



A Study on the Aspects of Consumer Protection in Microfinance

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Abstract: Microfinance is aimed at improving the lives of the poor populations by making financial products and services available to them. In that sense, microfinance has been welcomed as the 'silver bullet' solution to alleviate poverty. In recent years, however, several crises have drawn attention to the negative impact it can have when not done right. In reaction to this scenario, attention for client protection aspects has increased. Customer is the main asset or backbone of any business and it's the responsibility of the institution to safeguard the interests of the customers. Individuals who are functionally illiterate, first-time consumers, or different in language or ethnicity from the staff of financial institutions are particularly vulnerable. Even middle-income, relatively educated borrowers may be insufficiently informed about their rights and can be pressured into making poor borrowing decisions. Some of the important aspects of consumer protection are disclosure, transparency, product choice, fair treatment, complaints handling and recourse. The policies of the government and regulatory bodies are also important to ensure consumer protection particularly in the area of microfinance. The present paper aims at reviewing the present state of consumer protection in Indian Microfinance Industry which is very vital for protecting consumers from unfair financial arrangements and preventing unethical competition among the institutions.

Key words: transparency, product choice, fair treatment,

Introduction: Microfinance is generally called as "Banking to the unbankable". It means providing banking services to unemployed or low-income individuals, or groups who otherwise have no other access to financial services. Through microfinance services millions of people could be reached who are too poor to be served by regular banks because they are unable to offer sufficient collateral. So, microfinance is considered as a silver bullet to alleviate poverty. But, due to no proper regulation of MFI's "they used to follow unscrupulous practices of charging high interest rates and excessive lending,

leading to increased indebtedness among poor borrowers and there by MFI's using inappropriate ways to recover the loans" (Shailesh Menon, 2016), which lead to the suicide of many microfinance borrowers popularly referred as "AP crisis 2010". So it is quite evident that consumer protection is essential, especially in the case of microfinance clients they are very poor and can't recoup back to their original lifestyle quickly. Unlike other consumer protection Acts, a bit different rules and regulations for microfinance consumer protection should be there keeping in



mind the socio-economic condition of the consumers. The main objective of this paper is to review the consumer protection issues in the microfinance industry and to suggest a four pillar approach to ensure consumer protection in microfinance. This paper is based on the secondary information collected from journals, magazines, newspapers, internet etc. The paper is presented in three sections. Section I deals with importance and issues related to consumer protection, Section II deals with four pillars model for consumer protection and the last Section deals with suggestions and conclusion related to consumer protection.

Section 1: Importance and Issues Related to Consumer Protection

Importance of consumer protection in microfinance:

MFI's and Clients are very important stake holders of the microfinance business. Customer is the main asset or backbone of any business and it's the responsibility of the institution to safeguard the interests of the customers. So, there is need for consumer protection. For successful consumer protection, efforts from MFI's and consumers are needed.

"Although the principles of consumer protection are intended to benefit both financial service providers and their clients, the gap between what microfinance institutions (MFIs) means to say and what clients had understand has the potential to undermine the efforts of consumer protection" (Candace Nelson, 2009). This gap when addressed can help in protecting the consumer. "Like any other business Microfinance thrives on trust. The microfinance industry's reputation and financial

health depend on a positive corporate image; when unethical practices surface, both can suffer. Similarly, clients are the other half of the consumer protection equation and in the process of conducting business with a financial institution, and they want to borrow without fear or humiliation and want to preserve their dignity" (Candace Nelson, 2009).

Some of the drawbacks of the both stake holders which hamper consumer protection are mentioned here. Drawbacks from MFI's side could be grouped as

Before the loan process which includes giving high or false expectations on interest on loans & deposits & benefits from insurance; Inadequate orientation seminars or consultations; and Unclear policies & lack of written or oral information on the true costs & benefits of the products/services being offered.

During the loan process which includes withholding of funds or imposition of penalties on cancelled loans, deposits or insurance plans within a few days of transaction without proper disclosure to the client; products cost higher than disclosed because of hidden charges; and clients are not given copies of contracts, records or other documents on their transactions.

