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## Opening Notes

The contemporary issue currently engaging the attention of all the stakeholders in micro finance sector is about creating an enabling environment for the sector. As the micro finance sector matures and advances in India, dynamic changes are witnessed. Which calls for enabling regulatory and legal changes.

The issue begins with a curtain raiser on enabling legal and regulatory issues requiring to be addressed early. A comprehensive work on the legal and statutory issues affecting micro finance sector with suggestions for changes to be brought about in the existing legal frame work done by Mr Seshadri, of Audit firm M/s Sunanda & Seshadri, Bangalore, has been presented.

Credit is due to Reserve Bank of India for their proactive interventions hither to with facilitations by NABARD and SIDBI and Microfinance sector looks to their continued support for an enabling environment.

The microfinance sector has seen significant strides in Peru of Latin America. Ms Susana Pinilla shares about experience of the microfinance service provider EPYMEDES in building culture of client confidence for a long term relationship.

Plus other regular features in this issue.

**- M. Kalyanasundaram, Chief Executive, INAFI-INDIA  
International Network of Alternative Financial Institutions - India**

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# Enabling Environment for Microfinance Sector

*M Kalyanasundaram, Chief Executive, INAFI-INDIA*

## INTRODUCTION

**M**icrofinance is 'development finance' as this has come to be recognised as an important instrument to address poverty. It includes demand, supply and enabling streams.

**Demand stream comprises** of client's viz., the poor, either individually or through self-help groups and federations of SHGs. Preparing the clients or demand stream pre-supposes successful growth of the microfinance sector. This calls for greater amount of investment in terms of organizing the unorganized and builds their capacity to manage the microfinance effectively and to build linkages with financial institutions.

**The supply stream has multi agency approach in providing microfinance services.**

**It include:**

- ✕ Community owned financial institutions – SHGs, Federations
- ✕ Commercial banks, RRBs, Co-operative banks delivering microfinance
- ✕ NGOs involved in financial intermediation
- ✕ NBFCs involved in delivering microfinance (for profit and not for profit)
- ✕ Apex financial institutions and other bulk lending institutions like NABARD, SIDBI and RMK.

**The enabling stream includes** the NGOs and institutions involved in promotion and development of groups and federations through social intermediation. The regulatory and government bodies, institutions also form part of the enabling stream as they play critical role in providing favorable policy framework and supportive environment, which enables the growth and development of the microfinance sector.

This paper deals with issues relating to legal and regulatory frame work which would provide the enabling environment to the supply stream of financial institutions including MFIs which provide finance and the enabling stream of NGOs who builds demand the stream by organising the unorganised poor.

In this respect, it is noteworthy that RBI has been taking many policy initiatives to facilitate the credit flow to the banking system. The complementary role played by National Bank for Agriculture and Rural Development (NABARD) and Small Industries Development Bank of India (SIDBI) in triggering required policy changes deserve special mention. And the commercial banks like Canara Bank, Indian Overseas Bank, State Bank of India and ICICI bank did a commentable job in making SHG bank linkage a national programme for addressing poverty.

**Three major areas, which require legal, regulatory facilitations, have been identified**

**Raising of resources as one time investment in building the demand stream**

**Facilitation to the supply stream to smoothen the flow of credit**

**Regulation per se**

**RESOURCES/FUNDS FOR BUILDING DEMAND STREAM OF SHGs AND ITS FEDERATIONS:**

The promotional cost for building the social capital requires investment in the form of grant for organising the poor and enabling the access for institutional finance. The resources for this need to flow from RIDF of NABARD and from the commercial banks, besides the existing source of donors, Apex Institutions.

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**RIDF of NABARD:** The RIDF funds with inflow from commercial banks and Central Govt. generates not so insignificant surplus for NABARD which can be deployed for meeting the promotional cost of SHGs and its federations, other models of micro finance in the country. Being the apex agency charged with the responsibility of spearheading SHG programmes, NABARD shall set apart good part of the profit from RIDF for funding the promotional cost.

**Resource of commercial banks:** The nationalised commercial banks in the country could also set up a micro finance fund which could come partly from the profit and also partly from the investment of their contribution to RIDF fund. Which means, the commercial banks instead of contribution to RIDF fund, could retain the funds and handle it. Tax sops could be given to commercial banks for contributions to this fund.

**Status of legal entity to SHGs:** As things stand, SHGs, as association of persons, do not have the character of legal entity which is really dampening its multi-faceted inter-face with mainstream institutions, particularly, the Government Institutions and commercial enterprises. Just as the financial world recognises SHGs as a legal (quasi) entity to deal with (enabled/directed by RBI) without in a way, due recognition of the existing laws. It is impractical to expect the same treatment from other institutions and hence the need for formalising the status of SHGs as legal entity by an act, if necessary.

**Skill Building Centres:** The clients of demand stream require lot of capacity building support with accent on skill building for promoting their livelihood either through services or for setting up economic enterprises. Initiatives like Canara Bank which has promoted RUDSETI for building the capacity of rural poor, particularly the youth, need to be expanded with all commercial banks taking cue from this successful experience and earmarking part of their profit to start such centres.

## **ENABLING LEGAL/REGULATORY FRAMEWORK FOR SUPPLY STREAM:**

**Microcredit as directed lending:** The mainstream financial institutions being the largest source of micro finance services, policy pressures need to be built up in their system to direct/smoothen the credit flow to unorganised sector. Presently, commercial banks are required to ensure that 10% of the net credit should go to weaker sections, which largely comprise of unorganised sector. In order to enhance the flow of institutional finance to unorganised sector, the concept of 'directed lending' needs to be reinforced and the percentage should go up to 20% of net credit.

**Automatic route for ECBs under section 25 not-for-profit NBFC MFIs:** The facility of availing external commercial borrowings from foreign source under automatic route need to be extended to NBFC MFIs registered under section 25 of the Companies Act with not-for-profit motive as they can lend only to poor by regulation of RBI.

**New generation of not-for-profit NBFC companies u/s 25** are emerging to provide micro credit to the poor clients. We need to encourage this as part of multiple model approach. RBI has also exempted such not-for-profit companies focussed only in assisting poor, from the requirements of registration and licensing formalities unlike other for-profit NBFC companies. Nevertheless, the Regional Director and the Registrar of Companies are to be advised by the Company Law Board to issue license/registration without hassles to the MFIs formed under section 25 that comply with RBI's guidelines.

**Presently guidelines of RBI do not allow not-for-profit section 25 NBFC companies** to lend not more than Rs.50, 000/- for business enterprises and Rs.1, 50,000/- for housing to SHGs and its federations. This impedes smooth credit flow to SHGs when the members go for economic enterprises with higher investment. This prudential limit for credit should be applied to the individual beneficiaries and not to SHGs and its federations to enhance credit flow to the poor. RBI shall issue guidelines accordingly.

