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Need of Corporate Governance in NBFCS and MFIS in India

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ABSTRACT:

Success of an organisation depends upon efficient management of its resources. Money is one such resource factor which plays an important role in the growth of an organisation. Organisations do not have sufficient amount of funds to invest into fixed assets. Hence these organisations depend upon financial institutions. Financing is one of the most important activities of organisations. Banks and other financial institutions cater the financial needs of general public as well as business organisations. This scenario changes when rural people or lower income group people or small organisations go to these financial institutions. To cater the needs of this section of society, small organisations formed as banking institutions. Hence the growth of Non Banking Financial Companies ushered. Micro Finance Organisations initially started as lending institutions. Looking at the vast scope of business, these organisations started to accept unauthorised deposits which are against the primary objective of lending. Due to procedural complications rural and lower income group people do not go to banks and depend upon these institutions. Sometimes these institutions dupe people for increasing their deposits volume. Corporate governance broadly refers to the mechanisms, processes and relations by which corporations are controlled and directed. Governance structures identify the distribution of rights and responsibilities among different participants in the corporation; such as the board of directors, managers, shareholders, creditors, auditors, regulators, and other stakeholders and include the rules and procedures for making decisions in corporate affairs. Corporate governance includes the processes through which corporations' objectives are set and pursued in the context of the social, regulatory and market environment. Governance mechanisms include monitoring the actions, policies and decisions of corporations and their agents. Corporate governance practices are affected by attempts to align the interests of stakeholders. Hence, the need of Corporate Governance in these small scale lending institutions arise.

NBFC & MFI in India:

A Non Banking Financial Company is a company registered under the Companies Act, 1956 of India, engaged in the business of loans and advances, acquisition of shares, stock, bonds hire-purchase, insurance business, or chit business: but does not include any institution whose principal business includes agriculture or industrial activity; or the sale, purchase or construction of immovable property.

Difference between NBFCS & Banks:

NBFCs perform functions similar to that of banks; however there are a few differences in that an NBFC cannot accept demand deposits; an NBFC is not a part of the payment and settlement system and as such, an NBFC cannot issue cheques drawn on itself; and deposit insurance facility of the Deposit Insurance and Credit Guarantee Corporation is not available for NBFC depositors, unlike banks

Micro Finance Institutions:

Microfinance institutions, also known as MFIs, offer financial services to underprivileged and impoverished communities. Generally these kind of Institutions are prevalent in rural India. They provide short term loans at a certain rate of interests and procedural paper work is minimum for availing such loans.

MFIs go for NBFC licences:

An Increasing number of microfinance institutions (MFIs) are seeking non-banking finance company (NBFC) status

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from RBI to get wide access to funding, including bank finance. The Task Force on Supportive Policy and Regulatory Framework for Microfinance set up by NABARD in 1999 provided various recommendations. Accordingly, it was decided to exempt NBFCs which are engaged in micro financing activities, licensed under Section 25 of the Companies Act, 1956, and which do not accept public deposits, from the purview of Sections 45-IA (registration), 45-IB (maintenance of liquid assets) and 45-IC (transfer of profits to the Reserve Fund) of the RBI Act, 1934.

MFIs & SHG-Bank linkage programme:

In a joint fact-finding study on microfinance conducted by the Reserve Bank of India and a few major banks, the following observations were made:Some of the microfinance institutions (MFIs) financed by banks or acting as their intermediaries or partners appear to be focusing on relatively better banked areas, including areas covered by the SHG-Bank linkage programme. Competing MFIs were operating in the same area, and trying to reach out to the same set of poor, resulting in multiple lending and overburdening of rural households.Many MFIs supported by banks were not engaging themselves in capacity building and empowerment of the groups to the desired extent. The MFIs were disbursing loans to the newly formed groups within 10–15 days of their formation, in contrast to the practice of obtaining in the SHG – Bank linkage programme, which takes about six to seven months for group formation and nurturing. As a result, cohesiveness and a sense of purpose were not being built up in the groups formed by these MFIs.Banks, as principal financiers of MFIs, do not appear to be engaging them with regard to their systems, practices and lending policies with a view to ensuring better transparency and adherence to best practices. In many cases, no review of MFI operations was undertaken after sanctioning the credit facility.

