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INDUSTRY OUTLOOK

MICRO FINANCE INSTITUTIONS: EMERGING CONTOURS

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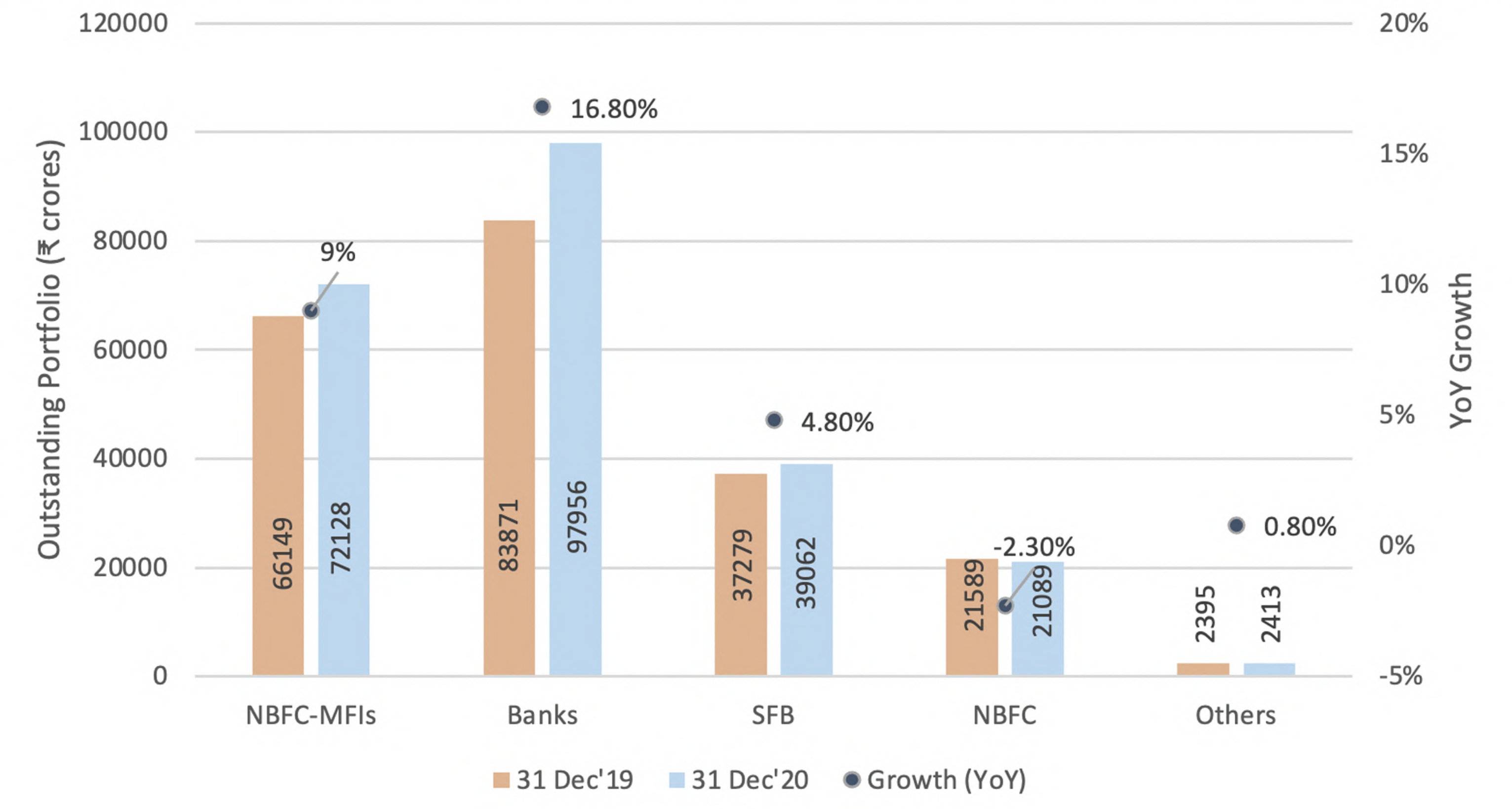
Introduction

Financial inclusion is an important instrument of empowering people to access social and economic justice. It gives the opportunity to small enterprises and people at the lower strata of the society to form an integral part of the mainframe economics and enhance the well-being of the overall society. Therefore, it is important to understand the working of this process and the challenges inherent in this broad-based process of economic development. In this overarching context, this report attempts to provide an overview and challenges confronting the Micro Finance Institutions (MFI) today. The winds of change sweeping the country in the realm of micro finance have significantly promoted improvement in livelihood opportunities and inclusive finance by rendering collateral free loans to persons at "the bottom of the pyramid", who lack access to credit from formal financial sources. Viewed in this perspective, the Micro Finance revolution in the county has improved access to credit, thereby transforming the lives of the most underserved and underprivileged sections of the society and bringing about some kind of a silent revolution in the country-side.