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**Pricing of micro credit by MFIs:** Interest rates for Micro finance, even while de-regulating interest rate (which are now by and large, market driven) needs to be affordable. Usury should not be allowed in the name of attaining sustainability on micro finance operations. Usury act shall be made applicable for MFI lending to unorganised sector.

**Rating Tool:** The Indian model of SHGs and federations does not require rating per se. Rating places unnecessary cost burden on the micro finance sector. Rating may be relevant only for those NBFC entities taking deposits from public for funding micro finance. Nevertheless, internal capacity of formal financial institutions to assess micro finance borrower needs to be strengthened. The MFIs or NGOs either as a loanee or a grantee can be assessed directly by the lender or donor, as the case may be, instead of rating agencies

**Entry norms for NBFCs** with profit motive should not be relaxed to keep away those players who are not serious or of doubtful motives. So also, the regulatory and supervisory norms and standards for these NBFCs, if any thing, further tightening is called for

### **FACILITATION TO ENABLING STREAM**

The Income tax act should define micro finance (Task-force report) as a charitable activity as most NGOs get their charitable status from section 2(15). This will enable not only the NGOs but also the SHGs and its federations to clearly account their lending and income under this activity in the balance sheet. It will facilitate in rebuilding the perspective of the Income Tax department regarding NGOs who earn a substantial part of their income from lending activity, and limit the probability of the interpretation that such activity violates Section 11(4) of the Income Tax Act resulting in a loss of the NGO's charitable status under Section 12A.

Savings of poor do constitute considerable part of funds for lending. Nevertheless, the savings of the poor need to be handled by the poor

themselves on the principle of mutuality for building their ownership and stake in the micro finance programmes. Intermediation by NGOs in handling savings of poor is fraught with serious risks/consequences given the bad experiences in the past.

### **REGULATION PER SE (FINANCIAL SUPERVISION)**

Of the five agencies delivering micro credit under the supply stream except the Community owned financial institutions – SHGs, Federations and NGOs involved in financial intermediation, other players are regulated by the reserve bank with a well defined set of prudential norms.

The issue now is should we regulate the community owned financial institutions and the NGOs involved in financial intermediations and in what manner and form? While some form of regulation is necessary, given the present level of growth and operations and also the fact that they are not permitted to handle the public deposits, external regulation by the Reserve Bank of India may not be appropriate nor required.

As the NABARD Task Force on Supportive Policy and Regulatory Framework for micro-finance suggests, self- regulation would meet the requirement of managing and enabling the growth of these institutions with a broad frame work of performance standards under the three important indicators-developmental, Institutional and financial. Nevertheless, the self-regulation would be in a way regulated by a body comprising of practitioners to establish norms and standards for practice. Self-regulation needs to be encouraged for community based/owned financial institutions such as SHGs, its federations, etc.

With regard to NGOs involved in the financial intermediation, they are merely a conduit for flow of credit to SHGs and its ilk and the lending institutions can keep a tab from the financial supervision perspective besides the voluntary adoption of self regulation practices by NGOs.

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# Enabling Legal Framework for Microfinance Sector

**D**iverse models characterise microfinance interventions in the country. Equally diverse are the various laws of the land which are to be complied with as the micro finance sector diversifies and deepens its reach, the laws have been found to be inadequate to facilitate this process. This dynamic growth requires periodical re-look and change to facilitate the growth of the sector. Towards this objective, SIDBI Foundation for Micro Credit (SFMC) has commissioned a study of the existing legal provisions covering various acts which have bearing on microfinance interventions. The study has been taken up by Mr Seshadri of M/s Sunanda & Seshadri, the audit firm and the study has looked at the existing provisions, the problems faced and the suggestions with rationale for the changes required. The following acts, which have relevance to this sector, have been examined.

- I. Foreign Contribution (Regulation) Act
- II. Income Tax Act
- III. Companies Act
- IV. The Societies Registration Act
- V. Indian Trusts Act
- VI. The Reserve Bank of India Act

## I FOREIGN CONTRIBUTION (REGULATION) ACT, 1976 (FCRA)

### 1 Existing Provisions

#### 1.1 Section 2(a)

*“association” means an association of individuals, **whether incorporated or not**, having an office in India and includes a society, whether registered under the Societies Registration Act, 1860 (21 of 1860), **or not, and any other organisation, by whatever name called.**”* (emphasis supplied)

#### 1.2 Section 2(c)

*“Foreign contribution” means the donation, delivery or transfer made by any foreign source,-*

- (i) of any article, not being an article given to a person as a gift for his personal use, if the market value, in India, of such article, on the date of such gift, does not exceed one thousand rupees ;
- (ii) of any currency, whether Indian or foreign ;
- (iii) of any foreign security as defined in clause(i) of Section 2 of the Foreign Exchange Regulation Act, 1973 (46 of 1973) ;

*Explanation - A donation, delivery or transfer of any article, currency or foreign security referred to in this clause by any person who has received it from any foreign source, either directly or through one or more persons, shall also be deemed to be foreign contribution within the meaning of this clause;*

#### 1.3 Section 6(1)

*“No association [other than an organisation referred to in sub-section (1) of Section 5] having a definite cultural, economic, educational, religious or social programme shall accept foreign contribution unless such association, -*

- (a) registers itself with the Central Government in accordance with the rules made under this Act ; and
- (b) agrees to receive such foreign contributions only through such one of the branches of a bank as it may specify in its application for such registration.” (emphasis supplied)

## 2. Problems faced

A second recipient of foreign grants is also to be registered under the FCRA but the self help groups (SHGs) are not so registered. It is to be noted that registration under FCRA is required,

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even if the recipients are unincorporated bodies or informal groups (refer para 1.1 above). Second recipient refers to a person who receives the foreign grants not from the international donor direct, but through a local organisation.

Section 6 of FCRA (which deals with registration and prior permission for receipt of grants) applies to any association defined in section 2(a) having a definite cultural, economic, educational, religious or social programmes. Thus unincorporated bodies also have to comply with section 6.

### 3. Suggested Amendments

#### 3.1 Insertion of section 2(fa) to define microfinance

*'Microfinance' means provision of thrift, credit and other financial services and products (including donations and grants) of very small amounts (whether interest bearing or otherwise) to the poor for enabling them to raise their income levels and improve living standards.*

#### 3.2 Insertion of section 2(ia) to define self help group

*A 'self help group' is an economically homogenous group of the poor, with not more than twenty members, voluntarily coming together to meet the microfinance requirements of only its members, on principles of mutuality.*

#### 3.3 To insert the words "(not being donations and loans to self help groups in account payee cheques or account payee bank drafts subject to limits as may be prescribed)" in the explanation to section 2(c) after the words "referred to in this clause".

