

Recent Developments in Microfinance Sector

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Introduction

The Microfinance sector in India has shown an incredible growth and change in the last few years and has come a long way since the Andhra Crisis. However the journey hasn't been a bed full of roses. The sector has seen its own rise and fall. But, it is believed; that the doom of 2010 has indeed come across as a blessing in disguise, as this marks the reform of the sector which has brought about many positive changes which was much needed.

Post the 2010 Micro-finance crisis in India, regularization of the sector was desperately needed and since then there has been a tremendous vibrancy in the sector both by the players as well as by the regulatory body to streamline the sector. It started with the Reserve Bank of India (RBI) appointing Malegam Committee which undertook an in-depth study to understand the reasons of the crisis. On the basis of the research, the committee recommended a set of guidelines to be followed by the Micro-finance Institutions (MFIs). This was then followed by a series of events like finalization of the guidelines, categorization of the institutions being able to undertake micro-finance activities, introduction and flourishing of the Credit Bureaus for the sector, establishment of SRO's (MFIN announced as SRO) and so on and so forth.

MFIN also laid down the guidelines for its members to share their client information to the Credit bureau such as Highmark and Equifax to avoid over lending. Client protection principles were adopted to save the rights of the customers. Model code of conduct was developed and MFIs were asked to follow to avoid any such crisis again in the field. Grievance redressal system and proper due diligence was mandated on ever MFI to check whether adequate action were taken to address the issues raised by the members.

Nevertheless, today the industry has evolved vivaciously with a variety of participants and stakeholders having brought in dynamism. Many forms of Micro-finance Institutions (MFIs) have come up with a variety of models and products. Banks have also leveraged the Self-Help Group (SHGs) and Joint Liability Groups (JLGs) channel to provide direct credit to group borrowers and some have even gone ahead with the Business Correspondent (BC) Model to increase their outreach through the MFIs

However, there still is some degree of uncertainty and ambiguity in the guidelines as it only applies to the NBFC-MFI category, and MFIs operating under other legal structures face minimal regulatory requirements. Though there is a pending Micro Finance Institutions

(Development and Regulations) Bill 2011 which has included all micro-finance institutions under the jurisdiction of the RBI, it is only awaited.

The price regulation in micro-finance started in December 2011 with a 26% cap on the interest rate charged. Later, the pricing cap was removed but a margin cap of 12% for MFIs with less than Rs. 100 Cr. Portfolio and 10% for that of above Rs. 100 cr. Portfolio, above average annual borrowing cost was introduced. In April 2014, RBI introduced an alternative calculation of the pricing cap as 2.75 times of the average base rate of the five largest commercial banks. The lower of either calculation is to be fixed.

As stated in an article by Live mint, for the quarter ended 31 December, 2014, the aggregate loan portfolio of India's for-profit micro finance institutions (MFIs) registered with the Reserve Bank of India (RBI) as non-banking financial companies (NBFCs) were to the tune of Rs.31,450 crore, disbursed to 28.7 million borrowers. Adhering to the earlier guidelines, an MFI wouldn't be able to give loans beyond Rs. 50,000 to a single borrower and the average loan amount disbursed per account by NBFC-MFIs is Rs.16,194.

The much awaited recent modification in the RBI guidelines is welcomely perceived by the sector, as it comes with a good ounce of MFI borrowers' limit enhancement. Considering the overall improvement and upturn of the Micro-Finance Institutions (MFI) sector, the recommendations of the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households (Chairman: Dr. Nachiket Mor) has resulted in the increasing of limits relating to

Total indebtedness of the borrower, excluding educational/ medical expenses increased from Rs. 50,000 to Rs. 1,00,000

Eligible rural and semi-urban household annual incomes enhanced from Rs. 60,000 to Rs. 1,00,000 and from Rs. 1,20,000 to Rs. 1,60,000 respectively

Loan amounts to be disbursed in the first cycle raised from 35,000 to 60,000 and that in subsequent cycles from Rs. 50,000 to Rs. 1,00,000.

aggregate amount of loans, given for income generation, is not less than 50 per cent of the total loans given by the MFIs

Further, adopting the suggestion of committee (Nachiket More) RBI drafted the concept of Payment bank and Small Finance bank to further strengthen the sector. This was aimed at providing the all the banking product to all the deprived and financially excluded section of the society in the remotest part of India. The role of Small payment bank as well as Small Finance bank will be to add hands to the existing banking structure. Since they have the advantage of penetration as compared to bank it will help the government to reach out to the last mile and provide them cash, credit, savings, remittance and various other products which a normal banks provides.

Taking a notch further up in the development of micro finance sector RBI granted banking license to India leading micro finance institution, Bandhan. This was seen as a big boost to the sector which was finding its way for existence.

Another major development of recent times is the launch of Micro Units Development Refinance Agency (MUDRA) Bank in April 2015, under Pradhan Mantri Jan Dhan Yojana with a corpus of Rs.20, 000 crore, and credit guarantee corpus of Rs.3,000 crore. The roles envisaged for MUDRA include laying down policy guidelines for micro enterprise financing business and registration of MFI entities as well as their accreditation and rating. It may also become a statutory body responsible for regulating and refinancing all MFIs that are in the business of lending to micro and small businesses engaged in manufacturing, trading and services activities. It will lay down policy guidelines for micro and small enterprise financing business, register MFI entities and regulate them. Besides, it will also rate MFIs, formulate a code of conduct for the industry to ensure client protection principles and methods of recovery, promote right technology solutions for the last mile, and run a credit guarantee scheme for providing guarantees to the loans that are being extended to micro enterprises.

