

MicroSave India Focus Note 89

Governance in Member Owned Institutions - Community Microfinance

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Introduction

Strong governance in Member Owned Institutions (MOIs) is important for their sustainability. If the governance is weak, there are high chances of fraud by staff, members with vested interests, and by the social and political elite. Such a situation could lead members to lose faith and withdraw their shares/ and leave the institution. On the other hand, good governance structures give confidence to members and investors, which can increase opportunities for future income flows through deposits and commercial investment.

Features of Ownership and Governance in MOIs

The obvious distinctive feature of any MOI is that the clients and owners are the same. Some of the other features are:

- Members' own capital (shares, savings and /or rotating internal capital) is a key source of funds.
- MOIs are normally unregistered or registered as associations, cooperatives, trusts or societies.
- Many a time, members are illiterate or semi-literate, while the staffs are literate, more aware and articulate.
- In the initial stages of any MOI, the board is dependent on the staff unless the President and/or board members are from the social or political elite.
- While staff is paid, the board is rarely paid. Even if they are paid, such payment is nominal. The board members therefore prefer to focus on their livelihoods (unless drawn from the elite) and rarely devote time for the MOI affairs.
- The Board of Directors or governing body is elected by members and comprises members themselves.
- Members supervise the board themselves.
- Multiple stakeholders (promoters, employees and members cum owners) work together in same institution but their motivations and interests may not be the same.

Issues in governance of MOIs specific to the SHGs and SHG Federations

In India many NGOs and government agencies have promoted SHGs and their federations to provide microfinance. While some SHGs and their federations are successful and financially viable, the majority of them are not. The major reasons for this often arise from issues related to governance:

Limited capacity of members to control their board and management: One of the risks to MOIs is the weak control that members exert over their boards and managers¹. In many SHG federations, the general body members do not question the key decisions of the board/ management

Limited capacity of board members to understand vision/mission and business plan: Board members often have limited capacity to develop and understand their organisation's vision, mission and business plan. This may be due to limited or no effort from the promoting organisation to build their capacities in this regard.

Complexity of the institutions: Since the members belong to different tiers in the federation structure, they often confuse their roles and responsibilities in the federation with their roles and responsibilities in the lower tiers. Due to this, members find it difficult to manage these institutions effectively.

Participation in the board meetings: A study done by APMAS² reveals that the majority of the board members are not actively involved in the board meeting discussions, and such decisions are normally suggested either by office bearers or by the federation staff. This makes the members lose interest in attending federation meetings and affects the overall performance of the federation.

Management capture: Many federations are managed by staff appointed by the promoting institutions. These staff are loyal to the promoting institution rather than to the board of the federation. Members also expect favours from these staff as they are perceived to be representatives of the promoting institution, who have greater influence and proximity to the promoting institution. This board-staff relationship adversely affects governance and ownership.

Confusion over ownership: Members see themselves as beneficiaries, and not as owners of the institutions. Members of the promoting institution's staff also tend to deal mostly through the federation staff for ease and convenience, and thus information exchange happens between staff of federations and promoting institutions bypassing the board/office bearers.

Lack of information for decision making: Access to reliable and up to date information is an important condition for good governance of all MOIs³. In many federations, due to the absence of proper management information systems (MIS), the boards do not get timely information for decision making, and many a times they do not even know the status of federation.

Lack of technical knowledge: Board members have limited knowledge of technical aspects like credit policies, analysing the loan portfolio and financial reports. As a result, board members do not understand the operational and financial performance of the federation. Hence, they are forced to depend on their staff to make decisions.

¹ [Comparative Study of Member-Owned Financial Institutions in Remote Rural Areas - Madeline Hirschland](#)

² <http://www.apmas.org/pdf/Status%20of%20SHG%20Federations%20in%20AP.pdf>

³ [SHG Federations Development Costs and Sustainability by Girija Srinivasan and Ajay Tankha](#)

Limited capacity to understand legal obligations: Members have limited understanding of statutory provisions and legal obligations. As a result the majority of federations do not comply with legal requirements, are are therefore under threat from regulators.