The MFI revolution has provided access to more people who want to seek credit to earn a living with reasonable interest rates. This process of exploring alternative credit mechanisms with reasonable interest rates has also led to an identification of the potential markets and consequential increase in the size of the pie with equitable distribution being an important consideration. As on December 31, 2020, the microfinance industry served 5.83 crore unique borrowers through ₹10.50 crore loan accounts. The overall microfinance industry currently has a total loan portfolio of ₹2,32,648 crores as per data provided by Micro Finance Institution Network (MFIN) in its 36th issue of Micrometer for Q3 FY 20-21. (see, Figure 1).

As can be seen from Figure 1, the industry has seen a Year on Year (YoY) growth rate for the NBFC-MFIs. Banks and NBFC-MFIs which account for roughly three-fourth of the industry, showed a tremendous growth of 9 and 16.8 per cent respectively followed by Small Finance Banks (SFB) which grew at a rate of 4.8 per cent.

Figure 1: Outstanding Portfolio for MFI Industry (₹ crores)

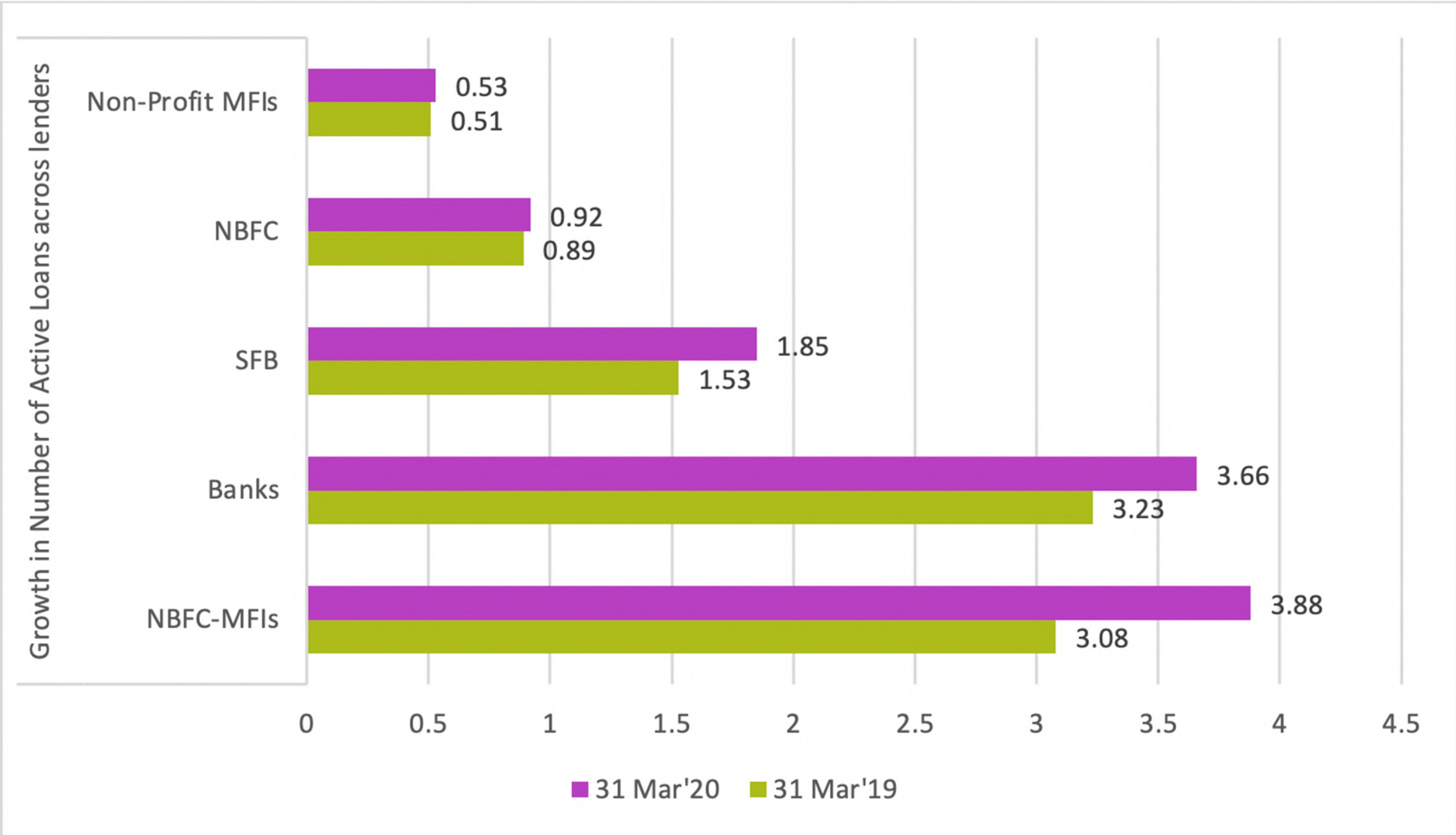


Source: Synopsis, Micrometer (Issue 36) by Microfinance Institution Network (MFIN).
Available at https://mfinindia.org/assets/upload_image/publications/MicrometerSynopsis/Micrometer%20Q3_FY_20-21_Synopsis.pdf
Note – As per latest report available.

MFI revolution is increasingly demand-led, which is evident in the figure below (Figure 2), where it can be observed that the number of loans has increased over time since the number of borrowers has increased.

