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INDUSTRY OUTLOOK

MICROFINANCE INSTITUTIONS (MFIS)

30 June 2020

In the last two decades, the banking sector has undergone a paradigm shift. An important element of the banking sector transformation has been the emergence of micro-financing (MF) as an innovative savings and loan mechanism for the poor. MF emanated from inadequate social safety net for the vulnerable sections of society and the inaccessibility of the formal banking system. Self-help, savings and credit groups helped to streamline the existing credit delivery mechanism by increasing the outreach of credit and enhancing the viability of institutions in rural credit.

MF and poverty alleviation programmes are inextricably linked because of the potentiality of MF programmes to link the formal banking structures with the rural poor by mobilization of savings and promotion of entrepreneurial endeavours. This enables the rural poor to expand and diversify their enterprises and increase their incremental income to repay loans at market rates and make savings deposits as vindicated by the experience of Grameen Bank, Bank Rakyat (Indonesia's Unit Desa system), BancoSol, Asociacion Grupos Solidarios de Colombia (AGS), DFID, ADB and the World Bank. Even in India organisations such as SHARE, BASIX, SEWA, MYRADA and PRADAN have made a commendable difference to the rural poor.

MF revolution is increasingly demand-led as contrasted to the supply-led, state sponsored rural credit. MF is profitable with banks/micro finance Institutions (MFIs) adopting a profit-centre approach with customer-friendly savings and loan products. Innovations by institutions across countries reveal that the poor are bankable and micro enterprise finance through repayment incentive structure, streamlined administration and market-based pricing is sustainable

Considered in a proper historical and comparative perspective, financial inclusion has always been important in India's development planning. This can be substantiated by the fact that the central objective of economic planning was defined by the First Five Year Plan as "raising the standards of living of the common people". But this process of empowering people to access social and economic justice has received a renewed emphasis in the last few years to promote both economic growth and distributive equity. It has been increasingly realized that we need not just increase the size of the national cake but also ensure that the size of the national cake has to be more evenly and equitably distributed.

Banks were initially hesitant to enter micro finance (MF), but it has now come of age. Components of the self-help group (SHG) programme and its linkage with banks include refinance to banks, uniform rate of interest on refinance to all agencies, no insistence on security, encouraging NGOs/VAs in linking informal groups of rural poor with banks, flexible activities, loan for both production and consumption, repayment ethics through peer pressure, timely and adequate credit, low transaction costs, better repayment and socio-economic empowerment through group activities.

Microfinance Institutions Network (MFIN), the regulatory body[1] represents various entities including NBFC-MFIs, Banks, Small Finance Banks, etc. These microfinance entities provide loans to the low-income, financially excluded segment of the population who otherwise have no access to financial services. Such loans are typically small size, income-generating loans without any collateral.

Table 1:Microfinance Lenders, Active Loan A/Cs &Outstanding Loans (as on 26 February 2020)*

Sl No.	Types of Lenders	Active Loan Accounts (Crore)	Outstanding loans (Rs. Crore)
1	Banks	3.56	83,876
2	NBFC-MFIs	3.64	66,159
3	Small Finance Banks(SFBs)	1.74	37,282
4	NBFCs	1.03	21,591
5	Other MFIs	0.13	2,395
	Total	**10.11**	**2,11,303**

*Published according to its latest 'Micrometer' report in Q3 FY 2019-20.

