November 2019

Vision of microfinance in India

Message from SIDBI

The microfinance sector plays an important role in promoting inclusive growth by providing credit to borrowers at the bottom of the economic pyramid. This sector has been instrumental in creating opportunities for low-income households by providing credit access to 64 million[1] unique live borrowers who were previously beyond the reach of traditional financial services.

Currently, this sector has a total loan portfolio worth USD 1.785 trillion and loan disbursal is growing at a rate of 20% in terms of volume.[2] This growth can be attributed to the rapid evolution of regulatory reforms, mass adaptation of UPI-based payments, developments in small finance banks and several initiatives by the government and regulatory authorities.

This sector has been providing huge impetus to the unorganised sector, driving businesses, creating jobs and transforming the lives of millions of beneficiaries. As consumer demand evolves, there has been a transition towards customer-centric products bolstered by robust customer profiling based on lifestyles, personalities, occupations and behaviours for higher adoption. This development has been attained through technology enablement, which has reduced overall turnaround times, operational costs for lenders and credit access costs for the borrower.

Additionally, the microfinance sector has its own set of challenges, ranging from lack of formal credit history, absence of collateral, laborious customer acquisition process, and low digital and financial literacy. There are also risks around customer data protection and data privacy, along with strategic and credit risks, which pose a significant challenge for institutions striving to become sustainable. While the RBI has launched multiple initiatives such as data localisation, a cap on multiple lending, a regulatory sandbox and public credit registry, the microfinance sector is yet to develop robust risk management frameworks as it matures.

Government initiatives play a significant role in channelling the credit flow to underserved sectors through priority sector lending, Micro Units Development and Refinance Agency Ltd. (MUDRA) Yojana, loan co-origination and private sector investments. To supplement these initiatives, steps are being taken to empower women by providing them easy access to credit, assistance in starting their own business and financial literacy programmes. Schemes like Pradhan Mantri Mahila Shakti Kendra are expected to create a conducive environment for women to realise their full potential. SIDBI's Prayaas focuses on supporting small entrepreneurs excluded from traditional financial services. Further, an INR 10 billion fund has been released by SIDBI to boost the microfinance sector. SIDBI has tied up with non-profit organisations and social ventures to channel funds at below market rates to facilitate affordable borrowing.

Against this backdrop, SIDBI, in association with PwC India, has prepared this knowledge report with the aim of highlighting the current status of the microfinance sector and charting its way forward. We hope the issues covered in this report will be discussed and deliberated upon at length during SIDBI's 2nd National Microfinance Congress and that the recommendations provided will enhance the functioning of the microfinance sector in India. I extend my best wishes for the success of the event.

Mohammad Mustafa

Chairman and Managing Director

SIDBI

1 SIDBI Microfinance pulse report, June 2019

2 SIDBI Microfinance pulse report, June 2019

Foreword

In the last couple of years, the microfinance sector has seen promising growth on the back of the rapidly growing Indian economy. The sector has been instrumental in offering formal credit to underserved low-income households and micro, small and medium enterprises (MSMEs), thereby increasing the contribution of these segments to India's overall GDP. In FY19, the microfinance sector displayed 40%[3] growth in terms of loan portfolio. With advancements in technology, development of regulatory policies, new partnerships and launch of diverse products, the sector is expected to maintain the existing level of growth in the near future.

In recent years, the microfinance sector has faced new challenges such as limited access to low-cost funding for microfinance institutions (MFIs), low financial and digital literacy among targeted borrowers, over-borrowing, and the demand for more innovative and customer-centric products. Interventions by the government and the Reserve Bank of India (RBI) have played a significant role in enabling the microfinance sector to reach out to new geographies. The Public Credit Registry (PCR) initiated by the RBI is a step in this direction, aimed at formalising credit and helping the sector conceptualise an optimised underwriting process and make decisions based on critical data points.

Recently, the Government of India has also increased the microlending limit of borrowers to INR 1.25 lakh with the aim of expanding the reach of the microfinance sector. RBI initiatives like co-origination of loans by banks and non-banking financial companies (NBFCs)/MFIs are also expected to mitigate the risk of lending to NBFCs with a major portion of the credit risk borne by the participating institutions.

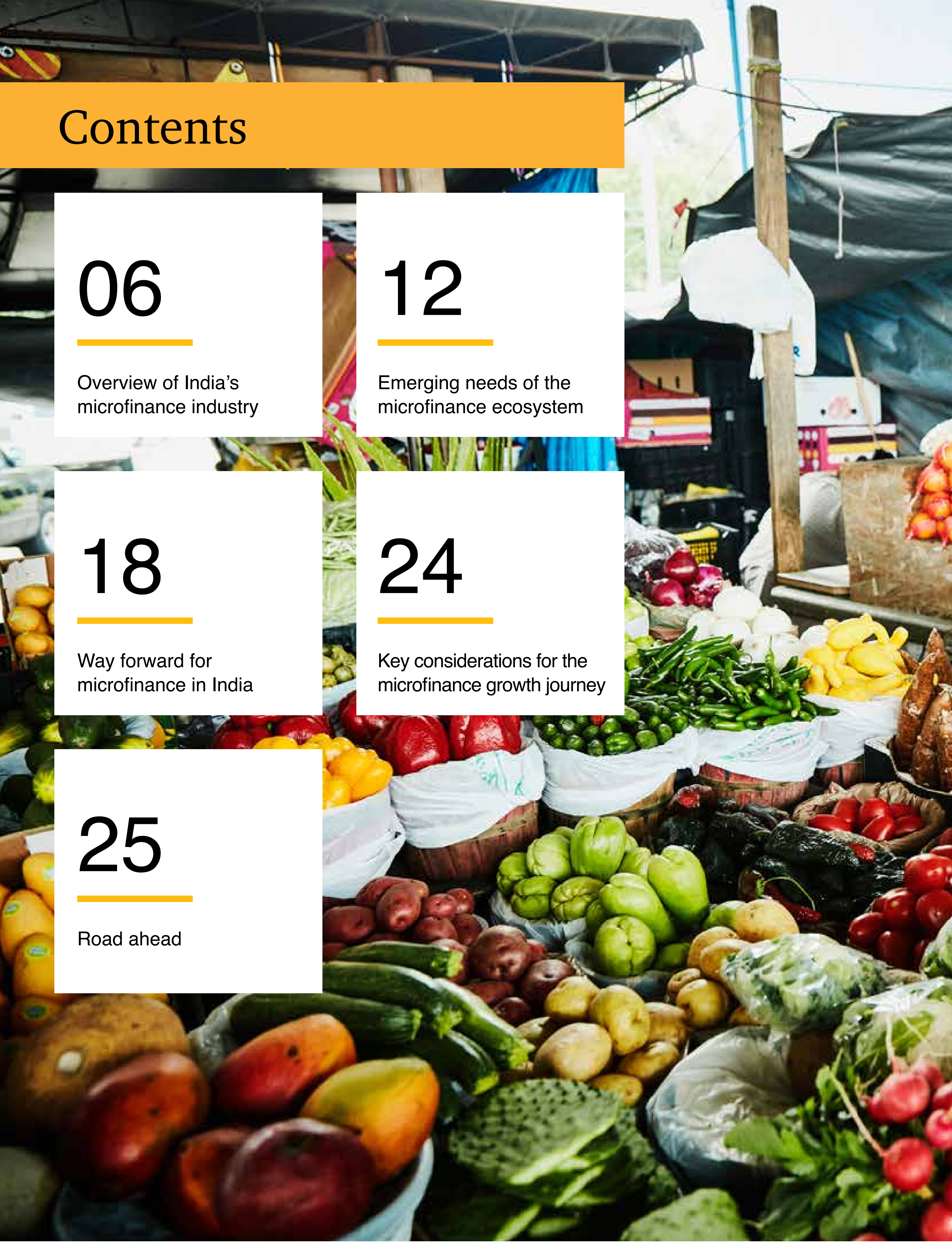
Through this report, we have attempted to understand the evolving needs of the microfinance sector and envision the future of microfinance in India by:

- exploring new investment channels to reduce the overall cost of funds for MFIs through the development of partnerships with corporates, impact investing and other platforms
- developing customer-centric products by analysing shifting consumer demand
- boosting FinTech innovation through controlled testing in a regulatory sandbox, and developing analytics-based underwriting and collection models
- bolstering governance and risk management through revised regulations and technology-enabled solutions
- empowering and assisting women in business and skill development through new products and partnerships.

Microfinance is essential for driving the growth of a large section of the underserved population and bringing an entire array of financial services within the reach of borrowers. Mobilising these new-to-credit borrowers will play a significant role in achieving India's vision of becoming a USD 5 trillion economy by 2025.

