# SIDBI National Microfinance Congress 2018

*Mass Market Banking – Navigating the Change*

October 26-27, 2018, New Delhi

## Summary Report

Knowledge Partner

McKinsey&Company

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## Context and Overview

The first edition of the SIDBI National Microfinance Congress was held at Hotel Taj Palace in New Delhi during October 26-27, 2018 to deliberate and bring to fore the emerging challenges and opportunities in microfinance and mass market banking in India. Over 300 delegates from leading commercial banks, small finance banks (SFBs), microfinance institutions (MFIs), non-banking finance companies (NBFCs), the Reserve Bank of India (RBI), academicians, fin-techs etc., participated in the discussions.

Over the course of two days, multiple panel discussions were held at the congress on various critical topics. The conversations and discussions during the various sessions of the Congress were setup to be highly interactive, following a three-part flow as below:

- Emerging challenges and concerns due to a shift in the operating landscape over the last few years
- Solutions to collectively address these concerns
- Key areas of policy and structural interventions

The deliberations of the congress are of utmost importance given that they are critical to the progress of the microfinance and mass market banking sector—the growth engine of the Indian economy. Also, the discussion spanned all the sub-sections of this sector too such as SFBs, MFIs, banks, fin-techs etc., making it inclusive.

To ensure action beyond dialogue, this report seeks to encapsulate the synopsis of the various discussions and key takeaways from the sessions. The report also presents an integrated set of action areas/suggestions that may guide the actions of the key stakeholders (regulators, industry participants, SROs, etc.) as arrived at by the collective congress.

## Synopsis of Sessions

Besides the inaugural and valedictory sessions, the two-day congress had four technical sessions and two special sessions.

### 1. Inaugural Session


The inaugural session began with an address by Shri Mohammad Mustafa, IAS, CMD, SIDBI. Shri Mustafa shared how the mass market banking sector is beset with enormous challenges - limited formal records, low requisite collateral and absence of footprint in over 100 districts in India, among other issues. To overcome these challenges, SIDBI was doing its bit - the institution had already augmented the capacity of more than 100 MFIs, provided cumulative loans totalling INR 175 billion which has benefitted 38 million beneficiaries. He shared how MUDRA has helped ease processes, while SIDBI 2.0 has made it easy for clients to share relevant data with them. He emphasized that SIDBI would continue to network with institutions, and urged the delegates to discuss and debate on how the cost of credit for micro and small enterprises could be brought down further. Shri Mustafa counted how SIDBI has been partnering with not-for-profit organisations to promote micro enterprises and bringing down the cost of credit for such micro entrepreneurs. He called upon the participating MFIs to look forward to bring down the cost of operations for the larger benefits of poor.


Shri Gavin McGillivray, Head of the UK Department for International Development (DFID) Office, took the stage and shared a story from his recent visit to the Panthara village - while women were confident and ran businesses, they had limited access to technology. He urged the attendees to think about the various policies governments and institutions could adopt to encourage gender sensitivity and to increase technology penetration among women and the poor in India.


Shri Junaid Ahmad, Country Director for the World Bank in India, urged the audience to think about ways to collateralize informal income. He also shared that deepening access to capital markets is critical for MFIs to grow as investors today are willing to invest towards empowering women and are ready to take a smaller range of returns in the form of impact investing. He also urged SIDBI to play a countercyclical role by intervening and working with SMEs, especially when the markets are in a downward cycle.

Shri Rajiv Kumar, IAS, Secretary (FS), DFS, Government of India, delivered a special address. He highlighted that the country is progressing tremendously on all fronts -India is the 6$^{th}$ largest economy in the world today. However, the question today to ask is: Is credit reaching everyone in an equal manner? He shared how socio-economic, gender and geographical vulnerabilities are a cause for concern since they could lead to doubts over the future of the underserved and the underfunded. He urged MFIs to take up this role of serving businesses in this gap - the missing middle.


Shri Rajiv Kumar highlighted the fundamental steps taken by the government to support this sector, especially with the syncing up of mobile numbers to Aadhaar and bank accounts. India contributed to 55 percent of all accounts opened in the world, the gender gap has reduced from 20 to 6 percent, and the number of adults having bank accounts has increased. This, according to him, leads to the government's next aspiration, i.e., move from an account for every household to an account for every adult. He shared how the government's initiatives are helping citizens, offering them insurance and protection at extremely affordable rates.