RBI relaxes norms for NBFCs:

NBFCs registered with the Reserve Bank of India may take part in the insurance agency business on a fee basis and without risk participation or the need to seek the bank's approval. In a notification issued, the RBI said such NBFCs should obtain permission from the Insurance Regulatory and Development Authority and comply with IRDA regulations for acting as a "composite corporate agent" with insurance companies.

MFIs of India:

Forbes magazine named seven microfinance institutes in India in the list of the world's top 50 microfinance institutions.Bandhan, as well as two other Indian MFIs—Microcredit Foundation of India (ranked 13th) and Saadhana Microfin Society (15th) – have been placed above Bangladesh-basedGrameen Bank (which along with its founder Mohammed Yunus, was awarded the Nobel Prize). Besides Bandhan, the Microcredit Foundation of India and Saadhana Microfin Society, other Indian entries include Grameen Koota (19th), Sharada's Women's Association for Weaker Section (23rd), SKS Microfinance Private Ltd (44th) and Asmitha Microfin Ltd (29th).

Criticisms:

Recently, microfinance has come under fire in the state of Andhra Pradesh due to allegations of MFIs using coercive recollection practices and charging usurious interest rates.[11] These charges resulted in the state government's passing of the Andhra Pradesh Microfinance Ordinance on October 15, 2010. The Ordinance requires MFIs to register with the state government and gives the state government the power, suo moto, to shut down MFI activity.[12] A number of NBFCs have been affected by the ordinance, including sector heavyweight SKS Microfinance.While the conventional definition of corporate governance and acknowledges the existence and importance of 'other stakeholders' they still focus on the traditional debate on the relationship between disconnected owners (shareholders) and often self-serving managers. Indeed it has been said, rather ponderously, that corporate governance consists of two elements:

1.The long term relationship which has to deal with checks and balances, incentives for manager and communications between management and investors;
2.The transactional relationship

This implies an adversarial relationship between management and investors, and an attitude of mutual suspicion. This was the basis for much of the rationale of the Cadbury Report, and is one of the reasons why it prescribed in some detail the way in which the board should conduct itself: consistency and transparency towards shareholders are its watchwords. As fundamentally important as these traits are, we prefer to take a rather broader view, which places the Cadbury Code and other codes developed

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since (Combined Code, Sarbanes-Oxley, King, etc) in a wider context and shows its recommendations emerging naturally in the course of a company's evolution. In an early book on corporate governance, also published in 1992, one of the creators of this website developed a definition of corporate governance as consisting of five elements which the board must consider:

•long term strategic goals
•employees: past, present and future
•environment/community
•customers/suppliers
•(legal/regulatory)

Separation of Ownership and Control:

The corporation, in contrast, for example, to a partnership, separates ownership from operational control - this concept is, of course, fundamental to any definition of corporate governance and is commonly referred to as the agency issue, or Agency Theory. It is this separation which creates the need for systems of independent monitoring and control. Historically, it was the freedom that this separation created to take much bigger risks in order to expand that prevented for so long the permission of such organisations to exist, with the potential dangers it implied. And it is this freedom which has required mechanisms to be constructed to try and prevent it being abused.

CONCLUSION:

Above research study comes to this conclusion that, Non Banking Financial Institutions cater to the needs of lower income group people to a certain extent. Where Banks and other financial institutions couldn't reach to the grass root level section of the society, these NBFCs can reach there. But, using the lacunas of law as well as the innocence of rural people, most of these mushrooming Organisations dupe the innocent people. Hence strict implementation of Corporate Governence policies in these Organisations will reduce the misappropriation of public money and also save these institutions from becoming extinct.

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