Source: Microfinance Institutions Network (MFIN) Press release 26 February 2020

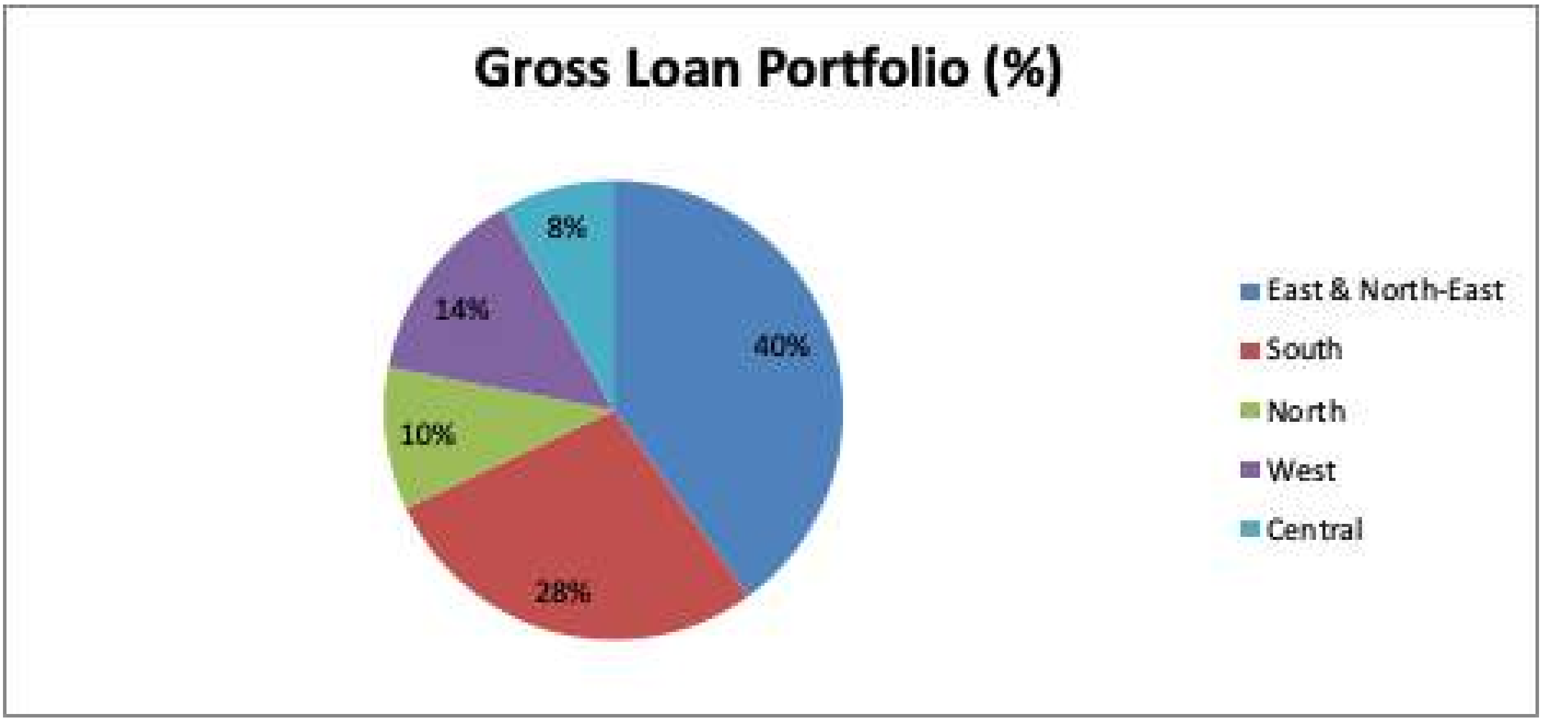
From Table 1 it can be observed that according to the latest available data from MFIN through a press release in 26 February 2020, banks hold the largest share of portfolio in micro-credit with total loan outstanding of Rs. 83,876 crore of the total micro-credit universe, which has increased primarily after the merger of Bharat Financial Inclusion Ltd (BFIL) with IndusInd Bank during June-July2019[2]. Non-Banking Financial Company - Microfinance Institutions (NBFC-MFIs) are the second largest provider of micro-credit with a loan amount outstanding of Rs. 66,159 crore; whereas Small Finance Banks (SFBs) have a total loan amount outstanding of Rs. 37,282 crore, NBFCs with total loan outstanding of Rs. 21,591 crore and other MFIs account for Rs. 2,395 Cr in the microfinance universe.