We would like to thank SIDBI for bringing this engaging topic into focus and initiating discussions around it. We are also grateful to SIDBI for selecting PwC as its trusted knowledge partner for SIDBI's 2nd National Microfinance Congress.

Asim Parashar
Partner, Financial Services
PwC India



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Overview of India's microfinance industry

Microfinance started as a global movement in the early 1980s to provide credit to low-income households with constrained access to traditional banking. The uncertain regulatory landscape, over-indebtedness of borrowers and lack of an institutional framework have been some of the key concerns for the microfinance industry globally. However, in recent years, the microfinance industry has undergone significant transformation with the creation of self-regulatory organisations (SROs), formulation of structured guidelines, digital interventions and adoption of a redefined customer servicing approach. This has led to a significant boost in the loan portfolio and, hence, the number of borrowers.

Today, the global microfinance industry is worth over INR 8.90 trillion with the loan disbursed amount growing at an average annual rate of 11.5% over the last 5 years[4]. The industry has impacted the lives of 139.9 million borrowers worldwide, 80% of whom are women and 65%, from a rural background.[5]

South Asia is one of the leading markets in the global microfinance industry. It had the largest number of borrowers in 2018 (85.6 million), growing at a rate of 13.8%, which is much higher than that of other geographies. A notable portion of these borrowers are in India. In FY19, the loan portfolio of the Indian microfinance industry has grown at a rate of 40% YoY, with an outstanding loan portfolio worth INR 1.785 trillion and 64.1 million unique live borrowers.[6] This growth has been fuelled by a landscape of diverse microfinance providers and varied microlending models.

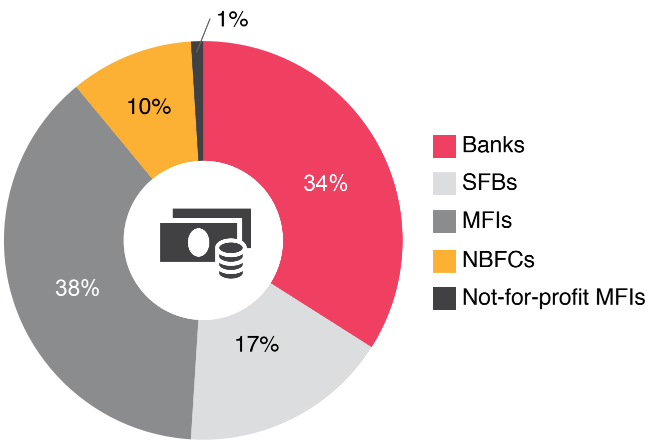
As part of our research on the microfinance industry in India, we conducted two surveys during September–October 2019, designed to understand the issues and challenges faced by the microfinance industry and gain insights into the expectations of the industry. One survey was administered to microlenders such as microfinance institutions (MFIs), non-banking financial companies (NBFCs), banks and non-governmental organisations (NGOs). A total of 85 responses were obtained from senior management (including CEOs, CFOs and managing directors) of 20 organisations (banks, MFIs, NBFCs and NGOs).

The second survey was designed to understand customer sentiments towards the microfinance industry. There were 200 respondents from various small-scale businesses in the transportation, logistics, agriculture, textile and other sectors.

Microfinance providers in the Indian lending landscape

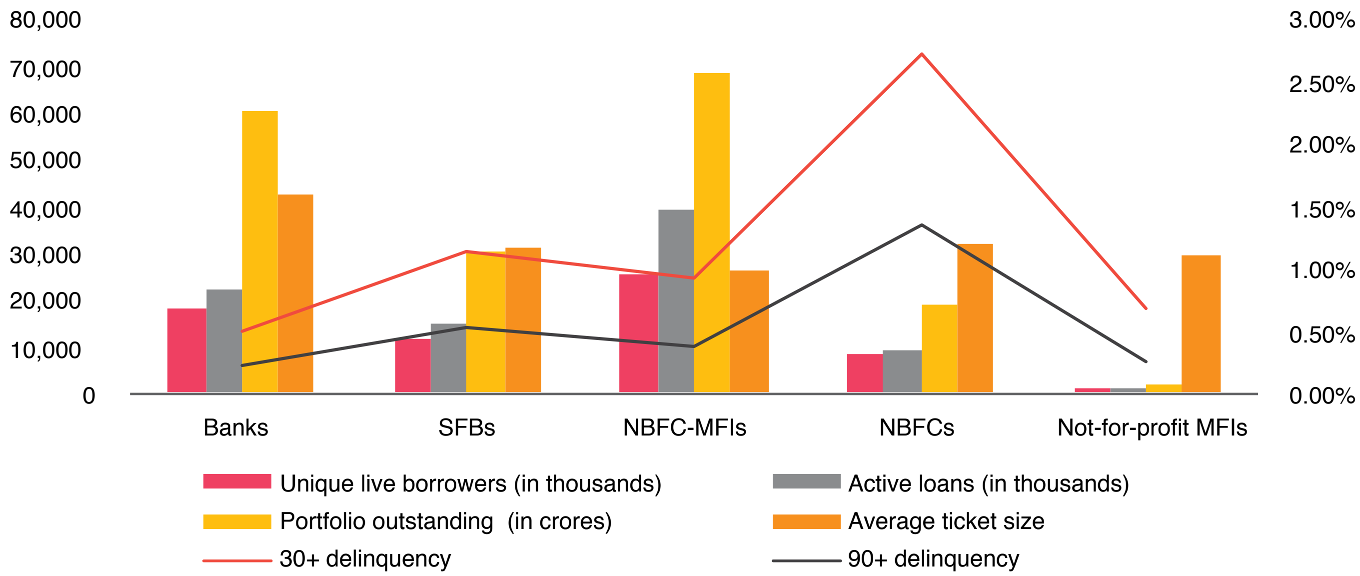
Different players like banks, SFBs, MFIs, NBFCs and not-for-profit MFIs enable microlending in India. MFIs hold the largest share of the loan portfolio, which stands at INR 681 billion and accounting for 38% of the total industry portfolio.[7] This suggests that borrowers are more inclined to take loans from MFIs.

Figure 1: Market share of financial institutions in outstanding portfolio[8]



4 Microfinance Barometer report 2019
5 Microfinance Barometer report 2019
6 SIDBI & Equifax Microfinance Pulse report, June 2019
7 SIDBI & Equifax Microfinance Pulse report, June 2019
8 SIDBI & Equifax Microfinance Pulse report, June 2019

Figure 2: Snapshot of players in the Indian microfinance industry[9]



Among the players in the microfinance landscape, banks have seen stable growth, supported by ease of access to funds, higher loan ticket size and low delinquency ratios. On the other hand, though MFIs hold the largest share of the loan portfolio, their growth is adversely affected due to limited fund availability and high customer acquisition and servicing costs arising from operations in remote geographies. As a result, the rates offered by the MFIs may range from 24% for larger NBFC-MFIs to 35–45%[10] for smaller MFIs, resulting in a structural problem of unaffordability for end customers and large NPAs for microfinance providers.

"Presence of stronger and more effective risk management procedures is our competitive advantage over the smaller ones" – 25% of the CXOs from the larger Microfinance providers

35% of executives from financial institutions have recognised high operating costs as a roadblock in working towards financial inclusion. "

PwC's Microfinance Lenders Survey 2019

9 SIDBI & Equifax Microfinance Pulse report, June

10 https://www.financialexpress.com/industry/why-Micro-finance-and-women-empowerment-go-hand-in-hand/1452759/

Besides banks and MFIs, a key emerging player in the current microfinance space are SFBs, which provide high-ticket loans and thus have an edge over NBFCs and MFIs. In FY19, the average ticket size disbursed per client by NBFC and MFIs was INR 25,850, while that disbursed by SFBs was INR 30,780.[11] SFBs are not constrained by MFI guidelines, which allows them to offer higher ticket size loans. As the market share of SFBs increases from the current 17%,[12] they are expected to penetrate further and provide competitive products to borrowers.

The presence of multiple players with their distinctive strengths and weaknesses has led to a need for a more collaborative approach for higher growth. Taking this into consideration, the RBI issued a circular on co-origination of loans by banks and NBFCs/MFIs in September 2018,[13] which required a joint arrangement between banks and NBFC/MFIs for credit and risk sharing. Co-lending is expected to mitigate the risk of lending for NBFCs, with a major portion of the credit risk borne by the participating bank. The bank is also expected to benefit from the widespread network of the NBFC/MFIs responsible for the sourcing and servicing of loans under this arrangement.

Prevalent microfinance disbursement models

A majority of the microfinance players in the Indian market disburse loans either through the joint Liability Group (JLG) or Self-help Group (SHG) model.