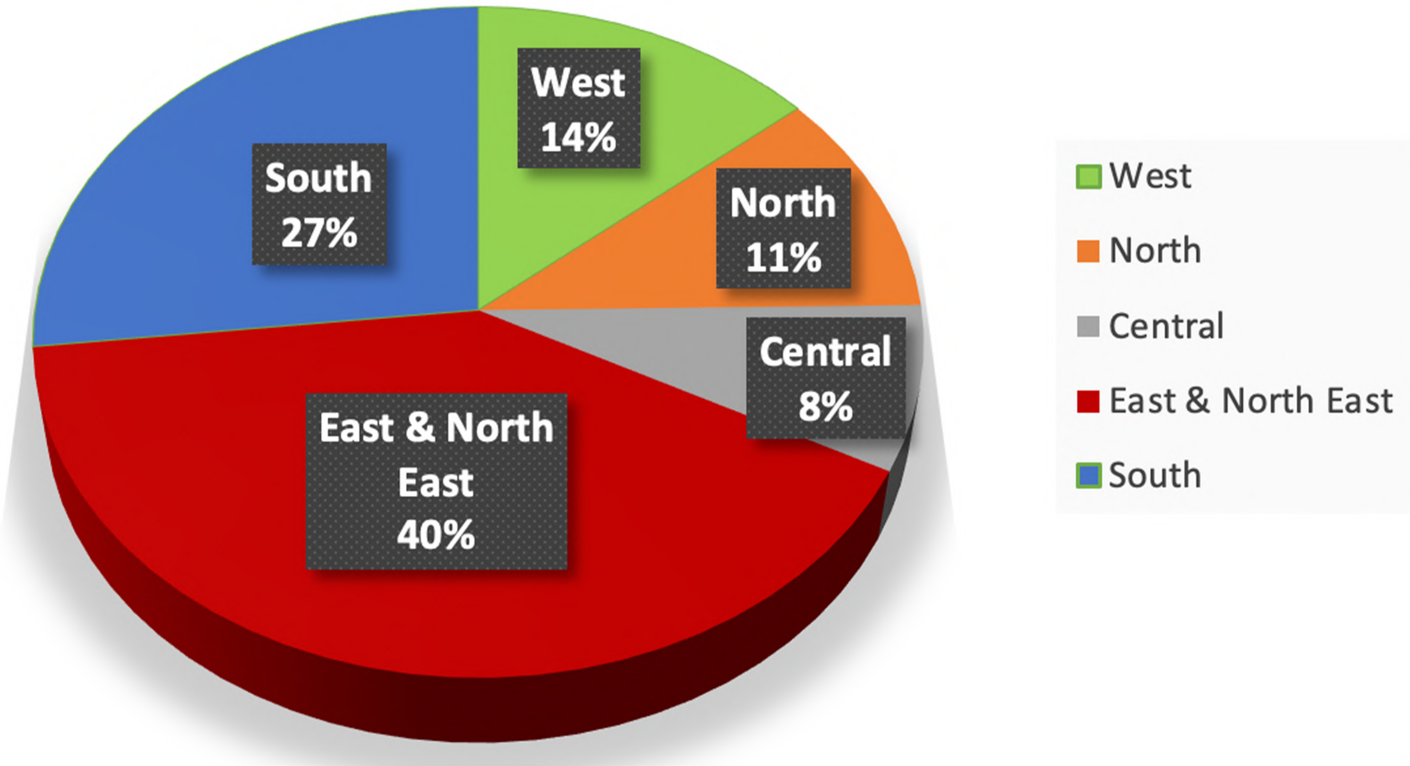
As can be seen from below Figure (Figure 2), the number of borrowers has increased for all the institutions in FY20. With the addition of new borrowers, the penetration of the industry has increased. However, the true penetration is more appropriately reflected in a geographical dispersion. This is seen in the figure below, where we see that the East & North East region shows the maximum percentage of portfolios held in the country followed by the Southern region. Low penetration is observed in the rest of the regions. This fact clearly brings out that there is still a lot of road to traverse.[1]

Figure 2: Growth in Number of Active Loans across lenders (in Crores)



Source: The Bharat Microfinance Report, Sa-Dhan, 2020. Available at
https://drive.google.com/file/d/1MmM7JbctxnAz2TREC9pC_hhrkzum_hpf/view
Note – As per the latest report available.