In 2010, the Indian microfinance sector had faced a major crisis following a controversial legislation passed by the Andhra Pradesh government[3]. Almost around 35, 000 people lost jobs due to that crisis and significant chunk of money given by banks to MFIs turned bad[4]. The RBI had to form a new category of NBFC-MFIs to tighten rules for the sector. A Sub-Committee of the Central Board of the Reserve Bank was constituted to study issues and concerns in the MFI sector.

Based on the recommendations of the Committee, it was decided to create a separate category of NBFC, viz., Non-Banking Financial Company-Micro Finance Institution (NBFC-MFI) and a detailed regulatory framework for NBFC-MFIs was put in place in December 2011.The income and loan limits to classify an exposure as eligible asset were last revised in 2015[5].

In terms of regional distribution of portfolio (GLP), East and North East accounts for 40%, South accounts for 28%, North holds 10%, West has a share of 14% and Central contributes 8%. The Top 10 states (based on universe data) constitute 82.5% in terms of GLP. Tamil Nadu continues to hold the largest share followed by West Bengal and Bihar.

Chart 1: Regional Distribution of Gross Loan Portfolio (GLP) of MFIs (%) as in February 2020



Source: Microfinance Institutions Network (MFIN) Press release 26 February 2020.

INSTITUTIONAL MEASURES

In an attempt to ease the pain for MFIs and NBFCs (especially for small and mid-sized firms) the RBI on 17 April 2020 announced new Targeted Long-Term Repo Operations (TLTRO) of Rs. 50,000 crore. Banks will have to deploy the funds in investment grade bonds of NBFCs, with at least 50 per cent towards small and mid sized NBFCs and MFIs. Within this, 10% will be invested in securities issued by MFIs. Under TLTRO, banks have to invest in only investment grade bonds of MFIs. However, as on December 2019, only about 25 per cent of MFI bonds are rated AA or A[6]. Further, 25% of MFIN members fall in junk category[7]. Also, as on 23 April 2020, the bid received by RBI is just marginally above 50%; Rs. 12,850 crore against notified amount of Rs. 25,000 crore[8].

SIDBI has launched a liquidity support scheme for micro, small and medium enterprises (MSMEs) impacted by the COVID-19 outbreak[9]. In a Circular published by SIDBI dated 22 April 2020, SIDBI has stated that it had received Rs 15,000 crore from the Reserve Bank of India (RBI) to provide financial aid to MSMEs. To provide liquidity support to MSMEs (impacted due to Covid-19) through MFIs. The scheme would provide resource support to MFIs by way of term loans to ensure operational continuity and promote onward lending to MSME sector. The type of such MFIs and eligibility for the facility is as follows:

- In operations for 3 years.
- Registered as Society, Trust, Company/Section 8 Company, NBFC-MFIs, Co-Operative Society and Mutually Aided Cooperative Societies (MACS).
- Have external rating of (BBB-) or superior (as at 31 March 2020) and minimum MFI grading of "MfR5."
- Promoter/ Entity should not be in RBI blacklist or defaulter list.
- Capital Adequacy Ratio should not be below RBI requirements any time in past 24 months (applicable for NBFC-MFIs).
- Company with appropriate regulatory guidelines.

The loan shall be repaid in bullet installment after 90 days from date of drawl or such date may be decided by the bank. Security should be need-based as per bank's extant norms. Processing Fee is 0.10% of sanctioned amount subject to maximum of INR 5 lakh along with applicable GST.

SELF-HELP GROUPS (SHG)-INSTRUMENT OF TRANSFORMATION

The SHGs are critical because of their socio-economic multiplier effects. The Indian experience demonstrates that some key elements of successful SHGs include formation around `felt-needs' of group members; creation of a common fund by regularly small savings, membership generally based on concept of `some common economic interest'; evolution of structure and byelaws in line with development and maturity of groups; emergence of a disciplined group contributing to collective deliberation and action; loaning mainly on the basis of mutual need and trust with minimum documentation and without any tangible security; usually small amounts, frequent, for short durations and mainly for unconventional purposes; variable rate of interest and creation of confidence building in the target group.