On-tap licensing for SFBs

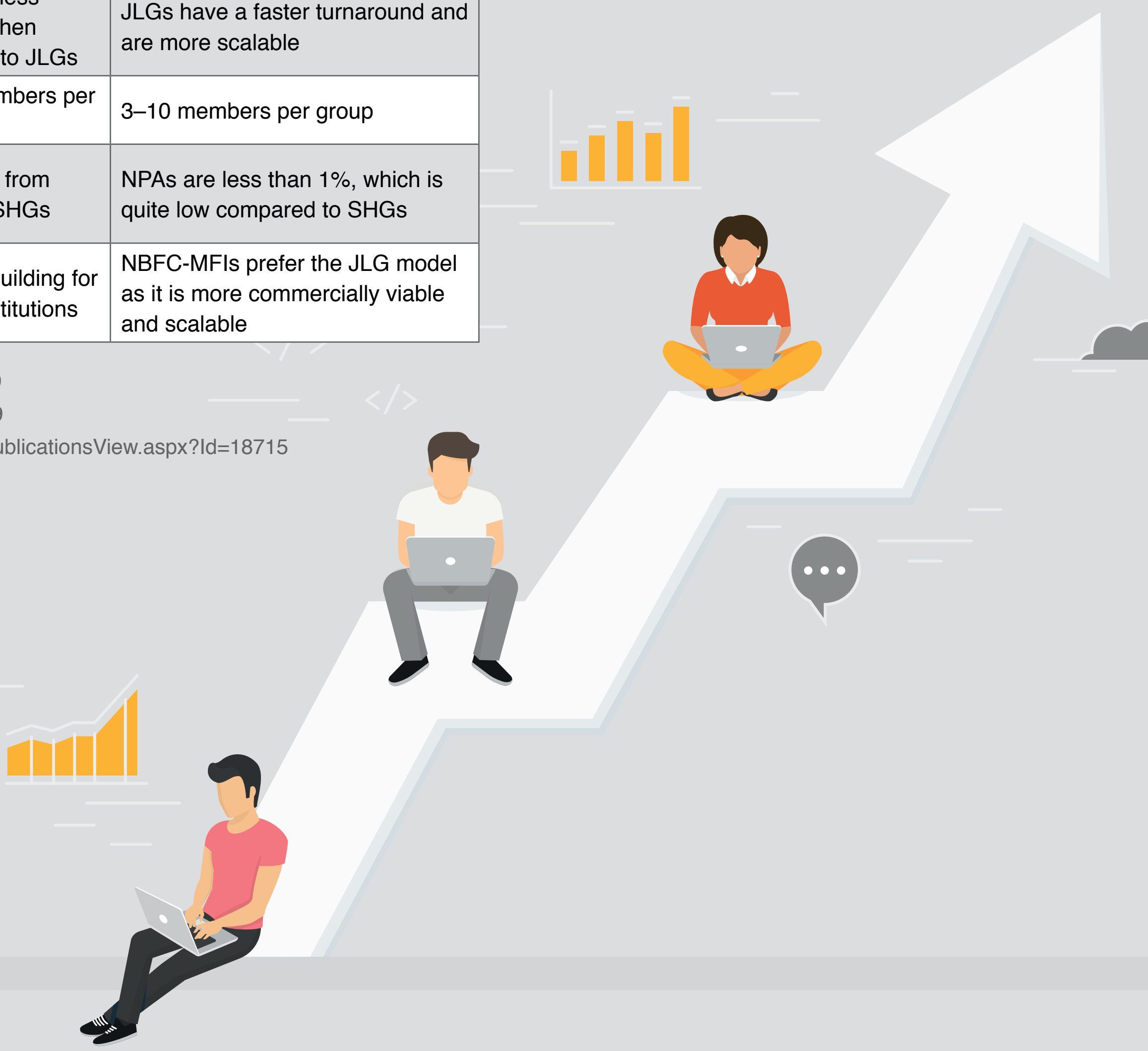
In September 2019, the RBI released draft norms for 'on-tap' licensing for the creation of SFBs. This will allow existing NBFCs, MFIs, payment banks and urban co-operative banks to apply for an SFB license if they meet certain conditions and have a minimum paid-up capital INR 2 billion.

Parameters	SHGs	JLGs
Underlying strategy	Greater focus on savings generation	Greater focus on credit generation
Scalability	SHGs are less scalable when compared to JLGs	JLGs have a faster turnaround and are more scalable
Average group size	10–20 members per group	3–10 members per group
Associated non-performing assets (NPAs)	NPAs vary from 7–8% for SHGs	NPAs are less than 1%, which is quite low compared to SHGs
Future landscape	Capacity building for partner institutions	NBFC-MFIs prefer the JLG model as it is more commercially viable and scalable

11 MSME Pulse report, June 2019

12 MSME Pulse report, June 2019

13 https://www.rbi.org.in/scripts/PublicationsView.aspx?Id=18715



SHG model vs JLG model

The choice of disbursement model depends entirely on the viability of the model and organisation strategy of the institution. With limited funding access, NBFC-MFIs prefer the JLG model which is more scalable – faster turnaround, lower NPAs (<1% compared to 7–8% for SHGs), and joint liability which reduces default risks, thus making it commercially viable to service the increasing customer base. Overall, there has been a 46% increase in the number of JLGs from FY18 to FY19,[14] with SFBs and commercial banks promoting JLGs through MoUs with NABARD. In future too, the SHG share is expected to decline compared to that of JLGs as NBFC-MFIs transition to adopt the JLG model. This is evident from the historical trend of SHG contribution to the total MFI portfolio in select states.[15]

NABARD entered into 7 MoUs with State Bank of India during FY19 which will assist banks in capacity building, training and skill development for financing and nurturing new JLGs through Joint Liability Groups Promoting Institutions (JLGPIs).