#### 3.4 The revised section 2(c) with the changes being highlighted will read as below :

#### Section 2(c)

*"Foreign contribution" means the donation, delivery or transfer made by any foreign source,-*

- (i) of any article, not being an article given to a person as a gift for his personal use, if the market value, in India, of such article, on the date of such gift, does not exceed one thousand rupees ;
- (ii) of any currency, whether Indian or foreign ;
- (iii) of any foreign security as defined in clause(i) of Section 2 of the Foreign Exchange Regulation Act, 1973 (46 of 1973) ;

**Explanation** - *"A donation, delivery or transfer of any article, currency or foreign security referred to in this clause (not being donations and loans to self help groups in account payee cheques or account payee bank drafts subject to limits as may be prescribed) by any person who has received it from any foreign source, either directly or through one or more persons, shall also be deemed to be foreign contribution within the meaning of this clause:*

### 4. Rationale

4.1 Transfers to SHGs (loans and grants/donations subject to prescribed monetary limits) alone are sought to be put out of the purview of FCRA, provided it is from a local NGO out of the foreign grants received by the latter. The proposal does not cover cases of SHGs (unlikely event in any case due to the provisions of the Income Tax Act inter alia) receiving money directly from any foreign donor, without the grants being routed through an Indian NGO.

4.2 Prescription of monetary limits and mode of payment are necessary safeguards to prevent large scale

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transfers taking advantage of the provision. To facilitate changes in limits without amending the law, the monetary limits are to be prescribed separately.

- 4.3 No exemption is sought in the case of transfers to federations of groups/apex bodies which are incorporated under various laws. These entities should obtain necessary permission/registration under FCRA for receipt of foreign grants due to their size and volume of operations. They have the capacity and the competence to do so.
- 4.4 In the recently amended Form FC 3 (annual return filed under FCRA) there is an entry (No.10 under the head purposes for which foreign contribution has been received and utilized) for "micro finance projects, including setting up banking cooperatives and self help groups" but the principal act and the connected sections are not amended.

## II INCOME TAX ACT

### 1. Existing Provisions

Two sections of relevance under the Income Tax Act are:

1.1 Section 2(15)

*"charitable purpose" includes relief of the poor, education, medical relief and the advancement of any other object of general public utility."*

1.2 Section 11(4A)

*"Sub-section(1) or sub-section(2) or sub-section(3) or sub-section(3A) shall not apply in relation to any income of a trust or an institution, being profits and gains of business, unless the business is incidental to the attainment of the objectives of the trust or, as the case may be, institution, and*

*separate books of account are maintained by such trust or institution in respect of such business."*

### 2. Problems faced

- 2.1 Under the Income Tax Act, a grant to another charitable trust is exempt and allowed as an application in the hands of the donor consequent to a circular issued by the Central Board of Direct Taxes (Instruction No.1132, dated 5 January, 1978) as below :

***"142. Availability of exemption in the hands of charitable trusts on amounts paid as donation to other charitable trusts.***

A question has been raised regarding the availability of exemption in the hands of charitable trusts of amounts paid as donation to other charitable trusts.

The issue has been considered by the Board and it has been decided that as the law stands at present, the payment of a sum by one charitable trust to another for utilisation by the donee trust towards its charitable objects is proper application of income for charitable purpose in the hands of the donor trust ; and the donor trust will not lose exemption under section 11 of the Income-tax Act, 1961, merely because the donee trust did not spend the donation during the year of receipt itself.

The above position may kindly be brought to the notice of all officers working in your charge."

Grants to SHGs cannot come under this category because they are not charitable trusts under section 11 of the Income Tax Act.

- 2.2 Under the Income Tax Act, the recipient has to be a charitable trust which also implies that it should be

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registered as a trust, company licensed under section 25 of the Companies Act or a society, in addition to enjoying registration under section 12 A of the Income Tax Act. Under the Income Tax Act registration under section 12 A is granted to incorporated bodies normally. Income Tax Act makes no distinction on the source of the donation – foreign or local.

- 2.3 The question is, what is the legal position of grants to SHGs by organisations? SHG as a concept has the approval of the government. SHGs are not registered bodies, but hold bank accounts. SHGs are being promoted as a vehicle of rural development in a very big way by government owned financial institutions. Under the circumstances, the contributions to SHGs are considered as an expenditure in the books of account of NGOs with no adverse legal consequences so far. However, it would be in the interests of the NGOs to get a specific clarification on this matter, from the authorities under the Income Tax Act to avoid legal problems later.
- 2.4 Under section 11(4A) of the Income Tax Act no business income is eligible for any exemption under section 11 unless the business is incidental to the attainment of the objectives of the trust. Lending on interest is a business activity even if it is to NGOs or beneficiaries. Thus it is difficult to conceive of the income tax authorities giving the benefit of exemption to charitable organisations which run only a credit programme and have no other charitable activities. An organisation should have other charitable objects also.
- 2.5 Even if a company is licensed under section 25 of the Companies Act there

is a need to get it registered as a charitable trust under section 12 A of the Income Tax Act. The issues raised in para (2.4) will come up, if the object to lend on interest is specifically highlighted either at the time of registration or is noted at the time of subsequent assessment proceedings. Licence under section 25 of the Companies Act does not automatically confer any right to obtain registration under section 12 A of the Income Tax Act.

### 3. Suggested Amendments

Insertion of the following explanation under section 2(15)

#### Explanation

- 3.1 *(a) Relief of the poor shall include 'microfinance activities'.*
- 3.2 *(b) 'Microfinance activity' means provision in account payee cheques or account payee bank drafts of thrift, credit and other financial services and products (including donations and grants) of very small amounts (whether interest bearing or otherwise) to the poor, either directly or to self help groups subject to the limits as may be prescribed and to other microfinance institutions, for enabling the poor to raise their income levels and improve living standards.*
- 3.3 *(c) 'Microfinance institution' means person carrying on microfinance activities and registered under section 12 A of the Income Tax Act.*
- 3.4 *(d) 'Self help group' means an economically homogenous group of the poor, with not more than twenty members, voluntarily coming together to meet the microfinance requirements of only its members, on principles of mutuality.*



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3.5 (e) *The revised section 2(15) with the proposed changes being highlighted, will read as below :*

Section 2(15)

*“charitable purpose” includes relief of the poor, education, medical relief and the advancement of any other object of general public utility.”*

**Explanation**

- (a) ***Relief of the poor shall include ‘microfinance activities’.***
- (b) ***‘Microfinance activity’ means provision in account payee cheques or account payee bank drafts of thrift, credit and other financial services and products (including donations and grants) of very small amounts (whether interest bearing or otherwise) to the poor, either directly or to self help groups subject to the limits as may be prescribed and to other microfinance institutions, for enabling the poor to raise their income levels and improve living standards.***
- (c) ***‘Microfinance institution’ means person carrying on microfinance activities and registered under section 12 A of the Income Tax Act.***
- (d) ***‘Self help group’ means an economically homogenous group of the poor, with not more than twenty members, voluntarily coming together to meet the microfinance requirements of only its members, on principles of mutuality.***

**4. Rationale**

4.1 The proposed amendment seeks to treat microfinance activity as a charitable purpose. Thus it cannot be considered as business activity and the question as to whether it is incidental to the main activity of the trust under

Section 11(4A) or not, cannot be raised by the income tax authorities during the assessment proceedings.