Figure 3: Regional distribution of portfolio on 31 December 2020



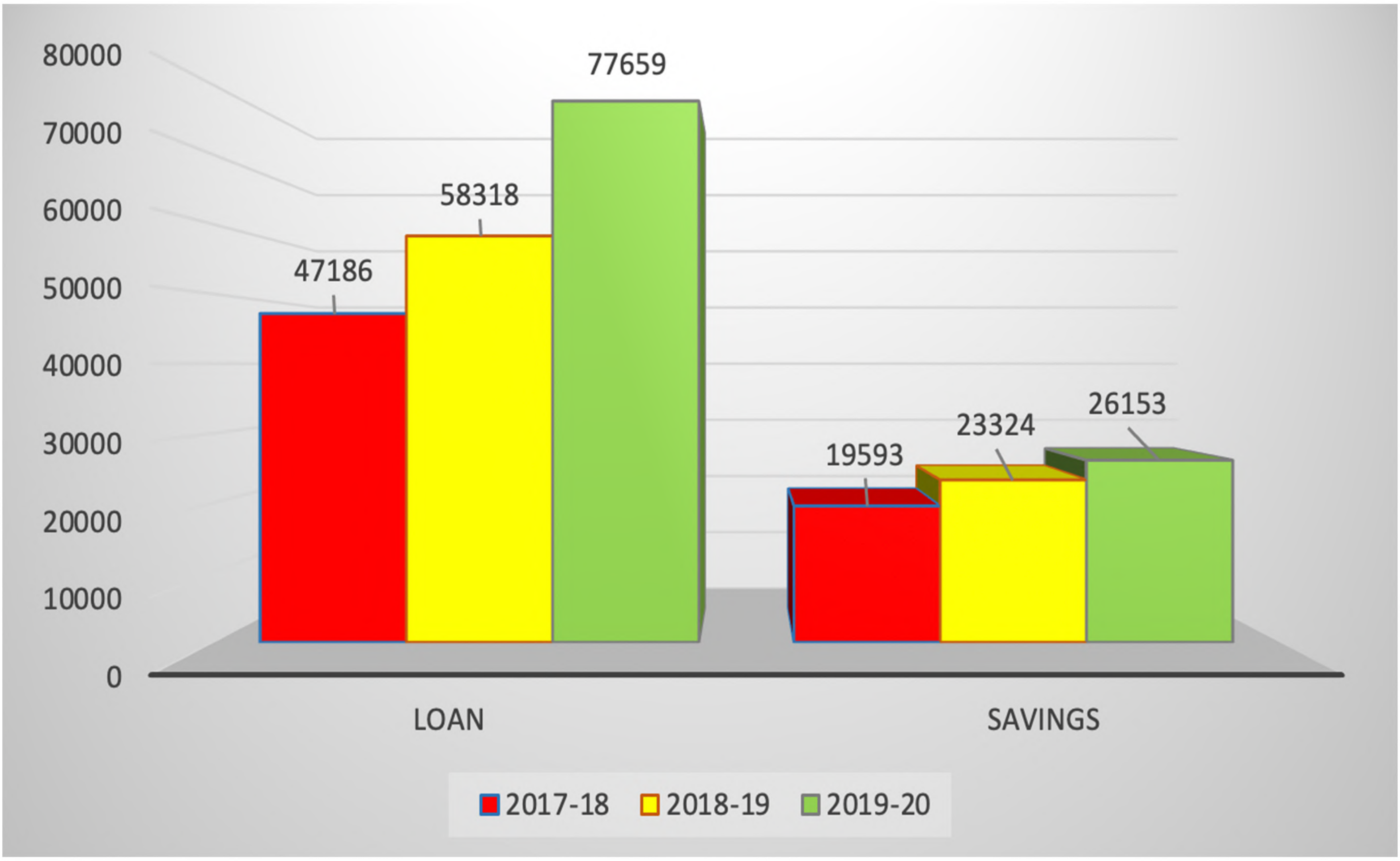
Source: Synopsis, Micrometer (Issue 36) by MFIN.

Self-Help Groups (SHGs)

Modern micro-credit/microfinance industry in India started in 1990s inspired by the Grameen Bank model of Prof. Mohammad Yunus in Bangladesh. The SHG model has transformed the way credit is availed of by the poor sections of the society. With almost 99 per cent of the MFI loans given to women from low-income households, it has certainly transformed the lives of many women who earlier were restricted in their abysmal environment by providing them entrepreneurship opportunities. The SHG model has demonstrated that the poor and the marginalised sections of society, including the women are under-banked but in no way un-bankable. Among the pioneering attempts to carry forward this process, mention may here be made of the increasing role Eshakti in better Banker- SHG interface. It has sometimes been maintained that Eshakti 2.0 can be an end-to-end solution for all credit needs of SHGs but the efficacy and effectiveness of this instrument is still as yet to be fully proven on the ground.

The NGO sector has played a prominent role in working as a Self-Help Group Promoting Institution (SHPI) by organizing, nurturing and enabling credit linkage of SHGs with banks. The National Bank for Agriculture and Rural Development (NABARD) has co-opted many institutions as SHPIs including Regional Rural Banks (RRBs), District Central Cooperative Bank (DCCBs), Primary Agricultural Credit Society (PACS), Farmers' Clubs (FCs), SHG Federations, Individual Rural Volunteers (IRVs), etc. These stakeholders are encouraged to take up promotion of SHGs by way of promotional grant assistance from NABARD. This savings-led microfinance model has now become the largest coordinated financial inclusion programme in the world covering almost 100 million households in the country.[1]

Figure 4: Loans Disbursed and Savings of SHGs (₹ crores)



Source: Status of Microfinance in India 2019-20, National Bank for Agriculture and Rural Development (NABARD), 2020.
Available at https://www.nabard.org/auth/writereaddata/tender/1607201015NABARD%20SMFI%202019-20_compressed.pdf
Note – As per the latest report available.