Source: NABARD - Status of Microfinance in India, 2018-19

14 NABARD Microfinance report 2018-19
15 NABARD Microfinance report 2018-19

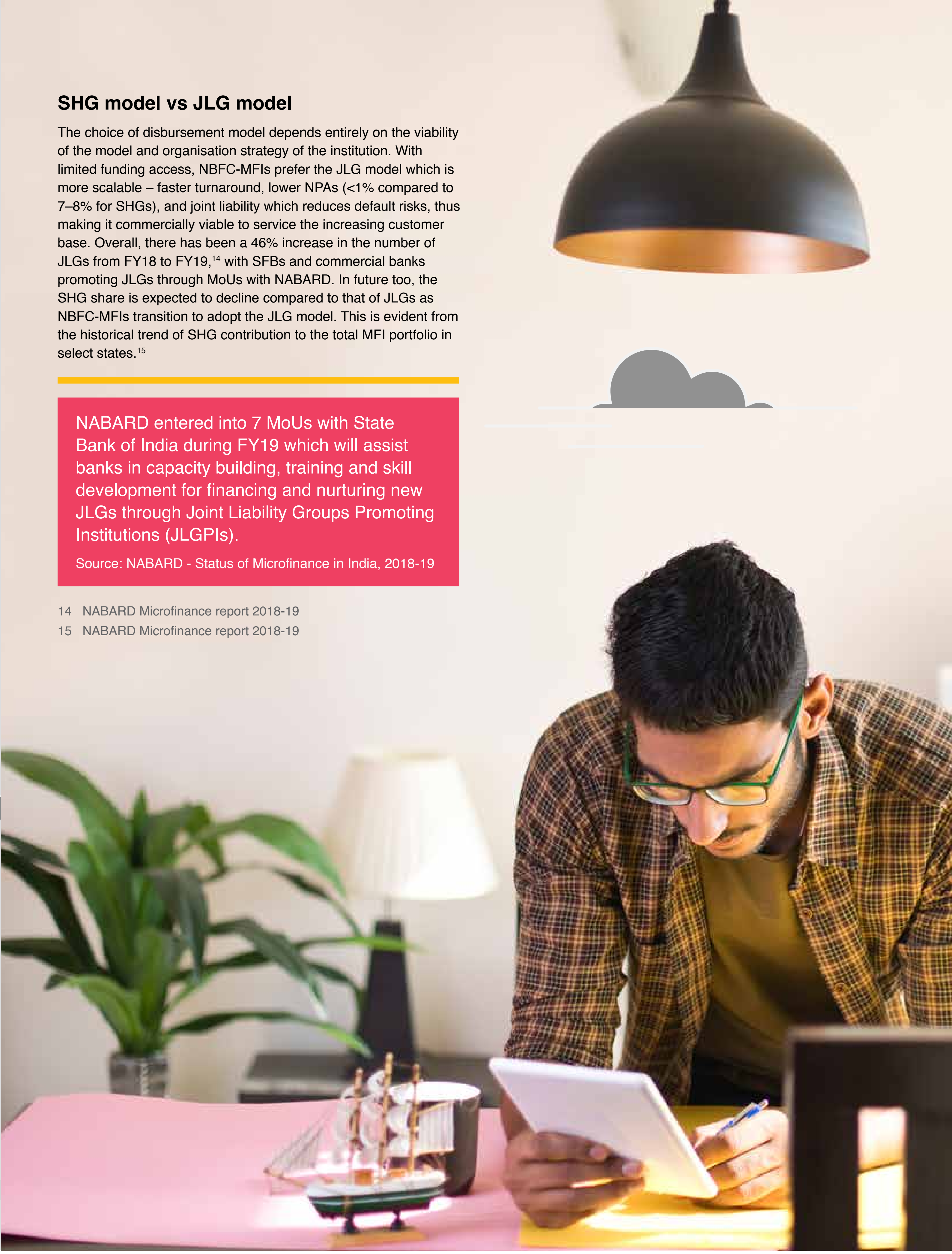
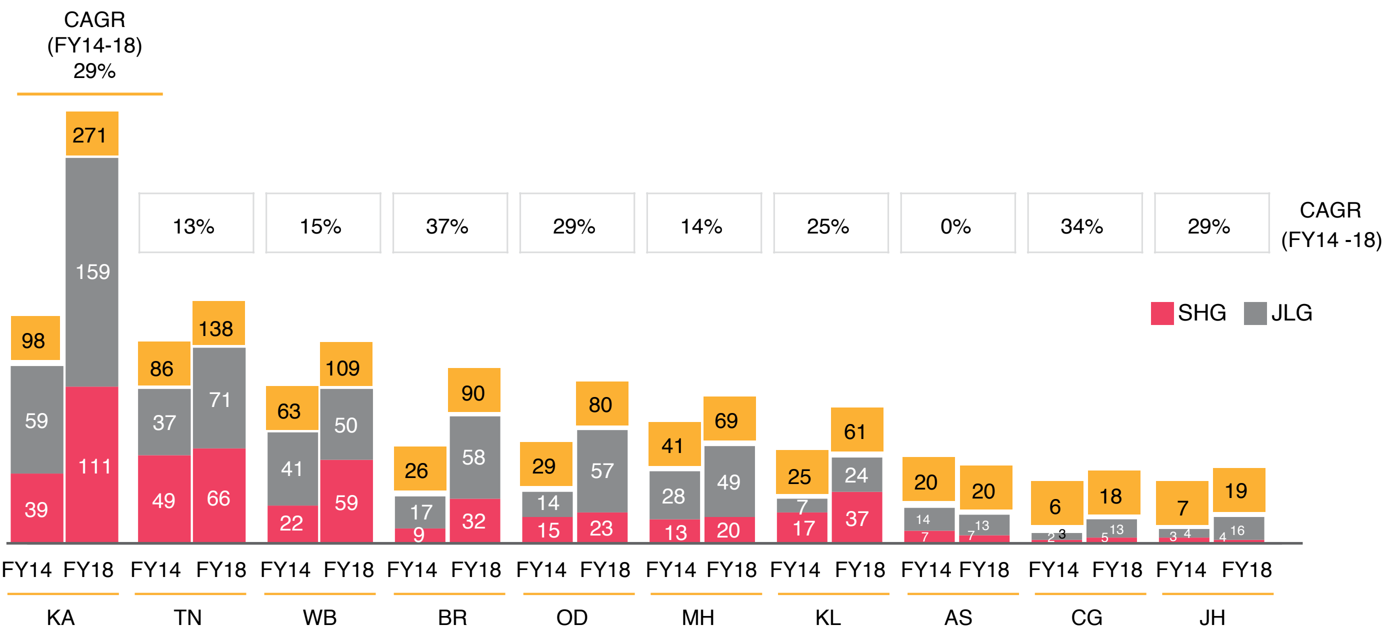


Figure 3: Overall segmentation of MFIs into SHG and JLG (INR billion)



Source: NABARD, Sa-Dhan, PwC analysis

Potential for growth of microfinance in India

Despite the presence of multiple players in the microfinance landscape and mature models of microlending, with a significant portion of its population in the low-income band, India represents a huge opportunity for the microfinance sector. Though government schemes and established financial institutions have enhanced access to microcredit for nearly 67% of the Indian population living in rural areas,[16] the significant geographic concentration of MFIs within a few districts of the country (34% of the districts with microfinance presence contribute 80% of the portfolio[17]) indicates the potential for achieving higher microfinance penetration.

Additionally, a significant portion of the Indian population still lacks access to credit from the formal sector and consequently borrows from informal channels like moneylenders or relatives, indicating the scope of microlending in achieving financial inclusion and overall industry growth.

However, to realise this growth opportunity, it is essential for the sector to identify and assess the emerging needs within the sector and address the same through relevant initiatives for optimised growth.

71% of the financial institutions believe that Eastern India offers the maximum potential for growth in future due to relative saturation in the southern markets.

PwC's Microfinance Lenders Survey 2019

Microcredit should be able to transform the borrower's journey from that of a job seeker to a job creator. As the sector evolves through better regulation and investment flows, there is a need to leverage funds in order to create a sustainable and profitable ecosystem for borrowers. The craftsman should have access to supplies to develop handicrafts along with access to offline and digital platforms to sell products.

16 India Population. (2019-08-28). Retrieved 2019-09-16, from http://worldpopulationreview.com/countries/india/

17 SIDBI & Equifax Microfinance Pulse report, June 2019

Emerging needs of the microfinance ecosystem

Sustainable growth of the microfinance industry is dependent on the bridging of the inherent ecosystem gaps and identification of prospective needs to create a robust microlending landscape.

Availability of alternative capital funding channels

In FY19, NBFC-MFIs received a total of INR 357.59 billion[18] in debt funding from banks and other financial institutions. This is a 63% increase from debt funding of INR 219.67 billion in FY18. While large MFIs source around 69% of their debt from banks, medium and small-sized MFIs source a majority of their debt funding from other financial institutions. As the microlending market grows, the need for venturing into new investment channels increases, especially for smaller MFIs with lower credibility and a smaller product portfolio. Additionally, high dependence on debt capital exposes smaller players to risks arising from external factors, affecting the overall market liquidity and emphasising the need to explore new and reliable business models for capital generation.

This funding gap paved the path for peer-to-peer lending, which has been heavily regulated by the RBI to prevent any systemic risk to the economy. High risk of subprime borrowers, high default risk and a poor network of borrowers and lenders have played a major role in impeding the growth of peer-to-peer lending.

Alternative investment channels and new business models can provide microlenders with access to cheaper capital, thus creating opportunities for a better gross loan portfolio, increased customer reach and enhanced products and service offerings.

53% of the executives of financial institution's believe that access to affordable funding will enable them to move towards a sustainable business model.

26% of the executives believe that in addition to other factors, adopting a different business model like the business correspondent model can help the organisation achieve sustainable growth.

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Customer centricity

The central theme for microfinance has always been uplifting the lives of low-income households in rural and semi-urban markets. Currently, the microfinance industry has a presence in 619 out of 722[19] districts in India. Loan disbursal has increased by 20%[20] in terms of volume in FY19 compared to FY18, with an average ticket size (ATS) of INR 31,623, which is a 13% increase on Y-O-Y basis.[21] This growth in microfinance has impacted more than 120 million households through 10 million SHGs and 5.07 million JLGs.[22]

Tapping this opportunity and achieving financial inclusion call for the evolution of the microfinance industry in terms of tailoring products and services to the changing needs and repayment capacity of customers. As the consumption patterns and living standards of borrowers change, credit demand will soon encompass consumption-based needs such as children's education fees, marriage funds, and medicine and hospital fees. Staying relevant by addressing these customer needs requires data-based analysis of customer economics and personas with a focus on tracking credit utilisation in order to develop hyper-personalised service and product offerings.

Further, overall financial inclusion can only be achieved by increasing ease of access and financial literacy.

Microfinance players must analyse the overhead costs associated with accessing financial services, such as those related to obtaining information about the services, applying for loans, transportation costs for loan repayments and tracking debt, and ensure that their product and service offerings are able to create sufficient returns for the borrowers on the incurred costs and efforts.

60% of borrowers have indicated a preference for taking microloans from MFIs compared to banks and other financial institutions.

Approximately 30% of the borrowers claim that their preference for MFIs and NBFCs was due to instant access to credit. Though interest rates play a significant role in the choice of a financial institution, around 20% of MFI and NBFC borrowers also cite flexible repayment schedules as a major decision parameter, indicating their willingness to take credit at higher interest rates in their hour of need.