He also spoke on the many partnership opportunities available to MFIs today, since partnerships could help them achieve greater growth – especially technology related. He also urged attendees to think about making credit contactless in India using technology and analytics, much like purchasing a railway ticket today.

He concluded his speech by recommending the domestic microfinance industry to leverage the 'digital pipeline' being created by the central government through digitalization, Jan Dhan accounts, digital money transfers, etc.

Shri Renny Thomas, Senior Partner, McKinsey and Company, spoke about the role of mass market banking in the economy and its contribution towards the country's economic growth, and how the sector has significantly more potential today to meet evolving customer needs. He shared some global examples on how organizations have innovated to leapfrog their peers.

Shri Thomas also discussed four key imperatives that could help enable the "next avatar" of mass market banking - reducing the cost-to-serve, offering a full suite of financial services, expanding reach and access to customers' doorsteps, and providing seamless services that leverage technology and data-driven underwriting capabilities.

In summary, the session was structured around three topics:

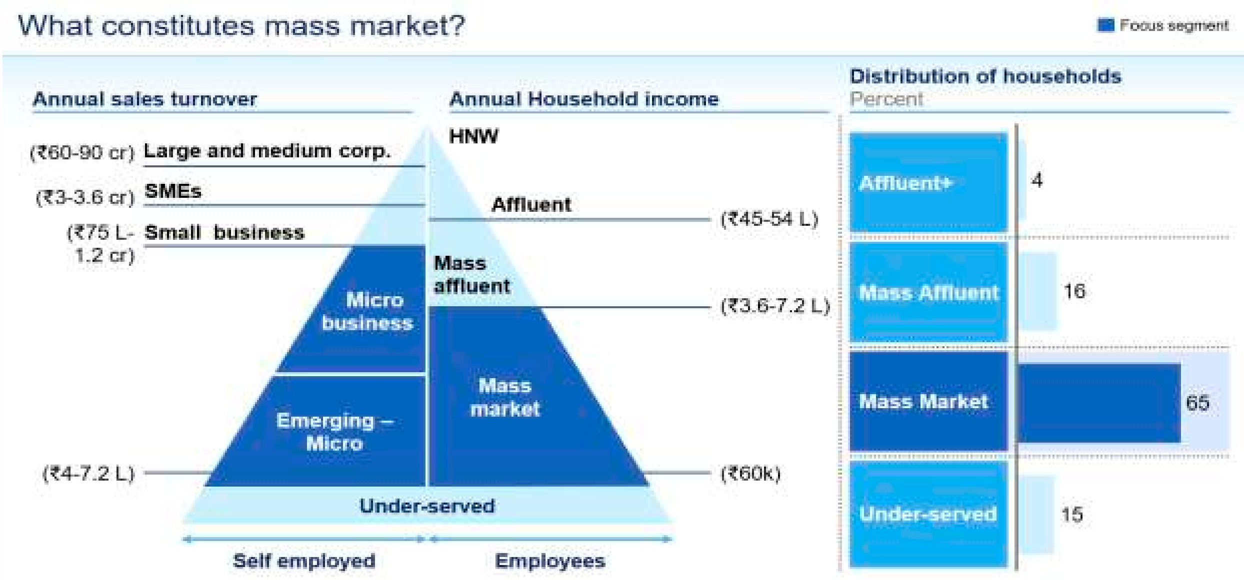

- Topic 1: Mass-market banking - critical engine of growth
  - It is an important and rapidly growing segment with underserved and evolving needs
- Topic 2: Global examples in the sector leading to breakaway growth
  - Players have created new disruptive business models, transformed their operating structure, and leveraged deep partnerships to leapfrog traditional growth paradigms
- Topic 3: Enabling the next avatar of mass market banking
  - Radical improvements in customer proposition, and accelerated and profitable growth in the sector are now possible thanks to supportive regulations, technology and a growing data ecosystem.

The detailed discussion under these three topics have been shared below.