Financial inclusion is an important instrument of empowering people to access social and economic justice. Consequently, a multi-model approach has been adopted since early seventies of the twentieth century. Among the various models, the SHG - Bank Linkage Programme (BLP) has been strikingly successful. With a modest beginning in 1992, this project steadily progressed in terms of number and amount of SHGs financed and refinanced, bank loans disbursed, and so on. What sharply distinguishes the SHGs from earlier approaches is its focus on the credit needs of the poor, whose capacity to save is extremely limited and, thus, induces economic development in an area where it is needed most. The SHGs have significantly empowered women as over three-fourths of the SHGs are managed by women. This model helped extensively to empower the poor, especially rural women, through providing savings and credit windows from banks.

An elaborate network of savings and credit institutions fostered setting up of tiny micro enterprises and consequently generated employment. NABARD’s Livelihood and Enterprise Development Programme (LEDP) has been implemented since 2015 with 532 programmes wherein 61,033 SHG members have been trained.

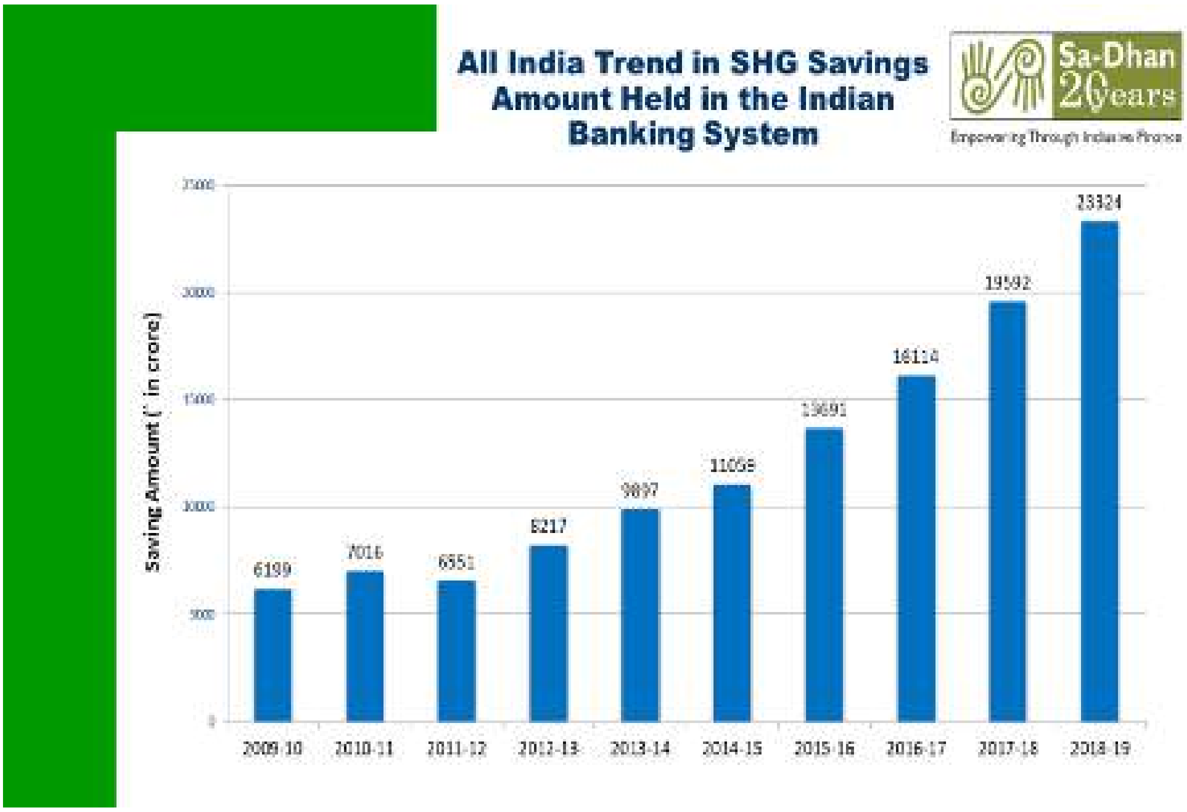
With the active collaboration of NGOs, Banks, the Governments and the NRLM, the SHG BLP has now crossed the milestone of 1 crore SHGs covering more than 12 crore families with savings deposits of R 23,324 crore and more than 50 lakh groups with loan outstanding of over R87,098 crore, of which, 88% was disbursed to rural women groups (up to 31 March 2019).

