Chapter 15

An Introspective Study on the Governance Practices of Major Microfinance Institutions (MFIs) in India

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ABSTRACT

In microfinance literature, the term governance first appeared in 1997 with respect to the relationship between the board of directors and the management of an MFI. A few studies have been made regarding the issues concerning governance and leadership of the MFIs operating in India. The objective of the chapter is to study the governance practices of the major MFIs in India. The study is based on top 50 MFIs as rated by CRISIL. For analyzing governance practices of these selected MFIs, the recommendations of nationally and internationally acclaimed codes/guidelines for good governance have been considered. The study reveals that overall governance practices of MFIs operating in India are not quite satisfactory. Although a few MFIs have appointed a few independent directors in their board, yet the majority of the boards of these MFIs are dominated by the promoter groups. Regarding formation of board committees a few MFIs had shown a commendable performance where the majority have been lagging behind.

INTRODUCTION

The word (good) governance is a current buzzword not only in management literature but also in every walk of public administration and public life. Every stakeholder in all kinds of enterprise expects good governance prevailing in the concern. It conveys about how a corporation is directed and controlled under a set of mission, values, and philosophy (Cadbury, 1992). It is a phrase implying greater transparency...
of management system in corporate entities. In common parlance, it is a relationship among various participants in determining the direction and performance of a corporation (OECD, 1999). But, unfortunately over the time, the common investors all over the globe had suffered a lot in the hands of the greedy managers and the scams like Enron, Adelphia, Tyco, WorldCom, Xerox, Paramalt, and Satyam had shattered the trust of the common investors in the very mechanism of corporate management and governance. During the last decade, much has been written on microfinance (Hermes & Lensink, 2007, 2011; Armendariz & Morduch, 2010). Microfinance is high on the public agenda after the declaration of UN Year of Microcredit in 2005 and the awarding of the Nobel Peace Prize to Mohammad Yunus and the Grameen Bank in 2006. Nevertheless, microfinance still reaches only a fraction of the world’s poor (Robinson, 2001; Christen et al., 2004). Helms (2006) and the Consultative Group to Assist the Poor (CGAP, 2004, 2006) consider the lack of strong MFIs to be a major constraint on the further development of the microfinance industry, and CSFI (2008) identifies governance as a major obstacle to MFI growth (Mersland & Strøm, 2009). Yet, comparatively little has been written on the corporate governance of microfinance institutions (MFIs); most of the existing studies on MFI governance consist of consultancy reports that assume that MFIs are comparable to regular commercial firms (Labie & Mersland, 2011 & Galema, Lensink & Mersland, 2012). In microfinance literature, the term governance first appears in 1997 Consultative Group to Assist the Poor (CGAP) and usually refers to the relationships between the board of directors and the management of an MFI. Subsequently, a formal guideline for the governance of MFIs named as “Principles and Practices of Microfinance Governance” had been published by Rock, Otero and Saltzman (1998) of ACCION International under the patronage of U.S. Agency for International Development, Global Bureau, Economic Growth Section, Microenterprise Development Office, through funding to the Microenterprise Best Practices (MBP) Project. In this particular guideline a lot of emphasis had been laid on the responsible board structure; skills and characteristics of microfinance board members; directors’ commitment to the dual mission of microfinance i.e. balancing social impact with financial objectives; directors’ ability and willingness to fulfill the duties of care, loyalty, and obedience; the board’s commitment to develop the knowledge and skills of new and existing members; the size of the board; the separation of the role of the board chair and that of the managing director or chief executive officer (CEO); effective board committees; proper documentation of governance performances etc. According to a more broad definition of governance, microfinance governance is the determination of how an MFI uses its resources and resolves conflicts of interest of the organization’s myriad participants (Daily & Cannella, 2003). As per the agency theory, microfinance governance should deal with ways in which suppliers of finance—donors and investors—ensure that they get a return on investment and the MFI reaches its social mission. In many organizations, which include most MFIs, there is a separation of ownership and control. Because managers and suppliers of funds have different interests and there is information asymmetry, there are agency problems and thus a need to control managers. The main function of governance is to control self-interested managers to solve agency problems. When sufficient oversight is lacking, managers are likely to enrich themselves or pursue other self-interest at the MFI’s expense (Galema, Lensink & Mersland, 2012). Therefore, in the proper governance of MFIs, effective, functioning and vigilant oversight by board of MFIs is a sine qua non. However, the “good functioning” of the board of directors is not enough to guarantee the mission and assets of an MFI. When discussing governance, it is necessary to broaden the scope of study to include all stakeholders involved (employees, managers, elected officials, clients, donors, bank partners, shareholders, the government, etc.) as well as any organizational form with a “governing” role that might have been set up at the onset of the institution. It is a well-known fact that MFIs are originated for pursuing a dual mission that combines both social
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