- 4.2 Further, registration under section 12 A will not be a problem for any microfinance institution which is a company, or a society or a trust as microfinance activity itself is treated as charitable.
- 4.3 Funds given to microfinance institutions who are registered under Section 12 A alone will qualify as application for charitable purposes in the hands of the donor - NGO. This is to ensure that the end use downstream is also for the benefit of the poor only. This also effectively prevents transfers to commercial entities working with profit motive from gaining tax exemption.
- 4.4 On prescription of monetary limits and mode of payment in the case of SHGs please refer para I (4.2) above. No monetary limits are prescribed in the case of transactions with other microfinance institutions as these are to be registered under section 12 A and thus can be monitored by the Income Tax department.
- 4.5 The benefits under section 10 on the lines of mutual funds (refer task force report) is not a good option. Mutual funds exempt under section 10 are not comparable as they are subject to SEBI controls among others. The income under section 10 is completely out of tax purview and thus persons who are in receipt of income under this category need not even file returns of income. The tax advantage will thus be open to abuse. The exemptions under section 11 as a charitable trust facilitates monitoring of the end use and thus is better from the angle of the microfinance institutions and the beneficiaries.

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### III COMPANIES ACT

#### 1. Existing Provisions

- 1.1 Section 153 of the Companies Act, 1956 reads as below :

*"No notice of any trust, express, implied or constructive, shall be entered on the register of members or of debenture holders."*

- 1.2 Section 41 of the Companies Act, 1956 reads as below :

"41.

(1) The subscribers of the memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as members in its register of members.

(2) Every other person who (agrees in writing) to become a member of a company and whose name is entered in its register of members, shall be a member of the company.

(3) Every person holding equity share capital of company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company."

- 1.3 Circular 4/72 dated 9 March 1972 of the Company Law Board has clarified the position on the legality of partnership firms being members of the companies as below :

*"A firm, not being a person, cannot be registered as a member of a company except where the company is licensed under section 25. Companies which have firms registered as shareholders should be advised to take steps to rectify the position within a specified time. In case the irregularity persists, despite a warning, necessary action can be taken under section 150 (2)."*

- 1.4 Licence under section 25 of the Companies Act, 1956 is subject to various conditions. One of the conditions (condition No.3) in the licence reads as below :

*"That no remuneration or other benefit in money or money's worth shall be given by the company to any of its members, whether officers or servants of the company or not, except payment of out of pocket expenses reasonable and proper interest on money lent, or reasonable and proper rent on premises let to the companies."*

- 1.5 The licence under section 25 of the Companies Act is issued by the various regional directors of the Company Law Board. The Reserve Bank of India has issued a circular exempting companies licensed under section 25 of the Companies Act and involved in micro credit from sections 45 IA, 45 IB and 45 IC of the Reserve Bank of India Act, provided the credit is extended to poor persons within certain limits and no deposits are accepted from the public.

- 1.6 A new amendment bill – Companies (Second Amendment) Bill, 2001 – proposes to introduce a new part IX A in the Companies Act, 1956 covering section 581 A to 581 ZR and introduces a new class of companies called 'Producer Companies'. The amendments are proposed to facilitate :

a) Incorporation of interstate cooperatives with objects not confined to one state as companies and conversion of existing cooperatives into companies.

b) Combination of the unique elements of cooperatives within a more liberal framework of the Companies Act.

Some advantages/features of a 'producer company' are:

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- 1.6.1 It will be a private limited company notwithstanding its membership. It cannot become or be deemed to be a public company under any circumstances. All the limitations, provisions and restrictions applicable to private limited companies apply to producer companies to the extent they are not contrary to the provisions of part IX A.
  - 1.6.2 There is no upper ceiling on the number of members.
  - 1.6.3 Institutions (incorporated or not) can be members.
  - 1.6.4 The voting rights are not based on equity shares held. One member is eligible for one vote only.
  - 1.6.5 The objects (section 581 B) are eleven in number and are primarily aimed at dealing with the products of and rendering services for the benefit of the members. Objects include extending of credit and rendering financial services for processing, procurement, marketing or other activities of the members.
  - 1.6.6 The producer company shall primarily deal with the produce of its active members only.
  - 1.6.7 The company can have only 'producers' meaning any person engaged in any activity connected with or relatable to 'primary produce' or any 'producer institution' (an incorporated or unincorporated institution having any of the objects listed under section 581 B) as its members.
  - 1.6.8 'Primary produce' is defined to mean farm produce, produce out of animal husbandry,

cottage industry, floriculture, forestry, handloom, handicrafts, byproducts out of these activities, etc. It includes any activities intended to make a qualitative and quantitative improvement of these items.

1.6.9 It will be a company limited by shares. Only equity shares can be issued.

1.6.10 It can pay dividends to members.

1.6.11 It will be a tax paying entity unless it avoids tax on grounds of mutuality.

## 2. Problems faced

Companies licensed under section 25 of the Companies Act are used for microfinance activities. The problems faced by them are listed in paras 2.1 to 2.4 below :

2.1 Companies licensed under section 25 of the Companies Act are incorporated under the Act either as a public limited company or as a private limited company. A company licensed under section 25 can be limited either by shares or by guarantee or a mix of both. A private limited company cannot accept deposits from the public and the number of members cannot exceed 50. Thus there is an inherent limitation in the capacity of a private limited company to raise capital.

2.2 If the company is incorporated as a public limited company and has a large body of shareholders, the voting rights will be based on the number of shares. In the case of a company limited by guarantee each member will be entitled to one vote while in the case of companies limited by shares the number of shares will determine the entitlement to votes. More the shares, more will be the votes commanded by a member. This could be a

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disadvantage as one or more groups of shareholders could control the company.

- 2.3 Some companies are toying with the idea of allotting shares to SHGs instead of individual members. This runs into a problem under the Companies Act due to sections 153 and 41.

The implication of section 153 is that a company recognises only the legal owner and the beneficial owner is not recognised. Under section 41 of the Companies Act only a natural person (individuals) or a legal person (companies, trade unions and societies) can be members. SHGs cannot be members. Even if the SHGs become members, the share certificate, membership and voting rights will be in the name of one individual only and the groups will have no legal right. The groups cannot enforce the right as beneficial interest is not recognised.

