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INDUSTRY OUTLOOK

WINDS OF CHANGE IN MICRO FINANCE INSTITUTIONS

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Introduction

Microfinance industry (MFI) is one of the most important paradigms of the Indian financial sector due to its grass-root coverage and its overarching vision of providing credit to the relatively unbanked sections of the society-but by no means un-bankable- thereby creating meaning and value in the lives of the people. It provides an opportunity to small enterprises and people at the lower strata of the society-what Prof. CK Prahlad famously called as the "bottom of the pyramid". This transformative effort constitutes an integral part of the mainframe economics and the well-being of the overall society.

A snapshot of the portfolio outstanding of MFI is given in the table below (Table 1). Banks and NBFC-MFIs account for the bulk share (more than 70 per cent) out of total outstanding portfolio of ₹259377 crore as of 31st March 2021.

Table 1: Portfolio Outstanding (as on 31-Mar-21) of MFI (₹ crore)

Types of Entity	No. of Entities	Unique Borrowers (Cr)	Active Loan Accounts (Cr)	Portfolio O/s (Cr)
NBFC - MFIs	85	2.59	3.69	80549
Banks	13	2.86	4.27	113271
Small Finance Banks (SFB)	8	1.47	1.8	41170
NBFC	53	0.84	0.92	21673
Others	29	0.13	0.15	2714
Total	**188**	**5.93**	**10.83**	**259377**

Source: https://mfinindia.org/microfinance/IndustryPortfolio

As of 30th June 2021, MFI loan portfolio stood at ₹237369 crores serving 5.68 crore unique borrowers with 10.3 crore loan accounts. The results for Q1FY22 show a reduction in the size of the MFI industry provided it is compared with the corresponding figures a year ago. The same is analysed in the table below (Table 2). Gross Loan Portfolio (GLP) as on 30th June 2021 showed an increase of roughly 4.2 per cent year-on-year (yoy) over ₹227727 crores as on 30th June 2020.

Table 2: Portfolio Outstanding of MFI (₹ crore)

Institution/Entity	30-Jun-20	30-Jun-21	YoY Growth
NBFC-MFIs	70819	75021	5.90%
Banks	92675	102405	10.50%
Small Finance Banks(SFB)	39667	38624	-2.60%
NBFC	22219	18730	-15.70%
Others	2347	2589	10.30%
Total	**227727**	**237369**	**4.20%**

Source: Micrometre (Issue 38), Synopsis, MFIN.

From Table 2, it can be seen that as on 30th June 2021, banks held the largest share of the portfolio in micro-credit with a total loan outstanding of ₹102405 crores, which is 43.14 per cent of total micro-credit universe. NBFC-MFIs were the second largest provider of micro-credit with a loan amount outstanding of ₹75021 crores, accounting for 31.61 per cent to total industry portfolio. SFBs had a total loan amount outstanding of ₹38624 crores with a total share of 16.27 per cent. NBFCs account for another 7.89 per cent, and other MFIs accounted for 1.09 per cent.

The top ten states constituted 81.96 per cent in terms of gross loan portfolio (GLP). West Bengal retained its spot as the largest state in terms of portfolio outstanding (₹34587 crore) followed by Tamil Nadu and Bihar (₹35312 crore and ₹26997 crore respectively). Among top 10 states, West Bengal had the highest average loan outstanding per unique borrower of ₹54159 followed by Assam at ₹48697. [1]

Self-Help Groups

The Self-Help Group (SHG) movement is a revolutionary initiative, which connects group members, many of whom had never had a bank account before, to formal financial services in a sustainable and scalable manner. The programme of linking SHGs to banks, SHG-Bank Linkage Programme (SHG-BLP) has helped transform this informal setting into a formal one. The progress of the SHG-BLP is given in the table below (Table 3).