PwC's Microfinance Borrowers Survey 2019

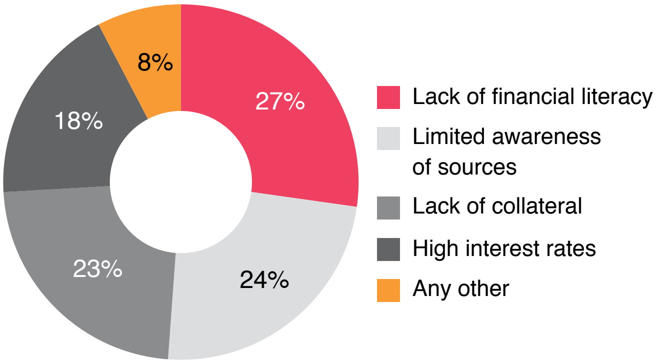
19 http://www.goidirectory.gov.in/district.php (last updated on 26 September 2019)

20 SIDBI Equifax Microfinance Pulse report, June 2019

21 SIDBI Equifax Microfinance Pulse report, June 2019

22 NABARD Microfinance report 2018-19

Figure 4: Challenges in accessing credit from the formal sector



Among the respondents taking credit from informal channels, a high percentage (>50%) have cited lack of financial literacy and limited awareness of financial sources as challenges in accessing credit, emphasising the opportunity for microfinance growth through relevant awareness initiatives.

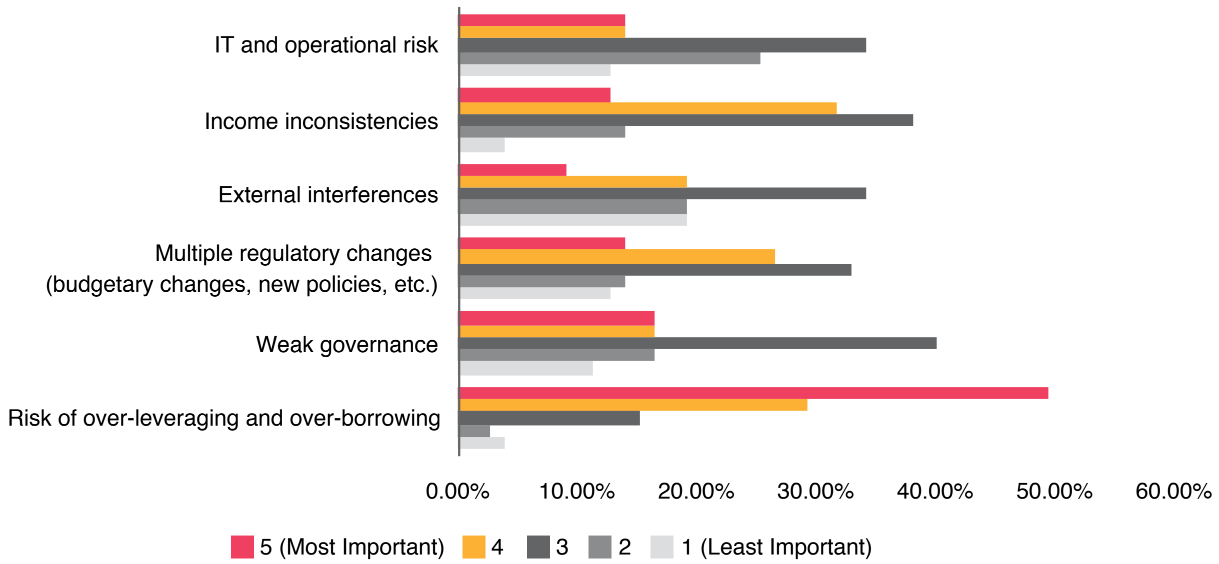
PwC's Microfinance Borrowers Survey 2019

Mature risk and regulatory landscape

The microfinance industry is currently in a growth phase, with a high dependency on macroeconomic factors and shifting consumer demand. As the industry grows, associated risks will manifest itself in the form of fraud, credit risk, security, asset and liability risks and inefficiency, which will demand efficient portfolio management and fraud management by lenders.

This underlines the importance of RBI regulations to empower the industry and create a healthy and competitive environment and provide the momentum to push the industry towards a stable and sustainable position.

Figure 5: Risks in the microfinance landscape

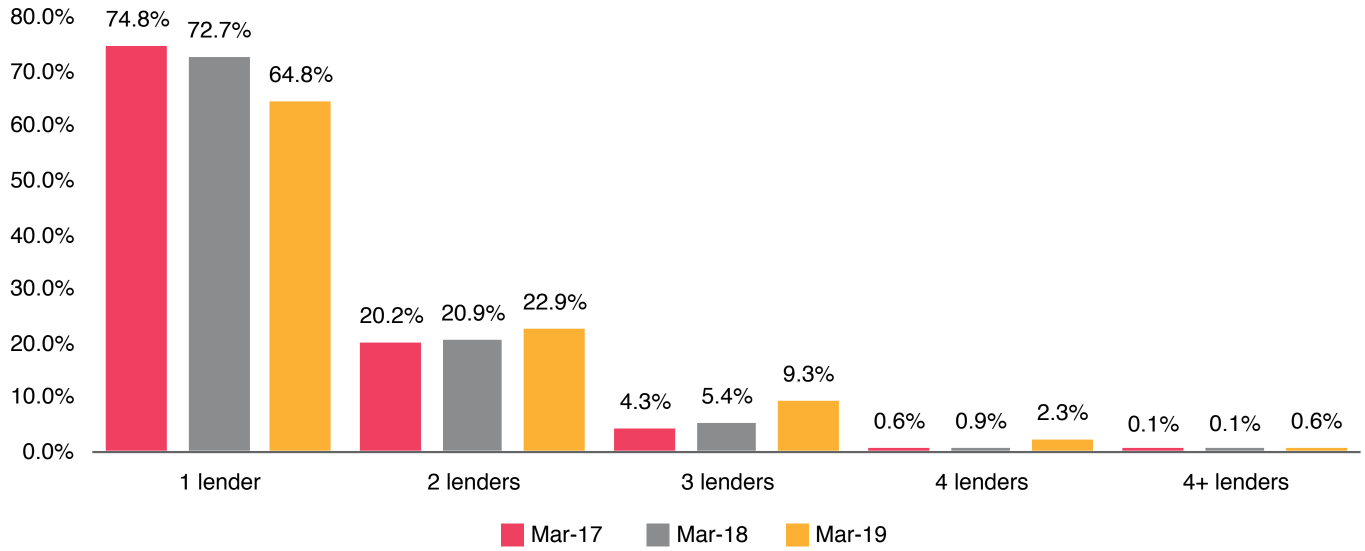


Majority of the financial institution's executives recognise over-borrowing (79%), regulatory changes (41%) and income inconsistencies among borrowers (44%) as the most important emerging risks in the financial landscape, emphasising the need for a mature regulatory landscape and preparedness on the part of financial institutions to manage these risks.

PwC's Microfinance Lenders Survey 2019

Figure 6: Over-borrowing pattern in microloans[24]

One of the major risks in microlending has been the issue of overborrowing, with nearly 35% of the borrowers having access to two or more lenders.[23] With the increase in borrowing and the advent of new-to-credit borrowers, the concern around maintaining a stable NPA ratio is natural.



Consequently, achieving a sustainable NPA ratio has been the top priority for regulators, the government and financial institutions, with various guidelines being launched in recent years to control NPA=-related issues like overborrowing and aggressive lending. An RBI notification published in Feb 2018 played an important role in stabilising the NPA ratio for individual microcredit borrowers at around 2–2.3% compared to 8–14% for loans to commercial entities in Sep 2018.[25] As per the notification, MSME entities were to be tagged as NPAs 180 days from the date of the first default, instead of 90+ days.

In order to address the need of a stronger regulatory framework, the RBI has also formulated regulations for priority sector lending to boost microcredit access to sectors like agriculture and MSMEs.[26] The impetus provided by the regulation has resulted in financial institutions lending beyond the prescribed limit of 40% of the adjusted net bank credit in the priority sectors.[27]

Figure 7: Achievement of priority sector lending targets[28]

End March	Public sector banks	Private sector banks	Foreign banks
2018	20723	8046	1402
	(39.90%)	(40.80%)	(38.30%)
2019	23060	10190	1543
	(42.55%)	(42.49%)	(43.41%)

23 CRIF High Mark
24 CRIF High Mark
25 MSME Pulse report, December 2018
26 https://www.business-standard.com/article/finance/banks-fail-to-meet-priority-sector-lending-targets-overall-rbi-data-119010300054_1.html
27 RBI annual report 2018-19
28 RBI annual report 2018-19

Streamlined operations of customer-facing personnel

Customer-facing personnel like loan officers play a critical role in acquiring new customers, selling products and providing training to borrowers. However, absence of a robust technology infrastructure, lack of proper training and high operational costs hinder the earning potential of the personnel in remote areas, resulting in higher attrition. Additionally, lack of a robust operational framework results in limited transparency in the personnel's operations, consequently affecting customer service. Such a scenario emphasises the need for streamlining the operations of customer-facing personnel through extensive use of technology to ensure customer acquisition backed by relevant data insights.