External resources especially grant reduces the ownership of the institutions: When the federations get significant grants from promoting institutions, the federation board as well as management do not worry about internal resource generation, thereby reducing their ownership in the institution. For example, the federations promoted by SERP⁴ received government grants which crowded out the ownership of members in the institution⁵. This external money also influences decision making and the governance of the federation, as the “investors” have their own vested interest and expectations from the institution.

Strategies to Improve the Situation in MOIs

The following are some of the strategies that can be used by MOIs and promoting institutions to address the issues.

Education of board members: Board members should be provided with training to understand technical, legal and financial aspects of managing federations and also made adept in asking right questions⁶. The members should also be trained on processes related to federation meetings such recording of minutes and decision-making.

Focus on board members' participation: Involvement of board members in decision making could be increased if the progress reports and financial information were presented in simple and easy to understand graphs and pictures. Simple and user-friendly systems for accounting, credit management, reporting and auditing are also crucial for strong governance. RGMVP encourage federations to form sub-committees to take care of key areas like audit, bank linkages, health and education. These committees increase participation of all board members in the management of the federation and enhance transparency.

Role of the promoting institutions: The promoting institutions should not interfere in the selection of federation employees and board members, but restrict themselves to guiding the board/general body on the selection process.

Member stake in federations: SHGs with a greater financial investment in the federation will have a greater stake in ensuring sound financial management and governance. For example each member SHG in *Boond Bachat Sangh*⁷, deposits Rs.1, 000 with the federation. This internal resource generation enhanced community ownership.

Compensation for the board members: To enhance the participation and accountability, the board members should be compensated for the time they spend on board matters. This will encourage competent persons to take up

membership of the board and they would not consider this to be a drain on their time.

Effective internal controls: Systems should be put in place to prevent violation of the byelaws of the federation and to prevent frauds. RGMVP⁸ has introduced Community Level Audit System and Federation Grading System with support from *MicroSave* to check the implementation of internal controls and identify potential risks.

Selection of board members: All members of the board should have basic financial capability, including the ability to interpret financial statements, or commit to acquire these skills through education/training within the first year of service. To avoid social and political elite capture, federations should take enough precautions in selection/election of board members. The primary cooperatives promoted by CDF⁹ ensure that their board members are elected from each of the ward/locality within the village so that the board is not captured by the social or political elite.

Accountability: The board is accountable to the general body of members, which is the highest governing body of the federation. It is the duty of the board to establish strategic direction, approve policies and monitor implementation of these policies. The duty of the management is to prepare plans and budget, undertake operations, implement the policies approved by the board and achieve the agreed targets.

Principle of subsidiary: To enhance understanding and control of members over the institution, they should be provided services from the closest institutions in the tier, and restrict their dependence on higher tiers to only highly specialised services.

Conclusion: An MOI with strong governance is able to establish a conducive environment for members through the right mix of ownership incentives, member decision-making and other control mechanisms. The common problems of MOIs can be reduced if the promoting institutions adequately train and educate members to take up leadership roles in the federation, and ensure that members participate and oversee the MOI. Members should discuss and have a clear vision for the community based organisation's financial sustainability, rules for the conduct of board meetings and recording of minutes. Simple and effective auditing, monitoring, review and critical feedback systems and balance between governance and management need to be established. Good governance structures give members and investors confidence and are necessary foundation for successful community-based organisations.

⁴[Society for Elimination of Rural Poverty \(SERP\)](#)

⁵[SHG Federations –Development Costs and Sustainability – Girija Srinivasan and Ajay Tankha](#)

⁶[Community-Owned Microfinance Institutions: “Enabling Double Bottom-line Impact”, Girija Srinivasan and N. Srinivasan](#)

⁷<http://www.bidnetwork.org/page/54531/pt>

⁸<http://www.rgmvp.org/>

⁹<http://www.cdf-sahavikasa.net/>