Table 3: Progress of SHG-BLP (Number in lakh/Amount in ₹ crore)

Year	No. of SHG's with Saving Linkage	No. of SHGs who Availed Loan	Amount of Loan Disbursed (₹ crore)	No. of SHG's with Outstanding Loan	Amount of Loan Outstanding (₹ crore)
2018-19	100.14	26.98	58317.63	50.77	87098.15
2019-20	102.43	31.46	77659.35	56.77	108075.1
2020-21	112.23	28.87	58070.68	57.8	103289.7

Source: Status of Microfinance in India 2020-21

As can be observed, the SHG-Bank linkage programme has improved as can be argued since the number of SHG's with saving linkage increased from about 100 lakh to about 112 lakh. However, the amount of loan disbursed dipped in the wake of COVID pandemic. The regional distribution of the savings linkage of the same is given in the figure below (Figure 1). Regional Distribution of Savings linked SHGs was around 5.5 per cent for northern region, 5.5 per cent for north-eastern region, 27 per cent for eastern region, 11.5 per cent for central region, 14 per cent for western region, and 36.5 per cent for southern region from 2018-19 to 2020-21.

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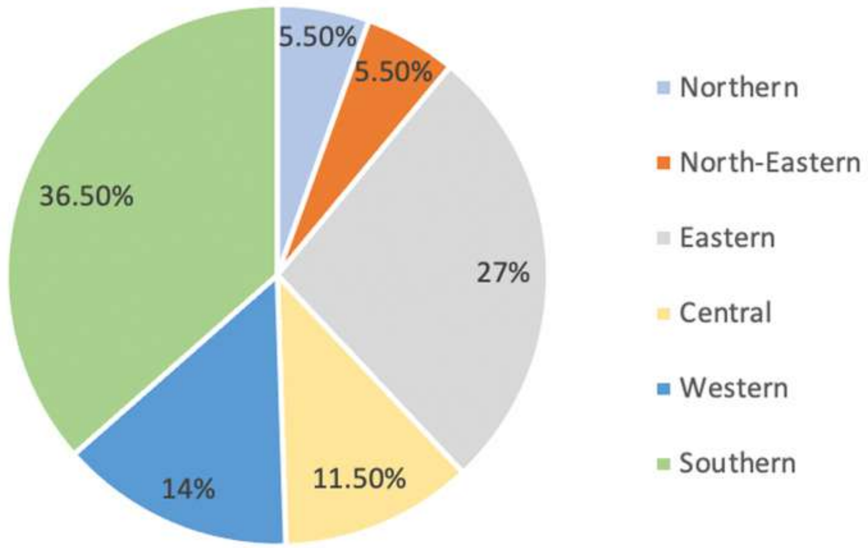
Figure 1: Regional Distribution of Savings Linked SHGs