52.4% of the executives of financial institutions believe that loan officers are the most important influencer in the customer journey, thus emphasising the need for empowering them for higher business growth.

PwC's Microfinance Lenders Survey 2019

Shared Agent Banking System (SABS), Uganda

SABS has been created as a joint venture between Uganda Bankers' Association & Eclectics International to enable centralised connectivity among financial institutions in order to provide easy access to customers at any bank.

Source: https://agentbanking.co.ug/

Robust credit risk assessment mechanisms

Given that a majority of borrowers are from low-income households, they often do not have a credit history which creates challenges in developing efficient underwriting processes and collection models. Lack of comprehensive data on customers, decentralised information sources and dependency on borrowers for data disclosure hinders the development of customer credit profiles. Further, lack of standardised data also impedes functioning of fraud management and the NPA monitoring systems with direct implications on compliance costs and the credibility of the organisation.

Extensive collaboration is needed between credit rating agencies, government bodies and microlenders to create holistic customer credit profiles for better analysis of current trends and understanding customers' borrowing behaviour.

37% of the executives of financial institutions highlight limited access to customer information as a hindrance in serving the unserved, thus underlining the need for a comprehensive customer profile.

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Risk management in Accion Microfinance, Nigeria

Accion Microfinance (MfB), along with its advisory team, has built credit scoring algorithms using behavioural data and sociodemographic data. This has helped in reducing the portfolio at risk to half and doubling the number of renewed loans per loan officer. They have also developed separate scoring systems for new and existing clients and developed business ranking tools to segment clients based on their industry and financial health.

Source: https://www.accion.org/accion-microfinance-bank-adopts-risk-management-systems-in-nigeria?utm_source

Technology enablement for the 'high-touch' industry

While there is a transition towards use of technology for improvement of transactional processes, the need of the hour is to leverage technological solutions to build stronger customer relationships and empower existing customers. Technology interventions should be able to provide doorstep services to customers while bringing down the overall turnaround times, operational costs for lenders and credit access costs for borrowers. The same should be enabled by having a robust customer data protection programme in place and strict privacy norms for maintaining the organisation's transparency on customer data usage and process credibility.

Women empowerment and the emergence of an entrepreneurship-driven landscape

With approximately 85% of the microfinance borrowers being women, there is a pressing need to provide them access to credit, access to information, rights to financial decision-making and assistance in varied entrepreneurial pursuits. Women-driven entrepreneurial enterprises will not only ensure regular repayments for microfinance lenders, but will also establish a strong influencer channel in the form of women entrepreneurs for higher credit penetration. Additionally, financial empowerment of women will also enable them to make financial choices for other consumption-based needs of their households, thus resulting in overall business growth for microfinance players.

32% of the executives of financial institutions believe that FinTech partnerships can provide financial institutions the required technology innovations for higher value delivery to borrowers.

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Way forward for microfinance in India

Amidst the emergence of diverse needs of the microfinance ecosystem, sustainable growth of the industry is dependent on transformation initiatives centred around effectively improving the stakeholders' experience and managing overall operational efficiency.

Affordable borrowing for one and all: Easy access to microcredit

Availability of credit is of paramount importance to retain and service microfinance customers. To encourage more borrowing among customers and stimulate the slowing Indian economy, RBI has increased the lending limit for low-income borrowers from INR 1 lakh to INR 1.25 lakh[29] and also increased eligible income limit from the current level of INR 1 lakh per annum for rural areas and INR 1.60 lakh per annum for urban/semi-urban areas to INR 1.25 lakh and INR 2 lakh, respectively. This increase in lending limits, supported with new investment channels and changing business models, will support holistic growth of the microfinance sector.

New investment channels: Microlenders are majorly dependent on commercial banks for debt and equity funding. The sector must develop partnerships with private donors like foundations, NGOs, development agencies, venture capital and social impact investing through corporate social responsibility (CSR) funds, global trust funds and other financial sources. In FY18, INR 17.17 billion of the CSR funds of NSE-listed companies were left unspent.[30] The microfinance industry can develop partnerships with private corporations to channel unused CSR funds for enablement of the industry. Regulated platforms for these partnerships will help in improved channelling of funds. The retail bond market can also be leveraged by microfinance players for long-term benefits. Funds from the retail bond market can be utilised for setting up financial training institutes and creating kiosks for women's development to help assist the microfinance industry. Creation of funds in line with India Microfinance Equity Fund (IMEF) will create an investment corpus for microlenders to access. Microlenders can easily access the funds and encourage the onset of an entrepreneurial mindset and culture and upskilling of existing labour, thereby contributing to the country's overall economic growth. Additionally, alternative investments are expected to develop strong network effects to channel more private/public investors in the microlending industry, thus providing the much-needed impetus for growth.

Microlenders could explore new-generation fundraising options like social impact bonds (SIBs), to access low-cost funds. Institutions with access to low-cost funds may consider channelling these funds to micro-borrowers through well-regulated intermediaries, like the Prayaas initiative by SIDBI. Additionally, alternative investments are expected to develop strong network effects to channel more private/public investors, thus providing the much-needed impetus for the microlending industry to grow.

New business models: The need to conserve capital for lowering dependence on external funding has led to the emergence of new business models for smaller MFIs. These smaller MFIs, while lending on their own books, are aggressively evaluating business correspondent (BC) models to source on behalf of larger banks and NBFCs, which would limit the risks of raising capital for them. These institutions generate fee-based revenue through sourcing of loans for larger banks. In return, they forgo interest-based revenue that could have been generated by sourcing their own loan, which comes with its own risk of overborrowing and NPAs. Microlenders needs to evaluate their risk appetite and need for funds and wisely choose the business model that would help in ensuring sustainability.

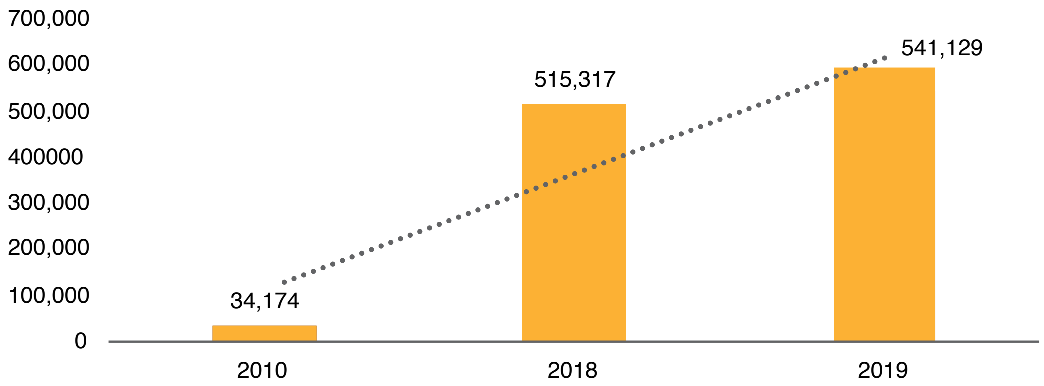
"This (working as a business correspondent) is the best way to optimise capital and the only option for smaller MFIs that lacked it. When raising capital turns difficult, it's better to grow your off-balance sheet exposure through a banking partnership and survive."

A leading Indian MFI with operations spanning 10+ Indian states

29 https://economictimes.indiatimes.com/small-biz/sme-sector/rbi-increases-income-loan-limits-for-nbfc-mfi/articleshow/71436171.cms

30 https://www.moneycontrol.com/news/business/no-takers-for-rs-1717-cr-of-csr-funds-in-fy18-report-3226411.html

Figure 8: Number of BCs in villages[31]



Reaching the doorstep of every unbanked customer

Awareness on microcredit generation, access to income generation and facility to benefit from government schemes define the true reach of financial services. As microcredit disbursement evolves, it strives to reach the underserved segment not only through direct access to credit but also through access to innovative products that would improve the unbanked population's standard of living. The National Strategy for Financial Inclusion (NSFI) for 2019-24 has been prepared by the RBI to ensure safe and transparent access to financial services for all the citizens. This is expected to expedite financial inclusion and tackle the issues of low literacy rates, lack of awareness, high interest rates and poor access to technology infrastructure.

Customer-focused product and service offerings: Financial inclusion is not limited to merely individuals having access to bank accounts. It is their ability to access a myriad of relevant financial products and services that are aligned to the changing dynamics of the target market. microfinance players should look to provide curated financial products which are focused towards individual needs like crop insurance and equipment leasing facilities with repayment terms catered to specific agricultural growth and output cycles.

Microinsurance, for instance, is expected to cover a multitude of risks, including natural risk and calamities, credit risk, market risk and health risks. Similarly, customised health financing products can include micro health insurance, access to subsidised medical products, and awareness of service providers' network.