- 2.4 The regional directors of the Company Law Board are taking divergent views on whether a micro finance company can be licensed under section 25 at all. In the objects clause, in one case, lending on interest was permitted, while in another lending was permitted free of interest. In yet another case, the application for licence itself was rejected. There is a need for a harmonious interpretation of the Companies Act with the circular issued by the Reserve Bank of India.
- 2.5 In the case of producer companies, the proposed section 581 ZK prescribes a tenor of six months for credit facility in connection with business to members and in the case of secured loans the tenor extends from three months to seven years. The members of producer companies carrying on micro finance

activity would belong to the poorer sections of the society and thus will neither be able to offer security nor will they be able to avail of loans with short tenor.

### 3. Suggested Amendments

- 3.1 The circular of the Company Law Board No.4/72 dated 9 March 1972 (para 1.3) clarifies that partnership firms can be members of companies licensed under section 25. Company Law Board can be requested to issue a similar clarification that SHGs can be members of companies licensed under section 25 carrying on microfinance activities. This will be purely an administrative action and no amendments to the Act will be required.

- 3.2 Additional clause No.7 A as below is proposed in the licence issued under section 25 :

*7A That nothing in this licence shall prohibit a company, being a microfinance institution from supporting its members through microfinance activities.*

For the purposes of this clause :-

- a) the expressions 'microfinance activity' and 'self help groups' shall have the meanings respectively assigned to them in sections 581A(o) and 581A(q) of the Companies Act, 1956.
- b) the expression 'microfinance institution' means person carrying on microfinance activities and registered under section 12 A of the Income Tax Act.
- 3.3 Licence under section 25 should be issued in all cases where the micro finance companies undertake to carry on the business in accordance with the Reserve Bank of India circular. The Company Law Board should issue

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circular to all the regional directors/ registrar of companies to this effect.

3.4 In the proposed amendment on producer companies (para 1.6 above) the following clauses can be added to introduce even microfinance companies in part IX A enabling them to take advantage of the many positive aspects of the bill.

3.4.1 Insertion of sections 581 A(o) to 581 A(q)

*Section 581 A*

(o) 'Microfinance activity' means provision in account payee cheques or in account payee bank drafts of thrift, credit and other financial services and products (including donations and grants) of very small amounts (whether interest bearing or otherwise) to the poor, either directly or to self help groups subject to the limits as may be prescribed and to other microfinance institutions, for enabling the poor to raise their income levels and improve living standards.

(p) 'Microfinance institution' means person carrying on microfinance activities.

(q) 'Self help group' means an economically and socially homogenous group of the poor, with not more than twenty members, voluntarily coming together to meet the microfinance requirements of only its members, on principles of mutuality.

3.4.2 In section 581 A(j) defining 'primary produce' the following additional clause (vi) may be inserted.

(vi) *microfinance activities.*

3.4.3 In section 581 B listing the objects of producer companies the following additional clause (l) shall be added:

(l) microfinance activities

3.4.4 The following proviso shall be additionally added in section 581 ZK :

Provided that any loan, advance or credit facility to a member by a company carrying on micro finance activity can be unsecured and the period of the loan shall extend to seven years from the date of disbursement.

#### **4. Rationale**

4.1 The amendments facilitate SHG membership in companies licensed under section 25 and producer companies.

4.2 The proposed changes seek to remove the contradictions in the approach of the Company Law Board and the Reserve Bank of India with respect to companies licensed under section 25 of the Companies Act carrying on micro finance activities.

4.3 For microfinance institutions wanting to be dividend/tax paying entities without the threat of take over but with large beneficiary membership base (thus equity) and the privileges of a private limited company, the amendments in part IX A (para 3.4) will help.

4.4 The changes suggested in paras 3.4.2 and 3.4.3 bring microfinance within the ambit of the objects and activities of producer companies.

4.5 Para 3.4.4 seeks to liberalise the provisions regarding loans to its members extended by companies carrying on micro finance activities. Unsecured loans with longer tenor are provided for.

## **IV THE SOCIETIES REGISTRATION ACT, 1860 (SRA)**

### **1. Existing provisions**

This is a central act but states and union territories can have their own enactments applicable to their states. Thus there are about thirteen state level Acts.

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Under the circumstances, amendments have to be made in all the states and not in the central act only. Generally, any charitable activity is covered but the question is whether microfinance activities involving lending on interest will be considered as a charity especially at the level of the junior officials who are in charge of incorporation and administration.

The report of the task force contains a copy of the letter addressed by the Minister of Human Resource Development to all state governments, requesting the latter to issue suitable instructions to the officials in charge of registration to permit societies to make suitable amendments in their byelaws.

## 2. Amendment proposed

Certain standard clauses as below are to be inserted at the appropriate places in all the state level and central enactments.

It is hereby clarified that societies involved in microfinance activities shall be registered under this Act.

For the purposes of this section :

- (a) 'Microfinance activity' means provision of thrift, credit and other financial services and products (including donations and grants) of very small amounts (whether interest bearing or otherwise) to the poor, either directly or to self help groups subject to the limits as may be prescribed and to other microfinance institutions, for enabling the poor to raise their income levels and improve living standards.
- (b) 'Microfinance institution' means persons carrying on microfinance activities and registered under this Act or as public charitable trusts or licensed under section 25 of the Companies Act, 1956.
- (c) 'Self help group' means an economically homogenous group of the poor, with not more than twenty

members, voluntarily coming together to meet the microfinance requirements of only its members, on principles of mutuality.

## V INDIAN TRUSTS ACT

Indian Trusts Act applies only to private trusts and not to public charitable trusts. Trusts registered in states other than Maharashtra, Gujarat and northern Karnataka have no governing law. Thus these trusts have to adhere only to the Income Tax Act and Foreign Contribution (Regulation) Act.

One important issue is that the laws on societies and trusts are very old and have not kept pace with the development particularly in the voluntary sector. Differing state laws will be a problem for organizations.

## VI RESERVE BANK OF INDIA ACT

### 1. Existing provisions

- 1.1 A company involved in lending will be treated as a non-banking financial company under section 45-I(f) of the Reserve Bank of India Act and thus has to comply with the requirements/norms of capital adequacy, reserve fund and maintenance of liquid assets, etc. A microfinance company will fall under the category of a loan company under clause 2(1) (viii) of the non banking financial companies acceptance of public deposits (Reserve Bank) directions, 1998.
- 1.2 The Reserve Bank of India has issued a notification No.138/CGM(VSNM) – 2000 dated 13 January 2000 in exercise of its powers under section 45 NC of the Reserve Bank of India Act exempting companies licensed under section 25 of the Companies Act from these requirements subject to fulfillment of certain conditions.

By this notification, sections 45 IA, 45 IB and 45 IC of the Reserve Bank of India

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Act do not apply to any non-banking financial company licensed under section 25 of the Companies Act, 1965, if it fulfills the following three conditions :

- 1.2.1 Credit provided should not exceed Rs.50,000/- for a business enterprise and Rs.1,25,000/- for meeting the cost of a dwelling unit.
- 1.2.2 The credit is to be provided to any poor person for enabling him/her to raise his/her level of income and standard of living.
- 1.2.3 No deposits should be accepted from public.