Digital Mode

Considered in a proper historical and comparative perspective, the first technological innovation in the MF sector, i.e., the Microfin software was developed by the C-DAC two decades ago. Despite considerable technological interventions and innovations since then to slash the cost of lending and facilitate salubrious change, development of effective and reliable credit disbursal, credit assessment and client substitution tools are still something like a work in process and much work requires to be done by various stake-holders in a coordinated and concerted manner to achieve the avowed goals of development. In this overarching environment, the COVID-19 pandemic has brought to the fore the significance of the digital domain in all walks of life and economic activity. The case has been no different for the MFI industry.

Some of the highlights[2] are as under:

- Small MFIs: 98 per cent by volume and 88 per cent by value of the disbursements were made in cash.

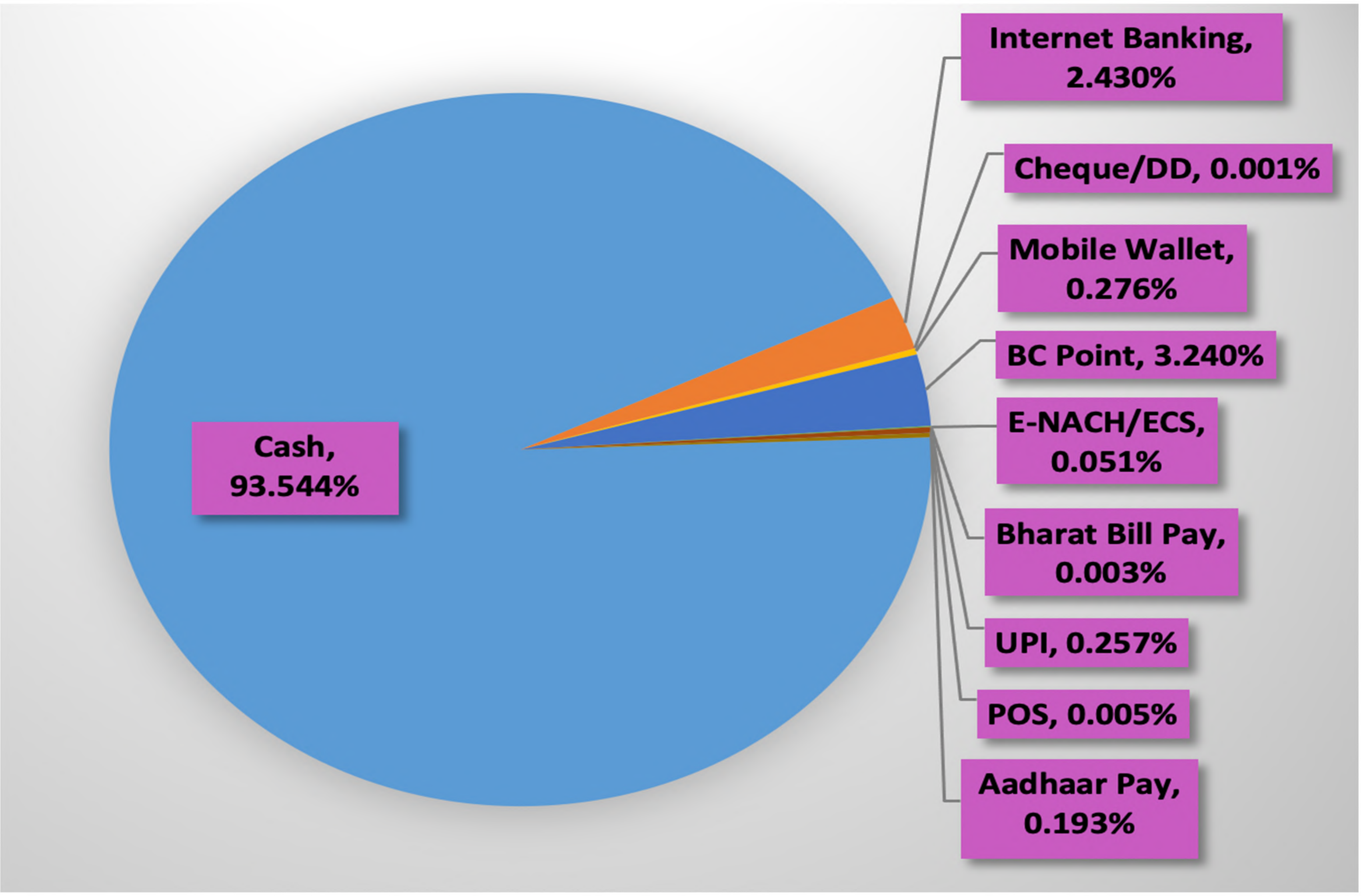
- Medium MFIs: 100 per cent disbursements by transfer to bank accounts.

- Large MFIs: 99% by volume and nearly 100% by value of the disbursements by transfer to bank accounts.

- Corporate Business Correspondents (CBCs): 100 per cent disbursements by transfer to bank accounts.