After the loan process which includes illegal and abusive behaviour in the conduct of transactions such as harassment to force clients to pay; imposition of unnecessary fees or surcharges & consolidation of debts at a higher rate; Inaccurate recording of client's transaction; and misuse or diversion of funds by service providers" (Microfinance Consumer Protection guide book, 2007)



Similarly, drawbacks from clients side includes most of the clients are uneducated because of which there a gap between what MFI's said and what clients understood; Most of the clients are unaware of the complete details regarding their products; because of miscommunication and unawareness there arises a conflict with MFI's; and no proper disclosure about the previous loans taken from other MFI's leading to over indebtedness.

Issues related to consumer protection:

In order to attain consumer protection both MFI's and clients should concentrate on some important parameters like Avoidance of over-indebtedness, Transparent pricing, Ethical staff behaviour, Complaints handling and recourse, Disclosure, Fair treatment and Appropriate collections practices.

"Avoidance of over-indebtedness:

Providers should take reasonable steps to ensure that credit will be extended only if borrowers have demonstrated an adequate ability to repay and loans will not put borrowers at significant risk of over-indebtedness.

Transparent pricing:

The pricing, terms, and conditions of financial products (including interest charges, insurance premiums, all fees, etc.) should be transparent and should be adequately disclosed in an understandable form to the clients.

Ethical staff behaviour:

Staff of financial service providers will comply with high ethical standards in their interaction with microfinance clients and such providers will ensure that adequate safeguards are in place to

detect and correct corruption or mistreatment of clients.

Complaints handling and recourse:

Providers will have in place timely and responsive mechanisms for complaints and problem resolution for their clients." (CGAP). Donors and investors also play an important role in ensuring the success of this initiative. By endorsing the principles, investors and donors commit to work to support providers that adequately protect their low-income clients.

Disclosure: Institutions and individuals that endorse the Client Protection Principles are committing to be a part of an industry wide process to translate the Principles into standards, policies, and practices appropriate for different types of microfinance clients, products, providers, and country contexts. By endorsing these Principles, providers of financial services, networks, and individuals working in microfinance are committing to a process of implementation of the principles into their own organization's operations and institutional culture.

Fair Treatment and Appropriate collections practices:

All consumers should be treated fairly and equally and debt collection practices of providers should not be abusive or coercive.

Section II: Four Pillar Model for Consumer Protection

In order to ensure consumer protection including all the above parameters we have formulated a four pillar model in which the four pillars are Transparency, Product choice and Over



indebtedness, Complaints handling and Regulatory environment.

Transparency:

Transparency is a basic element of consumer protection. It is so important because disclosure of sufficient information regarding pricing and other terms is necessary to enable consumers to assess a product's affordability and risks and to make informed choices regarding which product suits their needs. "Microfinance is originally a donor-funded innovation of the non-profit world, and now it is being popular for its movement towards commercialization"(Chuck Waterfied) because of high repayment rate and there by resulting in unfair competition and non-transparency.

When MFIs are operating in a very opaque pricing environment – where nobody knows how the price of one product compares to the price of another product – there exists the opportunity for MFIs to charge a price that results in very high profit levels. High profits generated off of the poor by charging non-transparent prices can create a bad public image for the microfinance industry and result in a strong backlash" (Chuck Waterfied).

All the MFI's should collectively work for the transparency and should create a single platform in which all the MFI's should disclose all the details regarding the products and services offered, their prices, methods of price calculation and interest rates etc; from time to time either quarterly, monthly or annually. So, by doing this all the MFI's can have access to each other's product details and strategies which helps in preventing unhealthy competition, and they can do

comparative analysis. And for consumers who are aware of their products they can check up on the prices and can compare that with similar product of other company this way ensuring consumer protection.

An industry-wide effort towards transparent pricing is essential to the long-term survival of the microfinance industry. It is known that interest rates are typically charged in microfinance, but there is little explanation or understanding of why microfinance interest rates are higher than previously believed, nor why there is significant variation in interest rates among different institutions. By practicing pricing transparency, a healthy and vibrant market for microcredit products can be built, providing a valuable component necessary in free markets and currently absent in microfinance ensuring consumer protection.

Product Choice: Product choice is the other important part of consumer protection in microfinance because most of the clients in microfinance are unable to repay because of over indebtedness and so to avoid this proper selection of product has got much importance. For choosing a product client should be aware of different kinds of products offered by MFI's but all most all the clients of MFI's are poor people with little or no education. For doing business with MFI clients it is the responsibility of the MFI's to educate them and client's responsibility is to know completely about the product. By choosing a wrong product not only consumer is at stake but also MFI's face problem of bad debts. So in order to tap the advantage by choosing right product it is the responsibility of both the parties to sit,



discuss and conclude on the right product.

