not-for-profit company under Section 25 of the Indian Companies Act to make direct interventions in the area of livelihoods. In the past SM has tried to enhance client livelihoods by setting up small units to manufacture charcoal briquettes with limited success. In the future SM plans to intervene in the area of dairy as this is an activity which many of Sahayog's clients undertake.

Sahayog, however, does not offer any specialized loan product to address client vulnerability such as health or lack of education. The organization is planning to introduce an emergency loan product within this financial year.

Annexure 1: Matrix of Score Obtained[3]

Indicators	A		Do		Ds		O		Total*	
	Max	Obt	Max	Obt	Max	Obt	Max	Obt	Max	Obt
Client origination and targeting	5	3.6	5	3.6	5	1.8	9	4.1	**24**	13.1
Loan Pricing	3	2.7	1	0.9	2	1.8	9	5.6	**15**	11.0
Loan Appraisal	4	3.6	4	3.6	3	0.0	5	1.8	**16**	9.0
Client Data Security	1	0.9	3	1.8	2	1.8	2	1.8	**8**	6.3
Staff Conduct	7	6.4	7	6.4	10	9.1	11	9.5	**35**	31.4
Client Relationship and Feedback	2	1.8	8	5.5	6	2.7	10	4.1	**26**	14.1
Integrating Social Values into Operations	3	1.8	3	2.7	3	1.8	5	3.4	**14**	9.7
Total*	**25**	**20.8**	**31**	**24.5**	**31**	**19.0**	**51**	**30.3**	**138**	**94.6**

A= Approval, Do=Documentation, Ds=Dissemination, O=Observance, Max = Maximum, Obt = Obtained score
*Totals have been rounded to one place of decimal.

Note: Scores have been reduced by a factor of 0.92 to reflect overall achievement on regulatory compliance.

[3] ADDO © Prime M2i Consulting Private Limited

Annexure 2: Tool Development, Methodology and List of Branches Visited

The code of conduct compliance assessment tool was developed as a response to the need expressed in a meeting of stakeholders in Indian microfinance by the Small Industries Development Bank of India (SIDBI) and the World Bank in December 2009. The code of conduct dimensions were identified by reviewing the various norms for ethical finance. These included RBI's fair practices guidelines for Non Banking Financial Companies, industry code of conduct (Sadhan-MFIN) and CGAP's client protection principles. The most important challenge for M2i was to create objective indicators which could comprehensively measure the seven dimensions. A total of 138 indicators[4] were developed across these dimensions, so that subjectivity in measurement could be minimized. The numbers of indicators for each dimension are presented below.

Dimension	Nos. of Indicators
Client origination and targeting	24
Loan Pricing	15
Loan Appraisal	16
Client Data Security	8
Staff Conduct	35
Client Relationship and Feedback	26
Integrating Social Values into Operations	14
Total	**138**

In order to make the measurement comprehensive and objective, a method of scoring was developed so that:

1. Measurements on the indicators are taken on the dimensions across the four parameters within an MFI – Approval, Documentation, Dissemination and Observance
2. Indicators are mapped to underlying characteristics which can be objectively measured. This is illustrated in the box below.

Illustration

One of the indicators developed to measure the dissemination of guidelines related to staff conduct is:

Has the MFI provided training to its operational staff on their conduct with clients, particularly relating to:

A. Conducting client meetings
B. Collecting repayments
C. Recovering overdue loans

The basis of scoring this indicator is the proportion of operational staff interviewed who have received training on these specific aspects. In case all the staff members have received trainings on each of these aspects then the score is 1 on each of these indicators, totaling to 3. If only 50% of the operational staff members interviewed have received training on these specific aspects then the score totals to 1.5 (0.5+0.5+0.5).

[4] Integrating Social Values into Operations with 14 indicators was added to tool in September 2012.

The Code of conduct assessment tool was tested on four MFIs during its portfolio audit and best practices validation engagements. M2i formally presented the code of conduct assessment tool at a microfinance lender's forum meeting held in Mumbai at SIDBI's office in June 2010.

RBI's Directions and Guidelines

With RBI issuing various specific guidelines for MFIs, M2i started scoring MFI's compliance to regulatory guidelines from 2012 onwards. The scores obtained by MFI on various COCA dimensions are scaled down in proportion to the score obtained in regulatory compliance.

Methodology

The code of conduct exercise is spread over four to eight days. The first day is spent at the head office. The assessment team visits the branches over the next three to eight days. Depending upon the size and the operational area of the MFI, three to fifteen branches and between 120 and 200 clients are sampled for primary survey.

Key Aspects

- Duration of the exercise: Four to eight days
- Nos. of branches to be visited: Eight to Fifteen
- Nos. of MFI clients to be interviewed: 120-200

This exercise requires:

1. Discussions with key staff members and the senior management at the head office, particularly the senior operational management team as well as the human resources team. These discussions focus on key issues of the code of conduct identified above.
2. Review of policy documents and manuals at the head office. These are reviewed in order to assess the policy as well as documentation regarding important aspects of the code of conduct. The last audited financial statements will also be required.
3. Sampling of branches at the head office. The assessment team samples branches for review. The branches are chosen in across different states in case the MFI operates in more than one state. Care is exercised to include older branches as well as branches that are distant from the head office or the regional office. The sampling of the branches is performed at the head office of the MFI.
4. Discussions with the branch staff at the branch office. Discussions with branch managers and the field staff is carried out to assess their understanding of the key code of conduct principles.
5. Sampling of respondents in the selected branches. A judgmental sampling is performed on the MFI's clients by the assessment team to draw respondents from the interest group, in order to maximize the likelihood that instances of non-adherence can be detected.
6. Interview with the clients. Information from the clients is collected ideally during the group meetings. If this is not possible, visits are made to the clients' locations for collecting information.
7. Review of loan files at the branch office. This review focuses on loan appraisal performed before disbursing loans as well as the documents collected from the clients.