While this new development looks charming and overwhelming, but as the old saying goes, there are always two sides of the same the coin. Sector experts, practitioners and other stakeholders have interesting views about the recent guidelines and its repercussion and impact going forward. The following is an effort to highlight some of the possible impacts on the varied stakeholders of the MFI sector.

MFIs have worked within the earlier limitations and have been able to provide an average ticket size loan between Rs 16,000 and Rs 25,000. Also, they haven't been able to go beyond the upper cap of Rs. 50,000 per member. But the new enhanced limits will enable MFIs to provide bigger ticket size loans to one member in a single tranche. Further, with the increase of scope of eligible prospective MFI borrowers, the MFIs would have an opportunity to encompass slightly higher income group individuals and increase customer base. But the question here is, would all MFIs be able to do so? To increase customer base and at the same size cater to all with big size loans will require enormous funds and fund raising capacity. In these circumstances, only the better-off, big and mid size MFIs clearly have an edge and would be able to reap benefits, flourish and increase their balance sheet size. Smaller MFIs, which do not have very good fundraising and leveraging capacity, will probably find it difficult to sustain in this race. Not to forget the obvious competition which is foreseen. Huge potential clubbed with saturated areas to work in, will give lucrative options to the bigger MFIs and smaller ones will slowly be forced to withdraw and may even perish.

There is another interesting angle which is the Operational cost and Operational self sufficiency

(OSS). Given that the MFIs would be able to provide higher amount loans to the same customer, their operations cost will lower substantially, resulting into significant drop in interest rate. Further, they might withhold aggressive expansion to new geographies and shift focus from expansion to saturation through client retention in the existing branches. There are also strong arguments that MFIs would now like to concentrate more on catering to the urban poor, as they have shown more creditworthiness alongwith having greater avenues of income generation and hence positive repayments. Would all this really help in the ultimate goal of financial inclusion, or will only help profit maximization. But this also comes with a given fact that when Operations cost will be lower, banks will also try to play with the interest rates and competitive prices would be offered.

This will also instigate MFIs to change their strategies. New product development like MEL/ Rural Housing will be taken up and in the next 1 year. The relaxation of minimum lending of income generation loans from 70% to a mere 50% and the asset qualification cap increased to 25% is surely giving a roadmap for various avenues and customization of products. These might also increase the quantum of individual lending and may even stir up the MSME and enterprise loan space.

But the real challenge for MFIs lies in client selection. MFIs are going to have difficulty in credit risk analysis of the borrowers considering the larger permitted debt burden and will need to exercise caution while determining the debt repayment capability of a borrower. The staff will need to be adequately and appropriately trained to do so. Further, risk mitigation strategies and delinquency management needs to be tighter, as with high gains would come higher risk. Here the borrowers may have an upper hand as they will have various sources of funds, so MFIs may need to provide competitive prices and products and services to earn their loyalty.

All said and done, the relaxation and upward raising of all limits will result into competition and huge requirement of funds. MFIs will surely try to access fund from all sources, including the managed portfolio by becoming a Bank's BC.

The recent guidelines have done justice in distributing all the stakeholders their own share of role. Since MFIs express great faith that Credit Bureaus would be able to adequately address the problem of concealed indebtedness, their role becomes all the more crucial and critical. They will have to accordingly revise the data and help MFIs with the credit risk analysis. But the often talked about topic of convergence of all Credit Bureau data or introduction of unique identification number system or even having only one credit bureau gathers greater relevance and urgency. However, going forward it is even more critical that all the MFIs share information and further these are consolidated and a one point source is accessible for all the MFIS to verify client data.

Similarly, the role of MIS service providers would also increase as they will need to incorporate all the modifications and include tools for credit risk analysis.

With the modification in MFI guidelines, the Relevance of Mudra Bank's refinancing program has increased as it focus more on enterprise lending. This new guidelines also favors enterprise lending by increasing individual lending cap to INR 1 lac. Mudra Bank is expected to offer refinance at a much cheaper rate and to that extent the cost of money will come down for small borrowers. The target segments of the proposed Mudra Bank are micro entrepreneurs, who credit requirement are in the range of Rs 50,000 to Rs 15 lakh. This category of borrowers is at present almost entirely unfunded by commercial banks. The MFIs are well poised to be able to deal with the funding requirements of this segment.

A lot many women, who were excluded due to the earlier guidelines, would now be the prospective borrowers for the MFIs. This for sure is helping in financial inclusion. The upper revision of the household income criteria has given a roadmap for many to enter in the MFI customer base. Moreover, it would be likely that borrowers could easily misstate details regarding their debt to avail loans and this is even more dangerous. The risk involved is high and hence it is unlikely that any single MFI would alone provide very high loan amount.

We are all hoping that the modifications which look overwhelmingly attractive and indulging bring about positive impact in the next 2-3 years. But there is a clear apprehension that inspite of such relaxation, whether any major changes would be seen immediately. To top it all, questions are arising on the quality, intent and impact of product and services to be provided hence forth. Unless utmost care is taken to diligently draw processes, train staff and put appropriate checks and balances, this Hare's run may prove to be detrimental. Hence the need of the hour is careful analysis of situation and playing the cards safely.

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