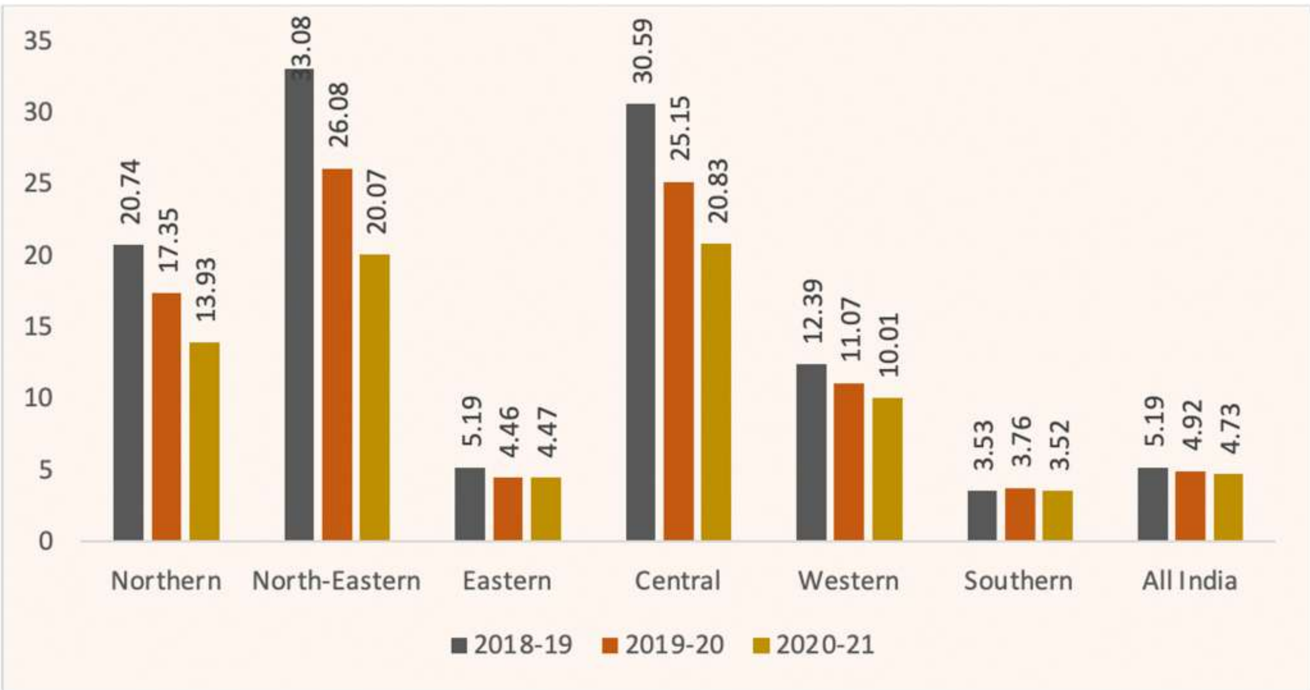


Source: Status of Microfinance in India 2020-21

The SHG programme can also be commended for improved performance since the NPAs as percentage to loan outstanding decreased over the given period (see Figure 2 below). Although marginally, but the path is towards reducing the overall NPAs. The important thing to note is that the Southern and Eastern region, which had the maximum share of SHG loan disbursement and loans outstanding, had NPA level below the All-India level. The reason for concern is the high percentage of NPAs in the Northern, North-Eastern, and Central region which have, however, reduced significantly in the past couple of years.

The All-India NPA as percentage to loan outstanding under SHG-BLP declined from 5.19 per cent in 2018-19 to 4.73 per cent in 2020-21.

Figure 2: Region wise NPA as % to Loan O/s under SHG-BLP



Source: Status of Microfinance in India 2020-21

Institutional Initiatives

Fintech

The COVID pandemic brought to the fore the need for social distancing norms and curb on movement prompted microfinance organizations to explore Fintech solutions to ensure customer safety and ease. Many organizations introduced Apps and services to smoothen the process of credit, for example, Satin Creditcare Network introduced an App – a one-stop solution for the clients for their post-loan services, Muthoot Microfin introduced 'Mahila Mitra', a customer app where customers can pay installments, view loan track, apply for new loans, refer leads, file a complaint etc., SaGgraha Management Services adopted a Collection Management Application which could capture information of 'Promise to Pay (PTP)' date provided by customers allowing employees to follow-up with them.

COVID-19 also propelled organizations to initiate digital collections. Many organizations adopted UPI enabled payments while some went ahead to endorse QR Code based UPI payments, where each branch/collection centre of the organization has a unique UPI QR code which the customers could use to make their loan instalment payments. [2]

Credit Guarantee Scheme for MFIs

Credit Guarantee Scheme for MFIs (CGSMFI) is a scheme to provide guarantee by National Credit Guarantee Trustee Company (NCGTC) to Member Lending Institutions (MLIs) for loans extended by them to NBFC-MFIs and MFIs in the country. The MLIs provide funding to the MFIs or NBFC-MFIs, as per their assessment, for on lending to eligible borrowers. Interest rate on such funding by MLIs is capped at 1-year Marginal Cost Based Lending Rate + 2% pa. This funding by the MLIs is guaranteed by NCGTC to the extent of 75 per cent of amount in default for a maximum period of 3 years. The loan extended to the NBFC-MFIs/MFIs can be for a longer period. However, tenor of NCGTC's guarantee is for a maximum period of 3 years. The scheme is applicable to all loans sanctioned by the MLIs under CGSMFI during the period from issue of the guidelines till 31st March 2022, or till guarantees for an amount of ₹7500 crore are issued under CGSMFI, whichever is earlier. [3]

Promotion of Joint Liability Groups (JLG)