In selecting the right product the role of MFI is to go to the client, know about the details of his earnings, family size, number of earners in the family, any collateral, the kind of business client is interested to do, credit worthiness of the client. After that MFI can decide on which product to offer and what could be the value added service they can offer jointly. MFI's can also offer value added services to the clients along with the product for social benefit and protection of consumers (Example: If there were any uneducated or unemployed youth MFI can motivate them by offering skill development program and there ensuring the productivity and protection of consumer). The role of client in the product choice is he should know his abilities and should disclose the complete facts asked by the MFI.

"Selection mechanisms of borrowers that reduced the risk of adverse selection, for example, peer selection and close relationships between borrowers and loan officers. Incentive mechanisms to prevent moral hazard, for example, group liability or guarantors, increasing loan sizes over cycles, collateral based on the subjective value of assets to borrowers rather than on market value, and small frequent instalments combined with a zero-tolerance policy by which consumer protection is ensured through product choice and over indebtedness" (Jessica Schicks, 2012).

The consumer who is in need of money will definitely not reveal or reveal only some information about the previous debt and by hiding this information both parties will be in trouble. So, in order to avoid such situation MFI's should take

certain initiatives looking at other financial institutions.

Complaints Handling: The third important part of consumer protection is the procedure followed for handling complaints. This kind of complaints situation arises mostly due to miscommunication. Most of the clients are uneducated and so there is a gap between what MFI's delivered and what consumer understood. "Handling complaints consists of sub parts like where and how to file a complaint, recording the complaint, investigating the complaint, complaint closure and feedback on the complaint", (Fusion Microfinance) and finally self-assessment of complaints. By this whole process we will be having ample of data on complaints handling which can be leveraged in the later stages by analysing it. So, for this whole procedure to be successful both the stake holders MFI's and consumers should know and act on their responsibilities.

Filing a Complaint: For filing a complaint as it arises from consumer's end consumer should know on which kind of issue he can give a complaint and it is the responsibility of consumer to know each and every small detail of his loan particulars and the responsibility of MFI is that they follow a clear procedure on how to receive a complaint like through toll free number, written complaint, oral complaint etc; and it's their responsibility to educate clients on how to file a complaint.

Recording a Complaint: After filing a complaint it should be recorded in the books of MFI's and the status of the complaint should be continuously updated from open till closed. By doing this we will have a record of the complaint with details like name,



address, contact, service provider details, photocopies supporting the complaint and summary of the complaint where all these makes it easy to track a complaint and if complaints and when the issue is solved the procedure followed and solution obtained is updated against the complaint. The complaints when categorized according to the complexity and type of issue then the solution of this complaint can be easily applicable to other issue of similar type.

Investigating the Complaint: After recording the complaint it should be analyzed first and then assigned to the service provider of that particular client and after they should try to solve it at the as lowest level as possible if not the issue should be taken up to next level and if necessary to Head Office level till the issue is solved.

Complaint Closure and Feedback:

After the issue getting resolved then the status of the complaint should be recorded as closed only with the consent from the consumer and also MFI's should get a feedback from the consumer on how satisfied he was during the entire process of complaint handling. Getting feedback is very important as it helps to improve the performance of the institution.

Regulatory Environment:

Very important 4th pillar for consumer protection is effective and efficient regulatory environment under which the MFIs are functioning. Microfinance institution acquires permission to function through registration. Each legal structure has different formation requirements and privileges. "Microfinance sector in India has gone through 3 broad risk phases in the past – high growth (till 2010), high volatility

(2010 – 11), consolidation (2011 – 13) and is now entering a IV phase of relative stability" (Care ratings, 2014).

Past Scenario: The phase I (till 2010), of microfinance is characterised by high growth where majority of MFIs registered under various state society Acts—called non-governmental organization (NGO)-MFIs—are under no regulatory supervision" and MFIs which have registered themselves as companies are under Reserve Bank of India regulation(Care ratings, 2014).Last of uniform regulatory processes MFI's used to follow unscrupulous practices of charging high interest rates and excessive lending, leading to increased indebtedness among poor borrowers and there by MFI's using inappropriate ways to recover the loans, which lead to the suicide of many microfinance borrowers and this in return triggered for the crisis of microfinance called "AP crisis 2010". Due to this social unrest government of AP had issued an ordinance to stop all the activities of MFI's.