Apex institutions such as the RBI, NABARD and SIDBI initiated several measures to promote equal participation of women by incorporation of gender concerns in planning, monitoring and coordination of credit. Measures taken to foster wider acceptability of the SHGs include issuance of detailed operational guidelines to banks, conduct of training programmes, monitoring and 100 per cent refinance to banks on their lending to SHGs/VAs/NGOs repayable over three-10 years. The SHGs can be organised in clusters of blocks or districts either by established VAs/NGOs or at the initiative of branch managers of CBs/RRBs/DCCBs. Some of the important mileposts in this area relate to the following aspects:

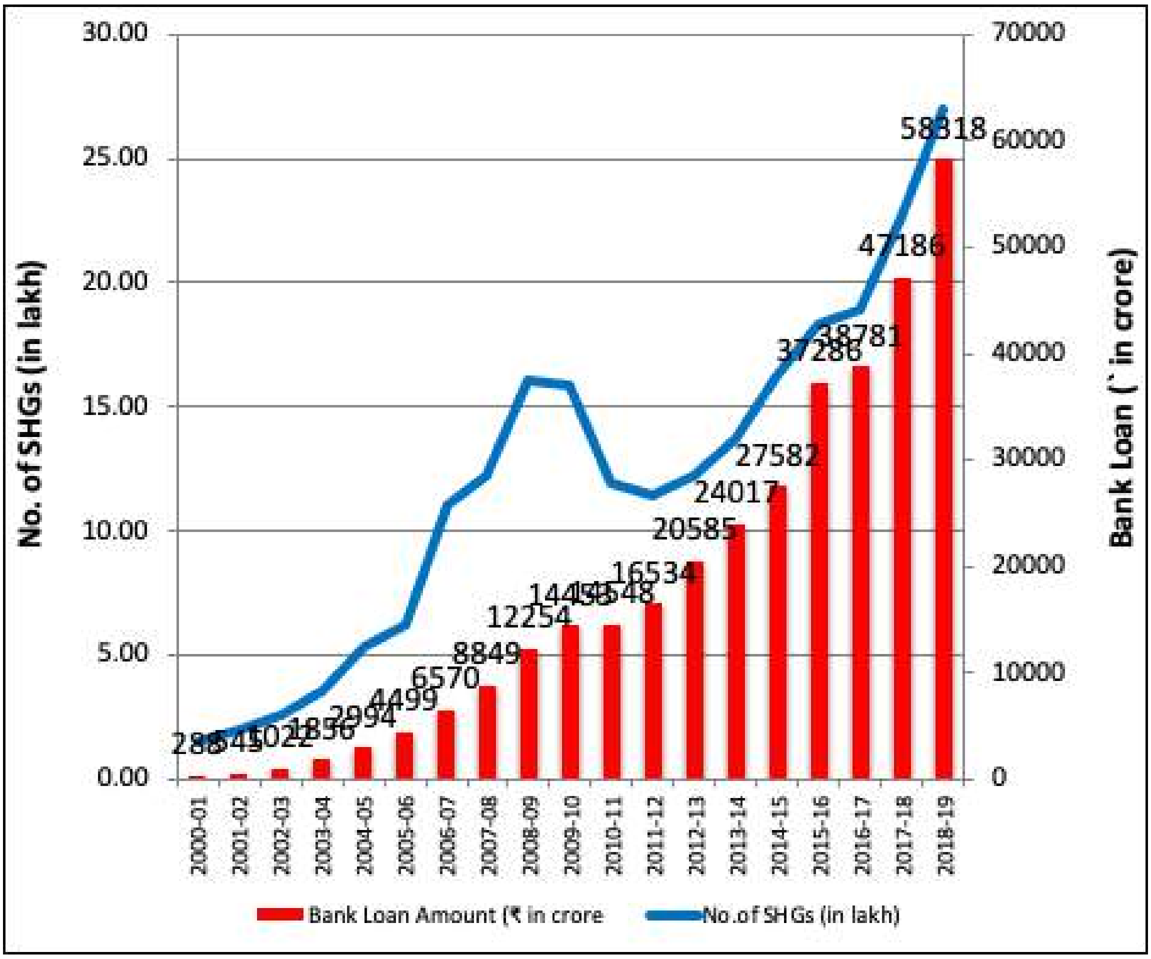
1. The no. of SHGs linked to banks crossed the landmark 1 crore at 100.14 lakhs, a growth of 15%.
2. The SHG savings amount held by banks: ₹23,234 crores, a growth of 19%.
3. 50.77 lakh SHGs have a loan outstanding of ₹87,098 crores, up from 50.2 lakh and ₹ 75,598 cr.
4. Loans disbursed to 26.98 lakh SHGs during 2018-19: ₹58,318 cr , up from ₹47,186 cr to 22.61 lakh SHGs
5. NPA of SHG Loans stood at 5.2%, a decline from 6.1% of last year.