Under its JLG promotion support initiative NABARD extends grant support for formation and nurturing of JLGs to Banks and other JLG promoting institutions. NABARD also extends financial support for awareness creation and capacity building to all stakeholders of the programme and refinance support to those banks which finance JLGs. In 2020-21 a total of 41.27 lakh JLGs were promoted as compared to 41.80 lakh JLGs promoted during 2019-20. Cumulative JLGs promoted figure is at 133.83 lakh JLGs as on 31 March 2021, a net growth of 45 per cent over 2019-20. [4] As on 31st March 2021, the cumulative amount of loans disbursed to JLGs by banks stood at roughly ₹213165 crore, which had increased from about ₹154853 crore as on 31 March 2020, registering a growth of over 37 per cent.

E-Shakti

In conformity with the Government of India's "Digital India" mission, EShakti, a pilot project for digitisation of SHGs was launched by NABARD in the year 2015 in two districts Ramgarh (Jharkhand) and Dhule (Maharashtra) and later expanded to 100 districts across the country during 2016 and 2017. It aims at digitisation of data of all SHGs for enhancing the ease of doing business with SHGs. Beginning with 2 lakh SHGs in 2016 project E-Shakti now covers 12.33 lakh SHGs and is being implemented in 281 districts in the country. [5]

II. Industry Risks

Microfinance Regulation

A major milestone achieved in the regulatory framework in 2011, as based upon the recommendations by the Y. H. Malegam Committee; the RBI introduced a comprehensive regulatory framework for NBFC-MFIs in December 2011. [6] The regulatory framework was placed with the objective of making credit available to low-income households and to protect borrowers from lender's strict recovery practices. However, this is applicable only to NBFC-MFIs, not for all other lenders, (who now have a share of around 70 per cent in the microfinance portfolio) devoid of comparable regulatory conditions, thus the 'level playing field' is getting affected.

Further, it has been observed that small borrowers obtain several loans from quite a few lenders well beyond their repayment capacity, contributing to over-indebtedness, and subsequently the borrowers end up defaulting on their repayment obligations. Therefore, regulations should focus on "repayment capacity of the borrowers" instead looking only the indebtedness from NBFC-MFIs in isolation.

It has been proposed to address the issue of over-indebtedness by prescribing a common definition of microfinance loans, which will be uniformly applicable to all lenders and linking loan amount to household income. The proposal is that the payment of interest and repayment of principal for all outstanding loans of the household at any point of time should not be more than 50 per cent of the household income. [7]

In this context, the recent regulation proposed [8] by Reserve Bank of India (RBI) received a mixed response. According to the consultative document, the overall permissible indebtedness limit is linked to the repayment capacity of the borrower at a household level, i.e., the limit should not exceed 50 per cent of the household income. This is a departure from the current policy, which permits a total indebtedness of an absolute value 1.25 lakhs for rural and 2.00 lakh for semi-urban. This move is likely to reduce the formal credit flow to the borrowers who may then look for informal source for credit. However, the RBI has correspondingly increased the 'range' of loan, which is now supposed to extend beyond 'income generation' purposes to others like repaying money lenders, paying for one's (or one's family's) education, paying medical bills, acquiring property, etc. Finally, the removal of interest rate cap on microfinance loans is the most debated. It is argued to make the market more competitive and promote innovation.

On the contrary, the absence of 'ceiling' opens avenues for abuse as borrowers may be charged disproportionately high interest rates as found in studies.[9] where it is revealed that the borrowers already pay an interest rate as high as 26 per cent. This fact was also recently [10] highlighted by the RBI itself, where it cautioned that chasing asset growth and good returns should not pull the lenders and emphasized that lenders play a critical role in balancing growth and welfare.