- NBFCs: Did not report any disbursement during Q1 FY 20-21[2].

Figure 5: Modes of Repayment Collection: By Volume (No. of Accounts) in 2020(in %)



Given the cost¸ infrastructure and capacity building requirements, relative to the scale and the profitability of the MFIs, involved in technology adoption, it can reasonably be maintained that technology adoption by MFIs would willy-nilly be an incremental process and not an exponential one.

The following figure (Figure 5) gives a snapshot. As can be seen from the Figure, the largest form of repayment is still cash.

Towards this end, it may be advisable for MFIs to first guide and encourage their clients to switch to digital solutions in their routine business and personal work to foster accelerated growth and transformation. During Q1 FY 2020-21, repayment collections of ₹1,629.79 crore from 84.2 lakh accounts were reported by twenty-seven institutions including twenty-four NBFC-MFIs, two Corporate Business Correspondents (CBCs) and one NBFC across twenty-two states and five union territories. Ten different methods were used by the MFIs to collect repayments: Aadhaar Pay, Point of Sales (POS, using debit card swipe), UPI, Bharat Bill Pay, National Automated Clearing House (NACH), BC Point, Mobile wallet, Cheque/DD, Internet banking (SMS Link, Payment Gateway, NEFT, IMPS) and Cash.

NABARD launched a pilot project for digitization of SHGs titled "EShakti" in March 2015 in 2 districts viz. Ramgarh (Jharkhand) and Dhule (Maharashtra). The overarching vision was to empower the SHGs through technology. EShakti is designed to capture the demographic and financial profiles of the SHGs as well as their members. Encouraged by the positive in Phase I, the pilot project was expanded to 23 more districts under phase II in 2016 and was further expanded to 75 more districts towards the end of 2017. During the year 2019-20, 150 more districts were covered under the project. The implementation of the project is currently on in 254 districts across the country. As on 31 March 2020, data pertaining to 6.54 lakh SHGs involving 72 lakh members in more than 98,000 villages have been on-boarded to E-Shakti portal. The credit linkage with banks under E-Shakti (all phases) rose from 2.17 lakh to 3.21 lakh as on 31 March 2020, thus vindicating the success of the project (NABARD, 2020).

Government Initiatives:

Scheme for Promotion of Women SHGs in backward districts of India

NABARD, in association with the Department of Financial Services (DFS), Ministry of Finance, Government of India implemented a scheme for promotion and financing of Women Self Help Groups in backward districts of the country. As on 31 March 2020, 2.11 lakh WSHGs promoted / savings linked and 1.29 lakh WSHGs credit linked.

SHG-BLP (SBLP) Strategic Advisory Board

A Strategic Advisory Board was constituted in NABARD in 2015 with members drawn from various bodies to focus on strategic action plan on SBLP, financial literacy, digitisation of SHGs, livelihood promotion, etc. The Advisory Board deliberates the issues of gap in savings and credit linkage, credit deepening, recovery and NPA, Micro Credit limit etc. and recommends ways to deal with them.

Financing of Joint Liability Groups

NABARD extends grant support for formation and nurturing of (Joint Liability Group) JLGs to banks and other JLG promoting agencies. Apart from extending 100 per cent refinance support to Banks, NABARD also extends financial support for awareness creation and capacity building of all stakeholders of this programme. As against 16.04 lakh JLGs promoted during 2018-19, JLGs promoted during 2019-20 were 41.80 lakh taking the cumulative number of JLGs promoted and financed by banks to 92.56 lakh as at the end of March 2020.

PM Street Vendor's AtmaNirbhar Nidhi (PM SVANidhi)

A Memorandum of Understanding (MoU) has been signed between Indian Bank and Ministry of Housing & Urban Affairs and Small Industries Development Bank of India (SIDBI) around October 2020. Under the Scheme, the vendors can avail a working capital loan of up to ₹ 10,000, which is repayable in monthly instalments in the tenure of one year. An interest subsidy of 7 per cent per annum will be credited to the bank accounts of beneficiaries through Direct Benefit Transfer on quarterly basis on timely/ early repayment of the loan.