These are contextually significant achievements. But obviously, much more requires to be done in this area in quantitative and even more importantly in qualitative terms.

All India Trend in SHG Savings Amount Held in the Indian Banking System



Historical Trend in Credit Linkage and Bank Loan Disbursed



Source: NABARD

We now need to consolidate the gains of this innovative mechanism and raise the bar to make a real and meaningful difference in the lives of the poor, the women and the marginalized and vulnerable sections of society. Accordingly, we need to address issues of uncertainty in bank loans, smart book keeping, limited adoption of technology and declining advantage of aggregation at SHG level etc.

NABARD's pilot EShakti project launched in 2015 provided an impetus to digitization of SHGs and their operations. This ambitious project is now under implementation in 100 districts and has great potential to deliver various banking services at the doorsteps of SHGs. As on 31 March 2019, more than 4.34 lakh SHGs have been on-boarded in the EShakti portal. This EShakti database is leveraged to bring SHG members under the social security and financial inclusion schemes of the Government of India.

Impressive work has been done in this area. But in the light of the gaps in the programme as brought out by empirical evidence, there is a need to do some course correction to make it more sound, robust and scalable. Given the magnitude of the problem, there is a compelling need for synchronized efforts with a sense of urgency.

INDUSTRY RISK

The lockdown has brought the collection operations of MFIs to a standstill, as most of the loan repayments are still done through cash. As loan officers collect the payments directly from borrowers, the lockdown has put a chill on loan collections. If fieldwork may resume in May 2020 after the lockdown is lifted, a lot would depend upon the zone in which the particular district falls (red, green or orange) based on the severity of the virus outbreak, and much will depend on how collections pan out after the moratorium ends. Concern on liquidity issue is also lingering as while MFIs might extend the option of loan moratorium to their borrowers,the same may not be true from their own lenders.

Small microfinance firms with less than Rs 200 crore loan portfolio each has sought conversion of their outstanding bank loans into equities as their fund dried up, as well as sought fresh loans from banks from running their operation. Moreover, MFIs are likely to face further difficulty in recovering their loans even after lockdown due to erosion of savings of end-borrowers and stoppage of savings.

Loan write-off is a very likely scenario. For instance, during demonetization, the lenders had to defer repayment collection like they are doing now – the NBFC-MFIs had written off anything between Rs 5000 crore and Rs 7000 crore during April-September 2017. The loan outstanding then was about half of its current size of Rs 2.1 lakh crore[12].

Potential risk of heightened credit losses in fiscal 2021 is a crucial risk for MFIs. With the lockdown being extended up to 3 May 2020; and the likelihood of restrictions being lifted only in a phased manner, disruption of income-generating activities of borrowers may prolong. Therefore, how quickly borrowers return to normal repayment discipline once the lockdown is lifted will also be crucial. MFIN is in discussion with market participants regarding certain financing structure to include small and mid-sized firms including pooled bonds[13].

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