## 2. Problems faced

- 2.1 The notification (para 1.2) in the present form has certain limitations :-
  - 2.1.1 It permits loans to individuals only and not to groups and federation of groups.
  - 2.1.2 It is restrictive and purpose specific. The credit can be provided only for business enterprises (Rs.50,000) and housing (Rs.1,25,000). Consumption loans and loans for purchase of lands, livestock, repayment of existing loans, etc., are not covered.
- 2.2 In the present dispensation any company entering micro finance sector will have to be a loan company, whose minimum capital requirement is Rs.2 crores and which is subject to stringent capital adequacy, provisioning and other norms. The norms are suitable for a company which has large scale operations, dealings with the public and accepts deposits from them. For a micro finance company which deals with the poor and exclusively with members, loan company is not a good option. Capital base has to be lower and the norms are to be broadly in line with those applicable to Nidhi companies.

## 3. Suggested Amendments

- 3.1 In the notification issued by the Reserve Bank of India (para 1.2 above) loans to self help groups (subject to limits as may be prescribed) and federations of self help groups and group members (without limits) should also be permitted subject to the condition that the ceiling laid down in the circular will be adhered to by the federations at their end when they lend to individual beneficiaries.
- 3.2 The purpose of the loan is not to be specified in the notification (para 1.2 above). Leaving the purpose to the discretion of the NGO/federation/group/beneficiary will increase the reach and offtake. Repayment of high interest bearing loans will contribute as much to the improvement of the standard of living and disposable income of a beneficiary as running a business enterprise.
- 3.3 A new category of non banking financial company called 'micro finance company' can be created with separate norms/rules independent of loan companies. In para 3.4 below some definitions to be included in the non banking financial companies directions are given. In para 3.5 a broad outline of the guidelines/norms to be made applicable to micro finance companies are listed.
- 3.4 Definitions to be included under para (2) of the non banking financial companies acceptance of public deposits (Reserve Bank) directions, 1998.
  - 3.4.1 '*Microfinance activity*' means provision in account payee cheques or in account payee bank drafts of thrift, credit and other financial services and products of very small amounts (whether interest bearing or otherwise)

to the poor, either directly or to self help groups subject to the limits as may be prescribed and to other microfinance institutions, for enabling the poor to raise their income levels and improve living standards.

3.4.2 'Microfinance company' means a company carrying on microfinance activities.

3.4.3 'Microfinance institution' means person carrying on microfinance activities.

3.4.4 'Self help group' means an economically homogenous group of the poor, with not more than twenty members, voluntarily coming together to meet the microfinance requirements of only its members, on principles of mutuality.

3.5 Broad outline of the guidelines/norms to be applicable to microfinance companies are listed below :

3.5.1	Capital requirement	Net owned funds (excluding preference capital) should be Rs.25 lakhs.									
3.5.2	Class of shares	Equity shares (face value – Rs.10). Preference shares can be issued but is not included in net owned funds.									
3.5.3	Regulatory authority	Reserve Bank of India									
3.5.4	Incorporation	Under the Companies Act and certificate of registration from Reserve Bank of India under section 45 IA of the Reserve Bank of India Act.									
3.5.5	Membership	Individuals being citizens of India.									
3.5.6	Minimum Membership	<table border="1"> <thead> <tr> <th></th> <th><u>Minimum</u></th> <th><u>Maximum</u></th> </tr> </thead> <tbody> <tr> <td>Public Company</td> <td>7</td> <td>No limit</td> </tr> <tr> <td>Private Company</td> <td>2</td> <td>50</td> </tr> </tbody> </table>		<u>Minimum</u>	<u>Maximum</u>	Public Company	7	No limit	Private Company	2	50
	<u>Minimum</u>	<u>Maximum</u>									
Public Company	7	No limit									
Private Company	2	50									
3.5.7	Nature of business	Limited to microfinance activity with members, self help groups of members and microfinance institutions of members. Prohibited from carrying on investment, insurance, hire purchase and leasing business.									
3.5.8	Investments	Investments should be in accordance with section 11(5) of the Income Tax Act.									
3.5.9	Deposits	No advertisement in any form and in any media or soliciting of deposits is permitted. No brokerage can be paid too. Private circulation of deposit schemes among members only is permissible. Deposits can be accepted only from members.									
3.5.10	Limit on deposits	10 times the net owned funds as per the latest audited balance sheet.									
3.5.11	Deposit Schemes – tenor, interest, etc.	Fixed deposits – 12 to 60 months									



		<p>Recurring deposits – 12 to 60 months Interest and premature closure norms for fixed/ recurring deposits will be determined by the regulatory authority.</p> <p>Savings accounts – No interest for deposit exceeding Rs.20000 and interest at 2% above the rate payable by nationalised banks.</p> <p>Current accounts are not permitted.</p>						
3.5.12	Definition of net owned funds	Paid up equity plus free reserves less accumulated losses and intangible assets.						
3.5.13	Norms for loans	<p>Secured and unsecured loans (to members, self help groups of members and microfinance institutions of members) are permitted provided it falls within the definition of microfinance activity for a period to be laid down by the company but not exceeding seven years.</p> <p>Interest      5% above the maximum rate payable on fixed deposits and shall be on reducing balancing method.</p>						
3.5.14	Ceiling on loans to individual members	To be prescribed and should be aligned to the limits prescribed in definition of microfinance activity in para 3.4.1 above.						
3.5.15	Management	Companies Act to apply.						
3.5.16	Dividend	Companies Act to apply.						
3.5.17	Liquid assets	10% of outstanding deposits as at the close of the last preceding month in unencumbered deposits with scheduled commercial bank not being a cooperative bank or an RRB.						
3.5.18	Provisioning/ Pru-dential Norms	<p>Income on NPA shall be recognised on receipt basis only. Accrued income recognised before asset turned NPA is to be reversed.</p> <p>Provision required</p> <table> <tr> <td>Substandard asset</td> <td>10% of outstanding</td> </tr> <tr> <td>Doubtful asset</td> <td>50% of outstanding</td> </tr> <tr> <td>Loss asset</td> <td>100% of outstanding</td> </tr> </table> <p>Value of collateral as on the date of sanction can be reduced from the outstanding if the court proceedings for the sale have been initiated within the previous two years of the income/instalment remaining unrealised.</p>	Substandard asset	10% of outstanding	Doubtful asset	50% of outstanding	Loss asset	100% of outstanding
Substandard asset	10% of outstanding							
Doubtful asset	50% of outstanding							
Loss asset	100% of outstanding							

3.5.19	Application of Reserve Bank of India directions	<p>NPA Interest/principal remain unrealised for 12 months.</p> <p>SSA NPA. Rephasement will not alter the character unless the performance is satisfactory in the last 12 months.</p> <p>Doubtful asset NPA for 1 – 2 years.</p> <p>Loss asset NPA for more than two years or documents are invalid.</p> <p>The non banking financial companies' acceptance of public deposits (Reserve Bank) Directions, 1998 and non banking financial companies prudential norms (Reserve Bank) Directions, 1998 shall apply to the extent it applies to Nidhi Companies.</p>
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#### 4. Rationale

- 1.1 The amendments (paras 3.1 and 3.2) to the circular of the Reserve Bank of India are to increase the scope and lend clarity.
- 1.2 The amendments in paras 3.3 to 3.5 are to carve out a new category of company – micro finance company. These companies will be bound by norms similar to Nidhi companies but are simple to incorporate. Nidhi companies can give only secured loans whereas the poor, who will be the clients of a microfinance company, cannot normally provide any security. In addition to this certain other modifications are made. The regulatory authority for microfinance companies will be the Reserve Bank of India unlike Nidhi companies which are

subject to the regulation of the Department of Company Affairs also in a large way, possibly due to their being notified under section 620 A of the Companies Act.