Key Discussion Points Under Topic 1

- Mass market is a spectrum that constitutes the bulk majority of house-holds in India (Exhibit 1)

Exhibit 1: Mass Market segment in India




(Source: Census; Dept. MSME)

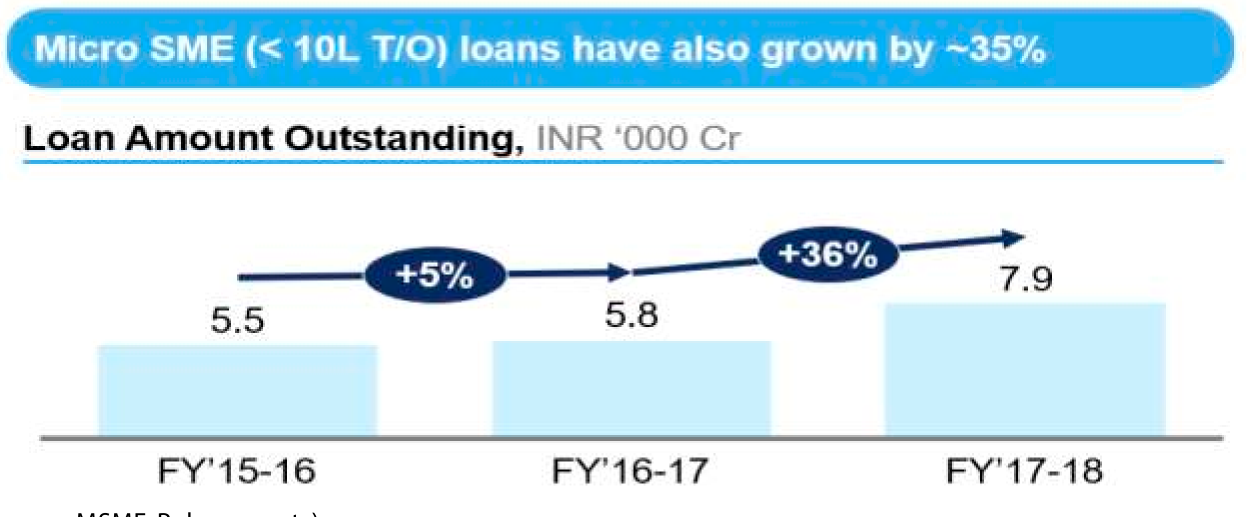
- Mass market lending has grown both in size and in reach over the last few years, as indicated by several proxy indicators:
  - The microfinance industry continues to grow at ~25 percent (Exhibit 2), which is among the fastest growth rates in financial services value pool

Exhibit 2: The growth of microfinance industry in India


(Source: Micro-meter reports)

  - Micro SME (< 10L T/O) loans have also grown by ~35 percent (Exhibit 3) though off a small base

Exhibit 3: The growth of micro-SME loans in India




(Source: MSME Pulse reports)

- The geographic reach of MFIs has been impressive (according to Micro-meter reports) -
  - The top 5 states in 'MFI loans outstanding' are all geographically diverse—Karnataka, Uttar Pradesh, Tamil Nadu, Orissa and Bihar
  - The East and the Northeast account for 35 percent of the NBFC-MFI portfolio, followed by 26 percent in the South, 15 percent in the North and 14 percent in the West.
  - Nearly 200 districts contribute to over 80 percent of outstanding MFI loans in India.
- The 'New to credit' (NTC) MSME segment is growing rapidly (as per MSME Pulse reports, CIBIL) -
  - Driven by both formalization and a regulatory push, NTC MSMEs (< 10L T/O) have grown to 10 percent of the total MSME borrower base in March 2018 compared to 5 percent in March 2016.