The transition towards customer-centric products and services should be enabled by robust customer profiling based on lifestyles, personalities, occupations and behaviours for higher adoption. The resultant access to diversified products can enable borrowers to expand their income capabilities and avert risks of over-borrowing.

Last-mile access: Multiple government schemes, private and trust fund initiatives have been promoted to provide and measure the access of financial services to needy individuals. In September 2018, the Ministry of Finance, Government of India, launched the Financial Inclusion Index to measure access to, usage and quality of financial services.[32] Additionally, Jan Dhan Darshak, a mobile app, has been launched by the Department of Financial Services (DFS) to help people locate relevant financial services in their vicinity. In order to provide last-mile services in unpenetrated geographies, microfinance players can look to leverage government initiatives and enter into new partnerships to drive financial inclusion efforts.

Additionally, BCs can play a pivotal role in providing customers access to financial services and enablement through self-regulatory organisations. They can help in streamlining their functioning by providing standard operational guidelines. In addition to this, interoperability of agents among microfinance players and leveraging the pre-existing distribution infrastructure through corporate partnerships with FMCGs, logistics and manufacturing companies can further help in expanding the customer reach. A two-tier 'Train the Trainers' programme[33] was designed and rolled out in March 2019, as part of the RBI's initiative to build the capacity and skills of BCs for effectively delivering financial services at the grass-roots level. The programme on financial literacy will sensitise the counsellors of Financial Literacy Centres (FLCs) and rural banks' branch managers, enabling them to deliver basic financial literacy at the ground level.

31 RBI Annual report 2018-19

32 https://pib.gov.in/newsite/PrintRelease.aspx?relid=183683

33 RBI Annual report 2018-19

Further, private institutions can partner with local government bodies or government-sponsored institutes like Rural Self-Employment Training Institutes (RSETI) to provide financial literacy. Trained personnel from these institutions can assist borrowers in creating accounts, accessing government savings and insurance schemes.

The knowledge sharing among borrowers can be further driven by field agents who can be trained to enhance their analytical skills, technology skillset, and awareness of regulatory mandates and latest product offerings. The field agents should have access to robust technology and extensive data to advise borrowers on the best-suited financial products and any credit-related issues that they encounter.

Higher approachability of field agents should be ensured to overcome the reluctance of borrowers. A key initiative in this direction could be leveraging of SHGs as agents. Eighty-five percent[34] of the SHGs are made up exclusively of women. Members from such previously existing groups can be employed as part-time or full-time field agents, as per the business needs.

These influencers can enable higher lead generation by reaching out to women borrowers who earlier could not be reached due to lack of awareness and sociocultural barriers.

FINCA-mobile partnership, Tanzania

FINCA International partnered with Vodafone, Airtel and Tigo to leverage their large agent networks to provide FINCA's low-income clients with convenient and affordable access to various financial services. FINCA was able to reduce its operational cost to INR 35.89 per transaction via mobile as compared to INR 61.01 for FINCA agents and INR 86.85 at FINCA branches.

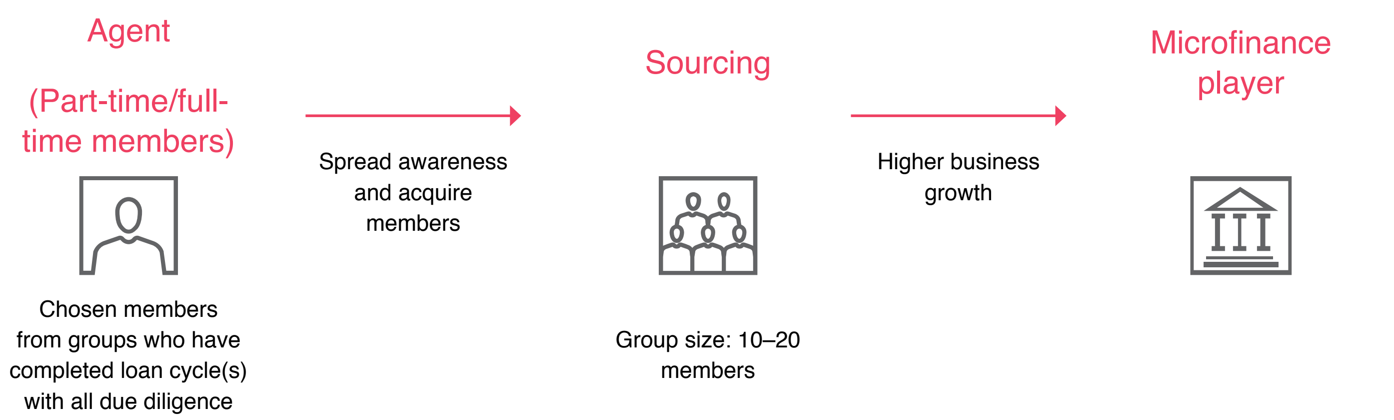
Source: AFI special report on 'Digital transformation of microfinance and digitization of microfinance services to deepen financial inclusion in Africa', August 2018

43% of the executives of financial institutions have recognised that people known to borrowers through family and friends or community influencers are the most influential people in a customer's borrowing journey.

More than 70% of the executives have acknowledged the high importance of providing easy access to financial services and creating financial awareness in encouraging borrowers to approach formal channels of microfinance.

PwC's Microfinance Lenders Survey 2019

Figure 9: Role of influencers in microfinance business growth



Leveraging the agency banking model: Agency banking model utilises BCs and other external stakeholders like mobile operators to provide seamless access to financial services. Agents should be involved with the borrowers beyond the handover of the credit and assist the individual borrowers and the entrepreneurs in the optimised utilisation of the credit to ensure customer retention so that additional working capital requirements of the financial organisation are met.

Road ahead for digital microfinance

Technology integration is inevitable for sustainable functioning of microlenders, increasing the accessibility of products and services to borrowers and gaining differentiation in a competitive landscape.

Customer-centric digital intervention: Customer-centric digital development, backed by data, will help in improving the entire lending journey from acquisition to servicing by enabling customer profile-based offerings and a transition towards paperless lending procedures. Considering the high penetration of mobile phones and affordable cost of internet services, microlenders can adopt a mobility-based approach for regular interactions, monitoring repayments and offering value-added services to individual customers, specifically the ones with lower literacy rates. However, key design considerations should be taken into account to make technology easily accessible across all microfinance customer segments.

Additionally, effective monitoring of loan utilisation should be done by digitally powered third-party partnerships for direct payments to beneficiary accounts, corresponding to regular household needs. Lastly, players should extensively leverage analytics models to predict the changing needs of customers and design customer-centric borrowing solutions.

Singular point of access through a Public Credit Registry (PCR): Formalising credit for underserved borrowers is a major step towards creating a robust microfinance ecosystem. The RBI has taken steps in this direction by initiating the set-up of a nationwide digital PCR[35] in 2018, which will help democratise and formalise credit and capture customer data, including wilful defaulters and pending legal suits to monitor financial delinquency. Technology firms have been shortlisted to build the platform and the RBI has initiated the steps to develop the PCR. Microlenders will be mandated to provide records of loans disbursed and perform extensive data reporting of their borrowers through BCs. The extensive data, along with a secondary information base, will support the development of the PCR. Availability of centralised credit information will enable microfinance players to prevent defaults through a more robust underwriting process and data-based decision-making.

Agency banking model, Senegal

Baobab, a microfinance provider, created its own agent network in Senegal to expand its geographical coverage and outreach to rural areas, reduce investment in new branches and reduce congestion in branches. Its agency banking model uses a combination of a secure web-based agency banking platform and a mobile application running on tablets for agents. Each agent manages its own float and can facilitate client transactions such as deposits, withdrawals, transfers, loan repayments, bill payments and automatic loan renewals.

Source: AFI Special Report on ‘Digital Transformation of microfinance and digitization of microfinance services to deepen financial inclusion in Africa’, 2018

35 https://www.rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1061

Predictive collection model: A majority of microfinance borrowers are dependent on seasonal incomes for their livelihood. The cyclical changes in their incomes and overall income variance can be analysed to develop collection models and repayment schedules customised according to the borrower's repayment propensity, thus reducing the number of defaults. The model can be further augmented to incorporate external factors like prediction of natural calamities and regulatory changes to maintain the lender's overall collection efficiency. Such a model would help in reducing the overall NPAs for microlending products and increase the overall profitability of the microfinance player.