The prudential norms do not apply to Nidhi companies at all – refer para 1(3)(a) of the directions. The core provisions of the public deposits directions which apply to Nidhi companies are ceiling on interest rates, furnishing receipts to depositors and form/contents of register of deposits and returns to Reserve Bank of India – refer paragraph 3(2) of the directions. Thus the two directions are made applicable to microfinance companies to the extent they apply to Nidhi companies.

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# Micro Credit Culture in PERU - Building Confidence:

*SUSANA PINILLA CISNEROS – EDPYMES – PERU*

In Peru the small and micro-company has had, in general, limited access to formal financial services. It is estimated that as of now, we have around 3.1 million small and micro companies (PYMES) that offer jobs to 74% of the economically active population and contribute with 43% of Peruvian GDP (Gross Domestic Product); these numbers are sufficient to establish that the Microenterprise sector constitutes in our country not only an activity of the sector of smaller resources but also is an alternative way of development. The PYMES therefore need a policy and strategies adequate to their own characteristics that the Banking System does not offer.

In December of 1996, Decree Law created the ORGANIZATIONS OF DEVELOPMENT OF SMALL AND MICROCOMPANIES, called EDPYMES; companies specialized in offering financial services to the sector of small and microcompany. The EDPYMES form part of the national financial system, supervised and regulated by the Supervision of Bank and Insurances of Peru (SBS).

In the new concept of the Intermediary Bank for small and

micro companies (PYMES) there are requirements that are not fixed by the financial intermediaries, but by the operational dynamics of the sector. In these circumstance the microfinance industry in the country has been having a positive impact on the improvement of service quality in the progressive reduction of interest rates and in the growth of the micro-financial portfolio.

## **MICROFINANCES IN THE RURAL AREAS**

For most regulated financial institutions, the rural areas of the country are not a priority, due to the characteristics of risk of the farming activities and the greater costs of financial transaction. Nevertheless, the rural areas are those that concentrate an important contingent of micro and small rural producers that provide foods and other basic products for the urban areas. The district of Junin, the Valley of the Mantaro and the city of Huancayo constitute a dynamic center of productive and commercial development that articulates with the main market of Lima. EDPYME CONFIANZA has developed a trustworthy technology of credit for rural areas, especially through the attention of the Pampas agency.

## **PERMANENCE AND DESERTION OF CLIENTS**

In the new context of the micro-finance, clients have developed new personal competence and are better informed about the existing credit supplies in the market, therefor a greater rotation takes place between the Organisations of Micro-finance that compete in the Zone. In this framework the fidelity of clients towards the Organisation is very important. Nevertheless desertions take place that it is necessary to control and to manage suitably. EDPYME CONFIANZA has developed a client control model that allows us to know the clients who do not take loans during the month and have cancelled the totality of the quotas of the previous month. Knowing this information allows us to execute actions to investigate the reasons behind their behavior in order to reincorporate them into the organisation if this is the case.

## **CULTURE OF CREDIT OF EDPYME CONFIANZA**

EDPYME CONFIANZA wants to forge a culture of confidence in its clients, sustained by the mutual and responsible commitment and by the enterprise capacities of

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innovation and creativity, promoting and fortifying the relation of the Organisation/ Client. The underlying value in the success of this process relates to the fact that the clients of the Organisation understand that the fulfillment of its credit obligations is part of a behavior that benefits their own enterprise activities and maintains a correct relationship with the Microfinance Organisation, guaranteeing a sustainable continuity.

From June of 1999, the Client of Confidence prize has been created as recognition of the successes of the farming producers, who through the support of EDPYME CONFIANZA have reached greater development and competitiveness in the market, fulfilling its commitments with responsibility, enterprise initiative and confidence in the Organisation.

In more than three years of the credit services of EDPYMES CONFIANZA to the small and rural and urban micro industrialists of the Central Mountain range of Peru, it was possible to affirm the greatly enterprising, creative capacity and the high responsibility of our clients. Besides fulfilling their credit commitments, they let their businesses grow and improved their economy and their conditions of family life. For them CONFIANZA implemented a Credit Product of preferential conditions in interest rates, additional

amounts of credits, terms and additional benefits.

### **Objective of the Program CONFIDENCE CLIENT**

Fortification of a credit culture of Confidence extends the possibilities of access to credit and growth of microindustrialists and producers of the region, as well as to the efficient and competitive management of CONFIANZA. Among other more specific objectives it has:

1. To improve the system of recognition and attention to the clients of the Organisation, especially to the Client of Confidence.
2. To maintain a system of control of desertion and the opportunity of recovery of clients in the immediate period.
3. To obtain a high client loyalty based on the improvement of our services and adjustment to their necessities.

### **Operation of the Program CONFIDENCE CLIENT**

**System of Recognition and attention to Client Confidence** - It will take care of the valuation and constant diffusion of the initiatives and successful enterprise practices, the efficient management of the credit and the responsibility verified by the microindustrialist in his financial and credits commitment, looking for the greater fidelity of clients with

excellent records and the clients with payments up to eight days, whenever the reasons for delays are sustained.

**Enterprise days of Confidence** - Clients of Confidence in-groups of 20 to 25 will participate in the biweekly days. These enterprise days are spaces of interchange, discussion and qualification of the Clients. The recurrent subjects of program 2002 - 2003 will be centered in: Identification of dynamic sectors of the regional economy, credit culture of Confidence, cleaning of properties and guarantees, systems of agrarian Insurances, analysis of enterprise risk, among others.

**Systematization and Diffusion of Experiences** - In the month of June of every year Confidence organises the systematization of successful experiences of its Clients, chosen by urban and rural zones and also by economic activity. The aspects of the approach will be those of Microenterprise management, family life, the contribution of credit and gender relations.

**Attention to the Client of Confidence** - Improvement of the service to the client will be constant through consultations, suggestions and complaints sent to the mailboxes installed in the offices as well as through the customized attention of specific personnel of the Organisation, who periodically will report the statistics of this service.