The Phase II (from 2010 – 11) there is a high volatility in the microfinance sector.The political intervention by the Andhra Pradesh government through ordinance created turbulence in the sector. Due to geographic concentration and funding constraints for the overall sector, led to bankruptcy of major AP based MFIs " (Care ratings, 2014).

The Phase III (from 2011 – 13) the sector experienced consolidation. The concept of a unified regulator for MFIs took root after a parliamentary standing committee of finance proposed the idea while discussing the Microfinance Institutions (Development and Regulation) Bill, 2012 (Care ratings, 2014). RBI had expressed its inability to



regulate the entire sector and was of the view that NGO-MFIs be left in the purview of individual state governments. Present Scenario:

The Phase IV of relative stability: "The Ministry of Finance has proposed that the regulation of MFI's is taken up by RBI till Micro Units Development and Refinance Agency (MUDRA) Bank comes into operation. The regulation and refinance of MFI's will be done by MUDRA bank. MFIs are very happy to welcome Mudra Bank (as far as) refinance is concerned. MFIs are worried that having MUDRA bank as a regulator and re financier could lead to a potential conflict of interest" (Sangita mehta,2015). "Recently clarifying its stand on regulation of microfinance companies, the government has said that the Reserve Bank of India would continue to regulate MFIs registered as non-banking finance companies (NBFCs) with the central bank. MFIs will not be regulated by the Micro Units Development and Refinance Agency (MUDRA) Bank, as proposed by the finance ministry earlier" (Sunny Verma, 2016).

This phase is expected to be characterized by a more stable regulatory environment, steady availability of funds, improving profitability with comfortable asset quality & capital adequacy and relatively lesser impact of concentration risk. "The Reserve Bank of India's decision to create small finance banks could be a game-changer for microfinance institutions (MFIs) in the country. Among the 72 applicants vying for small finance bank licence, 17 are MFIs, going by the list released by the RBI. This could be evidence for MFI's changing their form according to the new

business environment" (G Naga Sridhar, 2015).

SECTION III: Suggestions and Conclusions

To have proper consumer protection in microfinance sector the above said four dimensions need to be strengthened.

MFI's should address pricing transparency. "It should collect product prices on all micro-loan products around the world and report those prices by a common, objective measurement system and should undertake the equally important role of developing and disseminating straightforward educational material to enable microfinance stakeholders to better understand the concept and function of interest rates and product pricing" (Microcredit Summit Campaign, 2015). The best way to provide transparency for clients is when a client is availing for a product a declaration form is to be submitted to him in which all the details regarding the product like price, interest, repayment time, interest rate etc; which helps in promoting the consumer protection. By this consumer protection can be ensured through transparency.

The MFI's can come together to create a single platform to check not only the credit worthiness of the consumer in order to avoid over indebtedness but also to know the socio-economic status of the customer and his household which in turn reflects in protecting consumer. The use of technology and AADHAAR number being unique could be used to access, maintain details of the customers at a centralised work station. MFI's can offer risk mitigating methods in order to



protect the customers like offering insurance along with other products as a bundle and also designing value added products.

While dealing with complaints handling first the methods for registering a complaint should be clear from the MFI side and after consumer filing a complaint it should be proper recorder, categorized, investigated and finally close with the consent of the consumer. This way of effective handling of complaints ensures consumer protection. Self-assessment on the way how the complaints have been handled from time to time and assessment by external experts helps in ensuring the consumer protection.

Consumer protection can be ensured only by strong regulatory policy. MFI's should take steps to educate the clients whereas clients should participate in the capacity building and consumer education programs. By participating and knowing about the Consumer Protection Act help clients to obtain and demand better protection measure. For microfinance institutions the future regulations should be designed with a special care keeping in mind the financial status of clients, because the clients of microfinance are poor and below poverty line people. For more effective consumer protection the present Consumer Protection Act can be amended according to the MFI's clients or separate Act can be made especially for MFI's regulation and it should be implemented by a special regulatory body which works only for MFI's to ensure consumer protection. References:

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