Fintech innovation through regulatory sandbox: Besides credit assessment-related regulations, there is a need to develop innovative FinTech products in a controlled and well-regulated environment to enable large-scale adoption of microfinance. In this direction, the RBI has proposed a regulatory sandbox framework in 2019,[36] which aimed to provide a regulatory environment to fintech companies and financial institutions for creation of innovative solutions backed by data analytics. Such innovation should be aimed at developing robust credit assessment models, providing services as per customer needs and devising solutions for moving families out of poverty. As of October 2018, 10 countries (Bahrain, Indonesia, Jordan, Kazakhstan, Malaysia, Mauritius, Mozambique, Rwanda, Sierra Leone and Thailand) have introduced regulatory sandbox policies for MFIs to encourage more innovation and experimentation in the microfinance space using technology.[37] Implementation of robust regulatory sandbox policies in India, following in the footsteps of these frontrunners, could result in advanced fintech innovation that would propel the microfinance industry to produce curated products with well-controlled and regulated complexities.

China's social credit scoring

According to a government document, the detailed planning outline for the construction of a social credit system (2014-2020) and the social credit scores for its 1.4 billion citizens will be publicly available by 2020. This credit rating is expected to determine portfolio at risk, regulate the loan disbursement and help in customising interest rates, repayment schedules and ticket sizes of loans. While the social credit score is yet to be implemented, private sector companies like Ant Financial have launched the Sesame Credit System which determines credit rating by analysing a consumer's shopping habits and consumption pattern.

Source: https://www.wired.com/story/china-social-credit-score-system/

Indonesia's sandboxing policy, 2016

Indonesia introduced branchless banking rules in 2014 to allow banks to use agents, followed by its sandbox policy in 2016, under which FinTech start-ups valued at INR 5.25 million (USD 75,000) can register and test their products within relaxed requirements. They can also apply for a business licence on increasing their capital to INR 13.2 million (USD 188,000).

Source: PwC's report on 'Microfinance in Asia: A mosaic future outlook'

36 https://www.rbi.org.in/scripts/PublicationReportDetails.aspx?UrlPage=&ID=920
37 https://blog.mondato.com/regulatory-sandboxes-worthwhile-developing-countries/

Leveraging women empowerment and mobilising the entrepreneurial landscape

Holistic transformation of the microfinance sector can only be achieved by financially empowering women, who form a major portion of microfinance borrowers, and promoting a culture of entrepreneurship among them and enabling them to set up viable businesses.

Women-specific credit assessment mechanisms: Women entrepreneurs lack access to traditional collateral and knowledge regarding the financial feasibility of a business, which increases their dependency on male members of the family. Besides, an unconscious socio-cultural bias often hinders women's access to financial services. This can be overcome through disaggregation of women-specific data for efficient analysis, leading to strengthened loan appraisal and disbursal processes.

Skill development and business enablement: India currently ranks 70th out of the 77 countries covered in the Female Entrepreneurship Index and demonstrates the third-highest gender gap in entrepreneurship across the world.[38] Success of microlenders depends largely on financially supporting women entrepreneurs who are major contributors to the sectoral and overall economic growth. New partnerships can be developed with government or private institutions to conduct educational sessions on enterprise, personal finance and business management to aid women in effectively using credit. Additionally, microlenders should leverage partnerships with ecommerce start-ups and handicrafts associations to provide a platform for rural entrepreneurs to sell their products.

Wherever possible, training should be provided to both genders to create awareness on the autonomy of women in household decision-making, domestic conflicts and gender-based violence. These training will help in creating a conducive household environment for women to run their businesses.

Focussed training for micro-enterprises can be provided by making economic activity clusters and training producers by aggregating small businesses.

Additionally, skill development training programmes can also provide practical training to women, helping them to find become employment in fields such as technology, beauty parlour services, tailoring, farming and animal husbandry. Further, women can be educated on leveraging partnerships with equipment manufacturers and B2B marketplaces for directly sourcing products from suppliers through the microcredit received.

Women should be empowered to not only source jobs for themselves but also create jobs for the community. CSR could be leveraged to provide additional skills through the large network of skilled professionals. A part of CSR funds consolidated across various corporations can be allocated towards development of micro-entrepreneurs. This drive towards empowerment will help not only the borrower's family but also microlenders in creating high-quality credit borrowers.

38 Financial Inclusion of women owned MSME, July 2019 report

73% of executives of financial institutions have acknowledged skill development as a key factor in encouraging borrowers to approach formal channels of microfinance.

PwC's Microfinance Lenders Survey 2019

Business enablement through Certified Credit Counsellors

Certified Credit Counsellors is an initiative by the RBI that aims to provide handholding services and facilitate business enablement for entrepreneurs through professional entities.

Source: https://www.sidbi.in/en/certified-credit-counsellor-programme

WE Act for young women entrepreneurs in Cambodia

The United States Agency for International Development (USAID) launched the Women Entrepreneurs Act (WE Act) in partnership with Pact Cambodia in March 2019, to empower young women in Cambodia's urban centres and support their business ventures. 60% of Cambodian businesses are owned by women and the programme aims to mentor them through guidance from established businessmen and women and integration with business associations and business incubation centres targeting socioeconomic inequality.

Source: http://www.emergingmarkets.asia/consulting/news/2019/03/05/we-act-women-entrepreneurs/

Key considerations for the microfinance growth journey

It is imperative that microfinance players weigh the different considerations encompassing customer data protection, data privacy and strategic and market risks while moving on the high-growth path.

Macroeconomic considerations: In order to prevent any adverse impact of the global economic scenario, microlenders should index themselves to the right mix of leading and lagging industry indicators.

They need to perform a detailed pattern analysis of parameters like outstanding loans per year, waterfall effect from one reporting period to another, client dropout rates, liquidity ratio and inflation rate to predict future disturbances and take pre-emptive measures such as changing their lending or collection mechanisms to prevent loss in business.

IT and operational considerations: A high number of technology partnerships have led to the creation of digital infrastructure, which has increased technological and operational concerns. With the government's guidelines for data localisation and the proposed Data Protection Bill, it is expected that critical customer data will be stored in India for protection. Additionally, microlenders should devise mitigation mechanisms for control of fraudulent activities in the lending process. Such activities should be monitored through demographic analysis, with mechanisms for detecting red flags at different touchpoints of the lending value chain.

Over-borrowing considerations: As credit needs of borrowers grow, the risk of over-borrowing from multiple lenders becomes unavoidable. Though the RBI has set guidelines to prevent over-borrowing, borrowers may still depend on local moneylenders, co-operatives, peers and relatives, and other informal financing channels to meet growing consumption needs. Microfinance players should be able to perform robust analysis on existing loans of borrowers to strike a balance between giving credit for sustainable business growth and mitigating the risks that may arise due to over-borrowing.

Predatory lending and case of human rights abuse in Cambodia

There are 2 million micro-borrowers in Cambodia, and over-indebted borrowers are facing coercive action by collection agents. Clients are often forced to sell their land, their children are forced into labour, or they migrate to distant cities to earn and pay back loans.

There is a need for better policies to create a conducive environment for development of borrowers, lenders and the industry.

Source: https://www.business-humanrights.org/en/cambodia-report-shows-that-poor-farmers-experience-land-loss-and-human-rights-abuse-in-cambodias-micro-finance-sector

Streamlining agent operations through technology in Uganda

The International Finance Corporation (IFC) partnered with the Agent Banking Company in Uganda in developing an Agent Quality Management (AQM) framework to monitor quality of agents through geo-mapping, geo-tagging, planning, data management, monitoring and visualisation. India could develop a similar framework through collaboration between financial institutions and the government to limit the risks of fraud for lenders.

Source: https://agentbanking.co.ug/

Road ahead

India aims to become a USD 5 trillion economy by 2025 and the microfinance industry will play a leading role in uplifting the lives of millions of low-income households and enabling them to contribute to the country's economic growth. As the microfinance industry tackles the current set of challenges, it is imperative for the industry to establish strong governance and regulatory practices. The future course of the industry will be determined by the ability of players to forge new partnerships, develop new products, create new investment channels and leverage technology to meet the demands of consumers.

About SIDBI

Small Industries Development Bank of India (SIDBI) set up on 2nd April 1990 under an Act of Indian Parliament, acts as the Principal Financial Institution for Promotion, Financing and Development of the Micro, Small and Medium Enterprise (MSME) sector as well as for co-ordination of functions of institutions engaged in similar activities. SIDBI's mission is to facilitate and strengthen credit flow to MSMEs and address both financial and developmental gaps in the MSME eco-system.

Vision of SIDBI is to emerge as a single window for meeting the financial and developmental needs of the MSME sector to make it strong, vibrant and globally competitive, to position SIDBI Brand as the preferred and customer - friendly institution and for enhancement of share - holder wealth and highest corporate values through modern technology platform.

SIDBI is organizing the 2nd National Microfinance Congress 2019 to envisage the Vision of the Microfinance Sector in India. The primary objective of the Congress is to deliberate on the Vision of Microfinance in India and means to achieve the same in the backdrop of an evolving regulatory, political and economic landscape. Formulation of the vision will entail analyzing the emerging industry challenges and suggesting policy recommendations for a sustainable growth path.

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PD/November 2019-M&C 3531