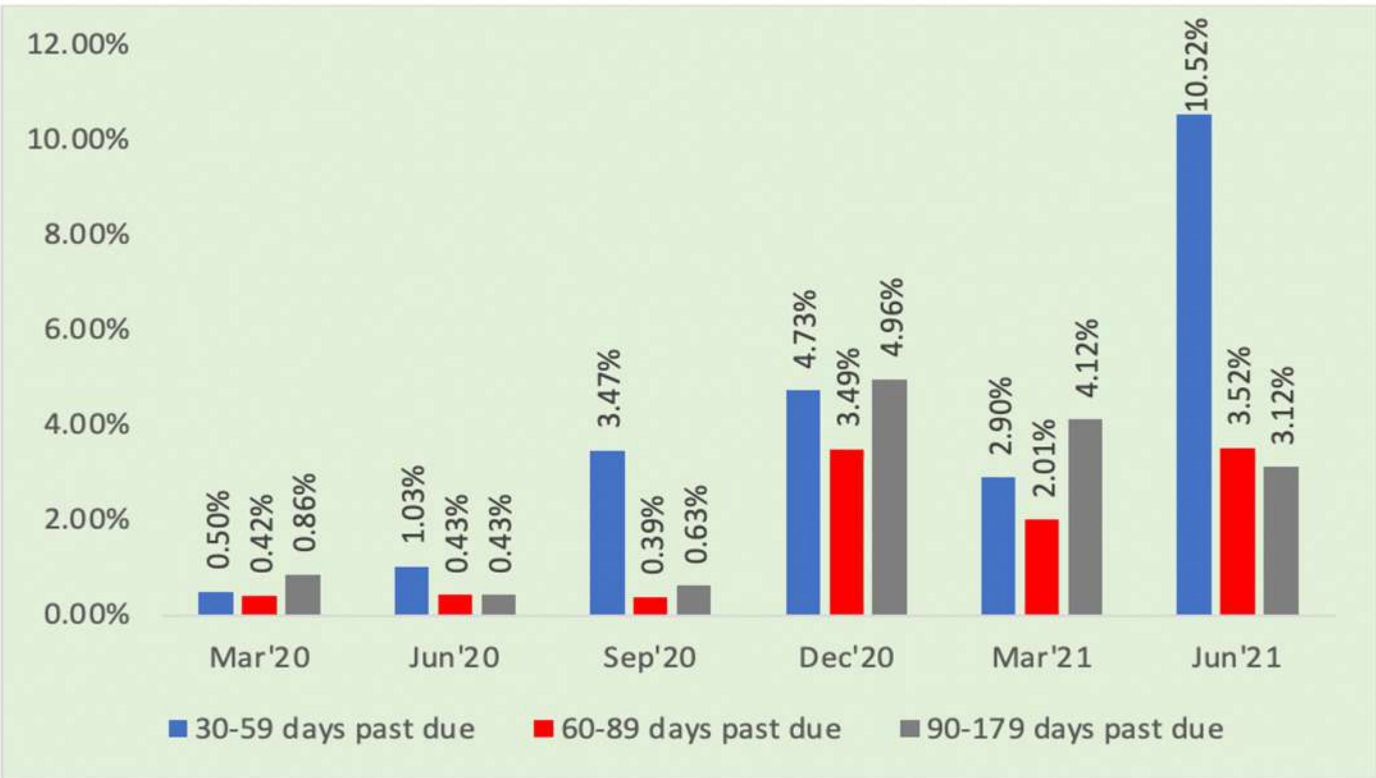
Additional Support under Credit Guarantee Scheme for MFIs (CGSMFI)

Micro Finance Institutions have been demanding an additional support of ₹7500 crore under the CGSMFI that was announced in June 2021, as the initial limit of ₹7500 crore has been exhausted. This additional funding, as argued, would cater to the lower end of the borrowers. The industry has also sought to make a distinction between banks' exposure to them and other non-banking finance companies (NBFCs) since under the current regime, loans are disbursed under NBFCs and once they reach their limit, MFIs are not able to get further loans. [11]

Delinquency and Non-Performing Assets (NPAs)

The COVID pandemic caused havoc to the already marginalised sections of the society, who relied on credit for their day-to-day needs. Those belonging to this group were unable to pay their liabilities as can be supported from the figure (Figure 3) below. The effects of the sudden and stringent lockdown started appearing right from the onset. The delinquency rates started to soar up right from Q1FY21. The magnitude was more in the "30-59 days past due" category where delinquency rate went up to 4.73 per cent till Q3FY21. This delinquency eased to 2.90 per cent by the end of FY21 but shot up to astounding 10.52 per cent in the devastating second wave. The delinquency rate rose in the "60-89 days past due" and "90-179 days past due" category as well. All this goes to show that the repaying capacity of the poor class was severely hit due to the pandemic.