As part of this assessment, we visited. The details of the project offices (branch) visited are provided below.

Sr No	Branch	State	No of clients interviewed
1	Karond,	MP	15
2	Bairasia	MP	20
3	Itarsi	MP	14
4	Piparia	MP	10
5	Bhopal	MP	20
6	Bilkisganj	MP	15
7	Umranala	MP	26
8	Chindwara	MP	5
Total			**125**

Annexure 3: Code of Conduct Assessment – Framework

Code of conduct dimensions

- Client origination and targeting: Client origination is central to ethical microfinance operations. The code of conduct requires MFIs to practice ethical client origination which results in greater access to financial services. Also, an MFI's commitment to target the low income clients demonstrates its social mission. The way an MFI identifies its clientele and goes about growing a clientele must be approved by the board, which should also see to it that there is adequate attempt by the MFI to ensure that its product and services reach the appropriate clientele.
- Loan pricing: The scientific determination of loan price (interest rates) reflects well on the MFI's management and it also shows how effective the MFI is in providing loans to the clients at the least possible cost. The way its loan products are priced should be approved by the board. Ideally the board members should be aware of the cost of the loan products to the clients.
- Loan appraisal: The lending to a client should be in accordance to her repayment capacity or else she may get over-indebted and her economic situation may deteriorate. The loan appraisal should take into account the repayment capacity of the clients given the loan sizes and the duration of the loan. These are important client protection principles.
- Client data security: The privacy of sensitive data of individual clients regarding their demographic details should be adequately secured so that it is not used by unauthorized parties to cause stress to the clients. For this purpose, MFIs need to define explicitly access rights to all the demographic data pertaining to clients sex, race, age, income, disabilities, mobility (in terms of travel time to work or number of vehicles available), educational attainment, home ownership, employment status, and location.
- Staff conduct: All the staff members of an MFI should treat its clients with respect and dignity. The two important aspects of staff behavior are:
  1. Communication with clients – There should be guidelines for staff to deal with specific situations involving their interface with the clients such as group meetings, loan disbursements and collections. These should ensure that customers with low levels of financial literacy understand the product, the terms of the contract, and their rights and responsibilities. Clients should also be aware of the debt recovery practices of the MFI. They should be aware of what to expect in case there is a delayed payment or a default. Clients should be encouraged to ask questions regarding the product and policies. Also, the staff should ensure that arrive for meeting in time.
  2. Loan collection and recovery process - MFIs should evolve collection practices that require all clients to be treated with dignity and respect, even when they fail to meet their contractual commitments. The following should be strictly avoided:
     - Abusive language or threats
     - Harassing borrowers at odd hours
     - Forcible entry into dwelling and forced seizure of property without the legal orders
- Relationship management and feedback mechanism: It is important for MFIs to build sustainable and long term relationship with clients. Sound relationship management enhances the quality of the clients' experience with the MFI. It also allows the MFI to

better understand clients' needs and grievances. MFIs need to have formal mechanisms to get feedback and complaints from the clients. Customer complaints need to be taken seriously, investigated and resolved in a timely manner. The responsibilities relating to receiving client grievance and feedback and acting upon them need to be clearly identified and allocated.

- Integrating Social Values into Operations: It is necessary to have high standards of governance and to have client focused social mission. It is also necessary to measure the socio-economic changes that MFIs' efforts are bringing in the lives of its clients and to compare it against the mission.

Compliance

In order to fully integrate operations with the principles presented above, MFIs need to adopt a comprehensive approach involving the board, the management as well as other staff members and clients. This tool measures the adherence to these principles on four parameters – Approval, Documentation, Dissemination, Observance (ADDO). This ADDO framework has been developed by M2i and is summarized below:

1. Approval at the policy level from the board
2. Documentation of the guidelines and procedures that emerge from the policy
3. Dissemination of the guidelines and procedures across the organization
4. Observance in practice of these guidelines and procedures.

Weights

The following matrix presents the weights given to the various dimensions and parameters in the tool.

Weight Matrix	Approval	Documentation	Dissemination	Observance	Totals
Client Origination	4%	4%	4%	7%	**19%**
Loan Pricing	2%	1%	1%	7%	**11%**
Loan Appraisal	3%	3%	2%	4%	**12%**
Client Data Security	1%	2%	1%	1%	**5%**
Staff Conduct	5%	5%	7%	8%	**25%**
Client Relationship and Feedback	1%	6%	4%	7%	**18%**
Integrating Social Values into Operations	2%	2%	2%	4%	**10%**
Totals	**18%**	**23%**	**21%**	**38%**	**100%**

Regulatory compliance (ReC)

Since it is mandatory for MFIs to comply with the guidelines given by the regulator, the MFIs are assessed for their compliance with these regulations. The level of compliance of an MFI to regulations is scored and this is factored-in in COCA by scaling down the scores on various COCA dimensions in proportion to the score obtained on ReC. In total there 12 indicators have been used to measure ReC.