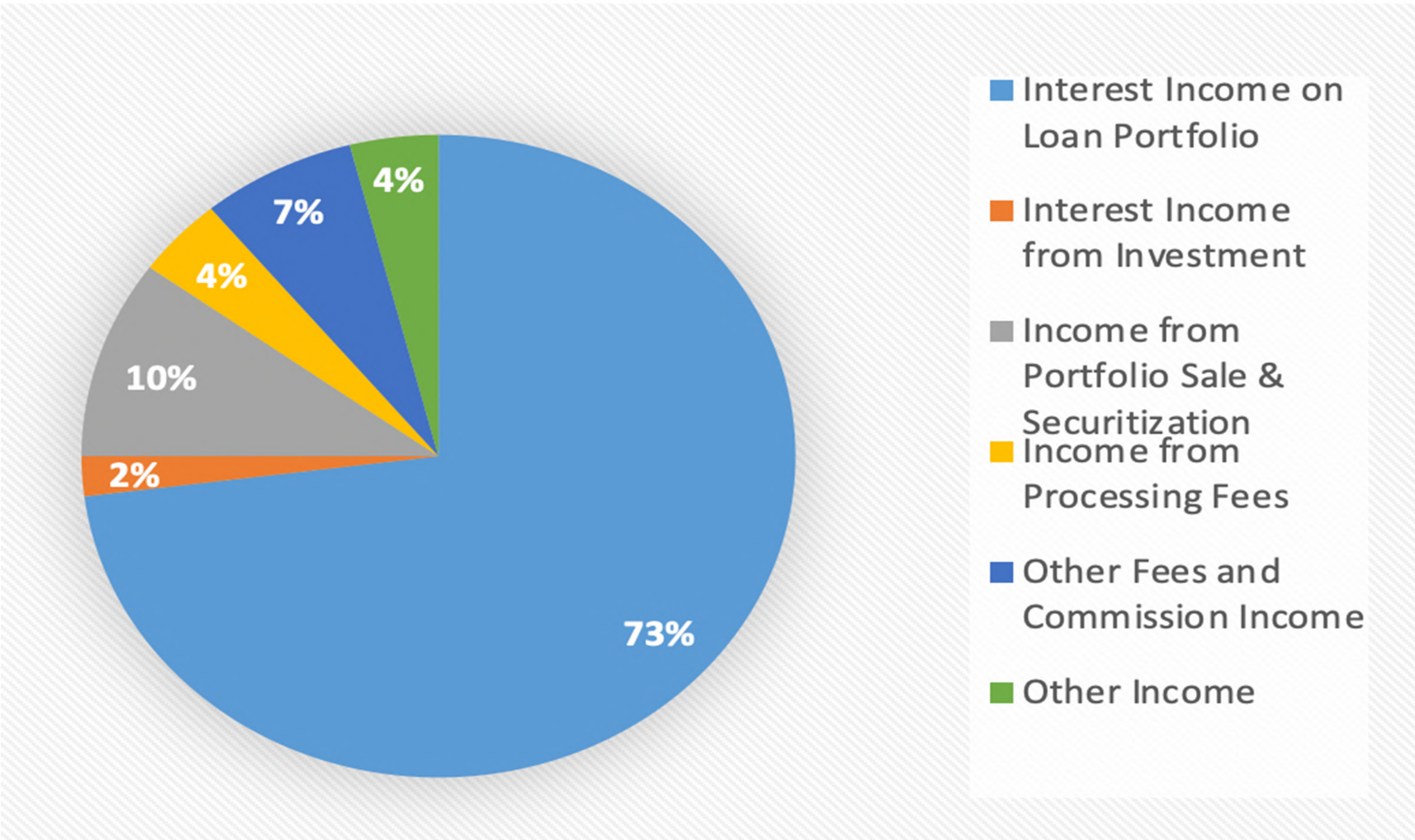
In view of the new challenges brought by the second wave of Covid-19 as well as to address the emergent liquidity position of smaller MFIs, the Reserve Bank of India (RBI) in a notification (5 May 2021) has allowed Priority Sector Lending (PSL) classification to the fresh credit extended by SFBs to registered NBFC-MFIs and other MFIs (Societies, Trusts etc.) which are members of RBI recognised 'Self-Regulatory Organisation' of the sector and which have a 'gross loan portfolio' of upto ₹500 crore as on 31 March 2021, for the purpose of on-lending to individuals. Bank credit as above will be permitted up to 10 per cent of the bank's total priority sector portfolio as on 31 March, 2021. The above dispensation shall be valid upto March 31, 2022. However, loans thus disbursed will continue to be classified under Priority Sector till the date of repayment/maturity whichever is earlier.[3]

Industry Risk

Though the second wave of Covid-19 poses further challenge for public life and economy of India, MFIs are relatively better prepared conditional upon adequate credit inflow from the banking and financial sector. Under normal condition, MFI Industry is likely to grow at a CAGR of 20-25 per cent over next five years , whereas Maharashtra is among top five states according to the MFI Asset Under Management (AUM). But with the onset of the second wave, various states have imposed localized lockdowns/curbs looking at the current situation, which could hamper collections in the MFI segment, and asset quality can deteriorate further.

The total income earned by 173 MFIs for the year 2019-20 is approximately ₹16,309 crores, which marks a significant increase from ₹14,128 crores in 2018-19 (Sa-Dhan, 2020) [2].

Figure 6: Income Components of MFI (June 2020) (in per cent)



Source: The Bharat Microfinance Report, Sa-Dhan, 2020.

There is, however, a disconcerting aspect in the micro finance story because the write-off percentage rose over the years (Table 1). For all categories of lenders, write-off percentage has increased over the years, whereas for Small Finance Banks (SFBs) though the write-off declined in 2019 compared to 2018 (in percentage), but it increased again in 2020.