Figure 3: Delinquency Rates for MFI Industry



Source: Equifax Microfinance Pulse, Vol IX - July 2021 and Sa-Dhan Quarterly Financial Report Apr-Jun 2021. Available at https://www.sidbi.in/en/microfinance-pulse-july-2021 and http://www.sa-dhan.net/q-mf-report/

The recent RBI's clarifications on the "Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances – Clarifications" (12 November 2021) for NBFCs is likely to improve prudential lending behavior thus enhancing credit discipline, albeit with a concern that such stringent norms might increase NPAs among especially unsecured, small and microfinance loans. However, stringent acknowledgement of NPAs in a time bound manner is necessary to enhance credit discipline among different categories of borrowers.

An interesting and encouraging example in this regard is that Assam has launched its Microfinance Incentive and Relief Scheme to incentivize those, who are regularly repaying their loans. While the scheme could benefit 24 lakh women beneficiaries in the state, the actual success of the scheme needs to be examined for a holistic assessment. [12] The borrowers who are paying regularly will be provided one-time incentive up to ₹ 25,000 or outstanding balance, whichever is less. This provides an incentive for the borrowers, who make timely repayment with the broader objective of improving and maintaining the good credit discipline.

The Way Forward

With the receding pandemic and festive season boost, the micro finance industry is likely to stabilise in the wake of regained economic activity. However, operating at the grass-root level, it becomes imperative for the regulators to constantly undertake mid-course correction, wherever necessary, in the light of cross-country experience, best practices and nation-wide experiences and enhance the outreach, adequacy and timeliness of credit while reducing the cost of credit. At the current juncture, there is a need to explore an additional relief package for the MFIs under CGSMFI and work sincerely towards increasing credit penetration. Despite augmented size, there are large numbers of people, who still depend on informal credit.

We are optimistic about the future of the industry in the near term given that the economic recovery seems here to stay despite some persisting concerns of supply disruptions, rising input prices, Delta variant and Omicron-virus. But given the sensitivity of the industry, it demands constant endeavours from the regulators in order for the well-being of the industry and millions associated with it. Some moves have been undertaken in improving and incentivising credit discipline in this regard (e.g., Assam's incentive schemes for borrowers, who are repaying timely).

In view of the multi-layered issues at stake, we need to make a careful examination of the reasons for the failure in making prompt repayment of loans and accordingly incentivise the borrowers to make timely payments.

Acknowledgment

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ENDNOTES

1. Micrometer (Issue 38), Synopsis, MFIN.
2. "Fintech Solutions - A boon to the Microfinance Industry for ensuring Customer Safety and Ease", Micro Finance Institutions Network (MFIN), Press Release (24rth September 2021). Available at https://mfinindia.org/NewsEvent/pressreleases
3. "Credit Guarantee Scheme for MFIs", July 2021. Available at https://www.ncgtc.in/en/publications-n-circulars/ncgtc-circulars
4. Status of Microfinance in India 2020-21 by NABARD. Available at https://www.nabard.org/auth/writereaddata/tender/SoMFI-2020-21.pdf
5. Ibid.
6. "The regulations prescribed the eligibility criteria for microfinance loans which was linked to core features of microfinance i.e., lending of small amounts to borrowers belonging to low-income groups without collateral, with flexible repayment schedules. Besides, the regulations laid special emphasis on protection of borrowers and fair practices in lending such as transparency in charges, ceilings on margins and interest rates, non-coercive methods of recovery, measures to contain multiple lending and over-indebtedness." See, "Micro finance: Empowering a Billion Dreams" (Inaugural Address by Shri M. Rajeshwar Rao, Deputy Governor, Reserve Bank of India - October 27, 2021 - at the Sa-Dhan National Conference on "Revitalizing Financial Inclusion") [27 October 2021] https://www.rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1137
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