**Certification of the Client of Confidence** – The certification of a borrower as Client of Confidence gives him the right to accede to preferential interest rates, the same ones that are specified in the Regulation of the Client of Confidence, application in course and constant modification according to the rates of the competitive market of the region.

**System of Control of the Desertion and Recovery of the Client** – This line of action includes the study of the desertion and increase of clients, considering for the first

case that the client has abandoned the services of the Organisation in a following period, in as much is considered as increase of clients to the increase of such in a certain period.

The Rate of Desertion of Clients is composed of the relation between the clients who did not return to ask for a credit in the period in observation and the clients who cancelled their credits in previous the immediate period (a month before).

Having to distinguish the **total desertion**, as the total of clients

with zero debt, of 1 to 8 days, greater to 9 days and greater than 30 days; of the **net desertion**, seizure from the total of the gross desertion, that is the clients who deserted and had of 0 to 8 days of the period to pay their debt. Previously information is taken from database of the Organisation, purified from clients who cancelled in every period by sector, identification of cancelled credits, elaboration of the general register of desertion for calculation of gross desertion, revision of the credit file, elaboration of general register of net desertion.

## INAFI CREDO

### Micro Finance

promotes banking with poor

builds people's institutions

nurtures local leadership

builds bridges with the mainstream

revitalizes local economy

provides social security cover



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## Evolving Self-regulation in INAFI – INDIA Network



INAFI – INDIA has chosen the self-regulation as a method to guide to the growth of micro finance intervention. The member organisation of INAFI – INDIA who are largely part of enabling stream (promoting institutions) has recognised this potential to direct the growth and development of the people institutions. In a development sense, it ensures the focus on increasing the outreach and depth of micro finance towards achieving the larger goal of poverty reduction.

INAFI-INDIA seeks to achieve the following through self-regulation

1. to ensure target group focus-poor and gender focus on women
2. to ensure the growth and development sector with order and quality
3. to set performance standards with primacy on development and social indicators
4. to minimise the cost of oversight / supervision

Thus, self-regulation is not just supervision but an enabling and guiding tool for the micro finance sector. It goes beyond rating or assessment and appraisal.

The INAFI – INDIA Network took the first step in the self-regulatory journey at New Delhi in the year 2002. The forum was an Asia International workshop on self-regulation for micro finance sector on August 29-30, 2001 at New Delhi where INAFI network members from India, Bangladesh, Sri Lanka, Nepal, Philippines have decided to adopt this as INAFI method. The workshop has enabled the members of the INAFI – INDIA networks to have better conceptual understanding clarity and also helped draw an operational road map for practice. The important part of the action plan chalked out in the workshop was identification of processes and steps for enabling the people institutions promoted by the members for practicing self-regulation.

The member organisations pledged that as promotional stream of micro finance sector, they would enable the people organisations such as SHGs, federations, etc. to evolve a self-regulation framework for them and enable them to practice.

The workshop set the tone and step by step process as under :

- ☒ Awareness / Appreciation – Sensitising the member organisations involving the stakeholders in developing standards
- ☒ Practicing of standards
- ☒ Counseling and review
- ☒ Sharing the experiences and learning, documentation of the code of conduct / standards framework for wider practice in the sector

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Indicative standards framework with broad parameters for the three major indicators of performance namely, development, institutional, financial have been developed in the workshop.

Sequel to the New Delhi workshop the members of the INAFI – INDIA network organised inception workshops during 2001 and early part of 2002 to sensitise the professional / operational staff of its member organisations and also leaders of people’s institutions for greater appreciation of the concept and to identify development / institutional parameters for benchmarking besides the financial standards.

The self-regulation now moves to the next phase wherein the member organisations will sensitise the people’s organisations such as SHGs and its federations, etc., on this concept so as to enable them to practice. Besides, inception workshops the member organisations have also organised follow-up workshops with support of INAFI – INDIA and involved leaders of people’s institutions to build their capacities so that they will advance self-regulation practices.

The self-regulation method for the people’s institutions would undergo the following four phases

1. Awareness / Sensitising
2. Evolving
3. Practicing
4. Advancing

The network members and the leaders of people’s institutions have undergone the first phase of awareness and sensitisation. The next process is to help build the capacity of the people’s institutions to evolve context specific standards framework for practicing self-regulation. And the role of member organisations in enabling people institutions to evolve the standards framework is crucial.

### **Way forward; Setting standards:**

With this backdrop of awareness and appreciation about the self-regulatory exercise, a network level workshop for self-regulation was organised by INAFI – INDIA at Lucknow on 26-27, September 2002 to achieve the following objectives.

- a. Sharing the experience of member organisations ‘since the New Delhi workshop in understanding and internalising the concept within the organisations and also the process of initiation in the people institutions.
- b. Sharing of member’s context of work, the people institutions’ model its structure, etc.
- c. Evolving a shared understanding of the parameters of the three performance indicators namely, development, institutional, financial and framework of indicative standards for the people’s institutions to practice self-regulation
- d. Developing a framework for Self-Regulatory Organisation (SRO) for the people’s institutions to direct and monitor the self-regulation practices.

The workshop has evolved the following guiding principles for the member organisations, which would serve as a basis for to define / redefine the standard framework.

1. Outreach of poor
2. Micro finance as a means to poverty alleviation rather than end by itself
3. Building community Institutions through enabling process
4. Developing objectives / outcome to guide financial services
5. Monitoring development impact of financial services
6. Practice of transparent and high quality financial services
7. Common methodologies and indicators for financial services

The workshop also analysed the need for identifying standards for processes and its parameters besides the standard for end product. Guidelines for institutional development and financial standards were also formulated.

## Events and Activities

Events	When and Where	Remarks
Interaction with the team of professionals from BAIF	August 28, 2002, Madurai	The Mission of INAFI – INDIA, the core programmes of the network and activities undertake for these programmes have been shared with the participants. Self-regulation as INAFI method to manage the growth of people’s institutions was also informed to the participants
Interaction with NGOs from Sri Lanka involved in microfinance programmes	September 21, 2002	Briefing the participants about the INAFI network, programmes and activities
INAFI – INDIA workshop of self-regulation for setting standards	September 26-27, 2002, Lucknow	Standards framework for people’s institutions promoted by the member organisations of the network have been evolved and it has been decided to build the capacity of the leaders of the people’s organisations and its members for practicing self-regulation by adopting the standards. For this purpose, series of workshops in the people organisations would be organised during 2003-2004

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### INAFI India Info Newsletter

59/28, Ponmeni Narayanan Street  
S.S.Colony, Madurai - 625 010  
Tamil Nadu, India  
Ph: 91-452-2302056  
Fax: 91-452-2602247  
Email: [indiainafi@eth.net](mailto:indiainafi@eth.net)

To

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