Table 1: Lender-wise delinquency write-off percentage

Lender Type	2020	2019	2018
NBFC-MFIs	1.47%	0.29%	0.68%
Banks	0.16%	0.09%	0.01%
SFBs	1.22%	0.77%	4.10%
NBFCs	6.01%	2.39%	1.16%
Non-Profit MFIs	0.92%	0.54%	0.56%
Overall	**1.33%**	**0.52%**	**0.89%**

Source: The Bharat Microfinance Report, Sa-Dhan, 2020

However, Non-Performing Assets (NPAs) under bank loans to the Self-Help Groups (SHGs) as on 31 March 2020 were 4.92 per cent as compared to 5.19 per cent as on 31st March 2019 (See Table 2 below). While the NPA declined marginally by 0.28 percentage points, the steep rise in absolute level of NPA amount in recent years is a cause for concern. It increased by 17.6 per cent from ₹4,524 crore in 2018-2019 to ₹5,321 crore as on 31 March 2020.

Table 2: Region-wise GNPA Level for SHGs (₹ crores)

	2018-19		2019-20	
Region	Amount of Gross NPA (₹ crores)	NPA as percent to Loan Outstanding(%)	Amount of Gross NPA (₹ crores)	NPA as percent to Loan Outstanding(%)
Northern	206	20.74%	212	17.35%
North East	275	33.08%	269	26.08%
Eastern	858	5.19%	1015	4.46%
Central	613	30.59%	566	25.15%
Western	306	12.39%	336	11.07%
Southern	2266	3.53%	2924	3.76%
All India	4524	**5.19%**	5321	**4.92%**

Source: Status of Microfinance in India, NABARD, 2020.

Among the states, maximum NPA level for SHG was witnessed in Uttar Pradesh (42.97 per cent), Haryana (38.8 per cent), Tripura (30.9 per cent), Assam (27.9 per cent), Uttarakhand (27.0 per cent) and Arunachal Pradesh (24.3 per cent), apart from the stark regional differences in the NPA levels highlighted above ranging from roughly 3 to 30 percent.

Way Forward

There is a need to focus and strategize ways to increase the penetration in Central and North areas for the underserved states of Self-Help Group Bank Linkage Programme. This can be done via Self-Help Group Promoting Institutions (SHPIs). Although, RBI in its fourth Bi-Monthly Monetary Policy (2019) had increased the household income limit for borrowers of NBFC-MFIs from ₹1.00 lakh to ₹1.60 Lakh for rural and from ₹1.25 lakh to ₹2.00 lakh for urban areas and the lending cap for eligible borrowers to ₹1.25 lakh against the earlier limit of ₹1 lakh , there is still a considerable scope to increase credit penetration.

Going forward, there is compelling need for a human centric approach, proper monitoring and regular interaction with the client. These aspects could help to make the operations of the MFIs more robust, efficient, cost effective and scalable. Going to scale requires greater interaction between the MF sector and technology providers for more product innovations like payments and loan collection in remote areas and wider use of process innovations like "Account aggregators". These changes will strengthen because of rise of new technologies, viz., artificial intelligence (AI), machine learning (ML), data analytics, cloud computing, internet of things, robust digital infrastructure, climate change and global liquidity. In this move from deep crisis to a more inclusive and resilient future, the MFIs need to be adequately secured with their assets, qualitatively strong and amply capitalized.

Of late, there has been an accent on hyper-automation, which stems from the philosophy 'today's disruptive is tomorrow's stable'. Post crisis, digital maturity and hyper-automation, which coalesce several components of process automation, integrating tools and technologies to amplify the ability to automate work will determine the strategy of MFI players and emerge as the key differentiator.

Also, the current COVID 19 pandemic has forced the borrowers to divert their resources towards non-income generating activities like consumption, housing, education, water & sanitation, health etc. Traditionally, MFIs have been lending for both consumption and productive purposes and it is believed that poor people use their loans for their emergency and consumption needs more than for livelihoods. For example, about 55 per cent of the MFI loans in the non-income generation category were deployed in housing (Sa-Dhan, 2020). From 2016-20, the average proportion of loans for income generation has been around 91 per cent whereas that for non-income generation has been 9 per cent. However, in the ongoing COVID crisis it would have been difficult for people not to divert their resources to non-income generating activities, be it health, housing or general consumption. Thus, the government must ensure that separate relief packages are announced in view of the non-income generation category so that people do not have to fear about their survival to ensure that the MFI loans are being used for its desired purpose.

Given the rapid evolving scenario and cross-cutting international evidence, the MF sector may consider investing in Fintech start-ups for customized solutions aimed at improving lending practices to minimise risks while enhancing business. Towards this end, the central bank of the country, i.e., the Reserve Bank of India, apex institutions like NABARD and Small Industries Development Bank of India (SIDBI) and the commercial banking system can join hands together to explore, examine and develop tech solutions- solutions, which are in conformity with the needs and requirements of both employee and client profile of MFIs. There are no easy answers but failure is not an option.

ENDNOTES

1. DFS, Ministry of Rural Development (MoRD) / National Rural Livelihood Mission (NRLM), RBI, Commercial banks, SIDBI, RRBs, Cooperative banks and Microfinance experts.

2. https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/1FOURTHBIMONTHLY2D49C7044C474E0
C8DF4A98BF6707836.PDF

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