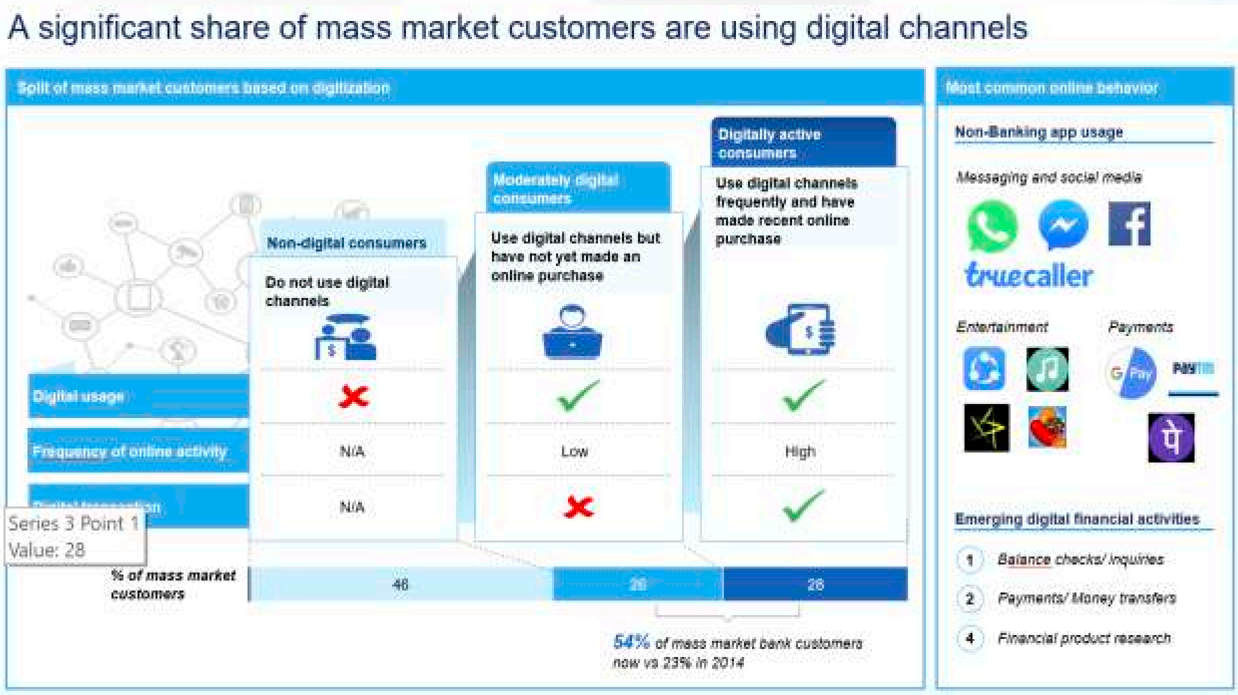
■ Mass market landscape has been evolving significantly and could present opportunities to serve this segment effectively

- Regulation is making mass market banking more mainstream
  - Large MFIs have been granted Small Finance Bank (SFB) licenses, banks have acquired MFIs
  - Banking outlet regulations have evolved to aid last mile service
- Customers awareness is on the rise

- ◻ Increasing financial, digital awareness and literacy (e.g., comparison of interest rates aided by WhatsApp).
- – Emergence of richer data and digital in under-writing
  - ◻ High fill rates of credit bureau, availability of aggregate government department data
  - ◻ Tab-based sourcing and scoring, and direct channels via smartphones, mobile broadband
  - ◻ Usage of cashless transactions leading to scrapable digital transaction data trail for analysis
- – New sets of players / intermediaries are establishing themselves
  - ◻ Alternate forms of lending in the organized sector (e.g., pay-day loans)
  - ◻ Tech enabled BCs and online platforms and fin-techs (e.g.  BankBazaar)

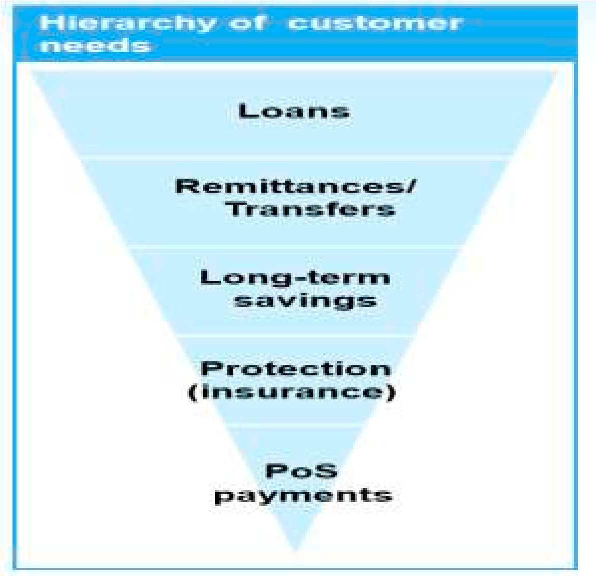
■ Mass market customers are getting increasingly digital and their needs of the customers have also evolved over time (Exhibit 4 and 5).

Exhibit 4: Digital maturity of mass market banking customers




(Source: McKinsey PFS Survey India 2017, AppAnnie insights)

Exhibit 5: Hierarchy of customer needs



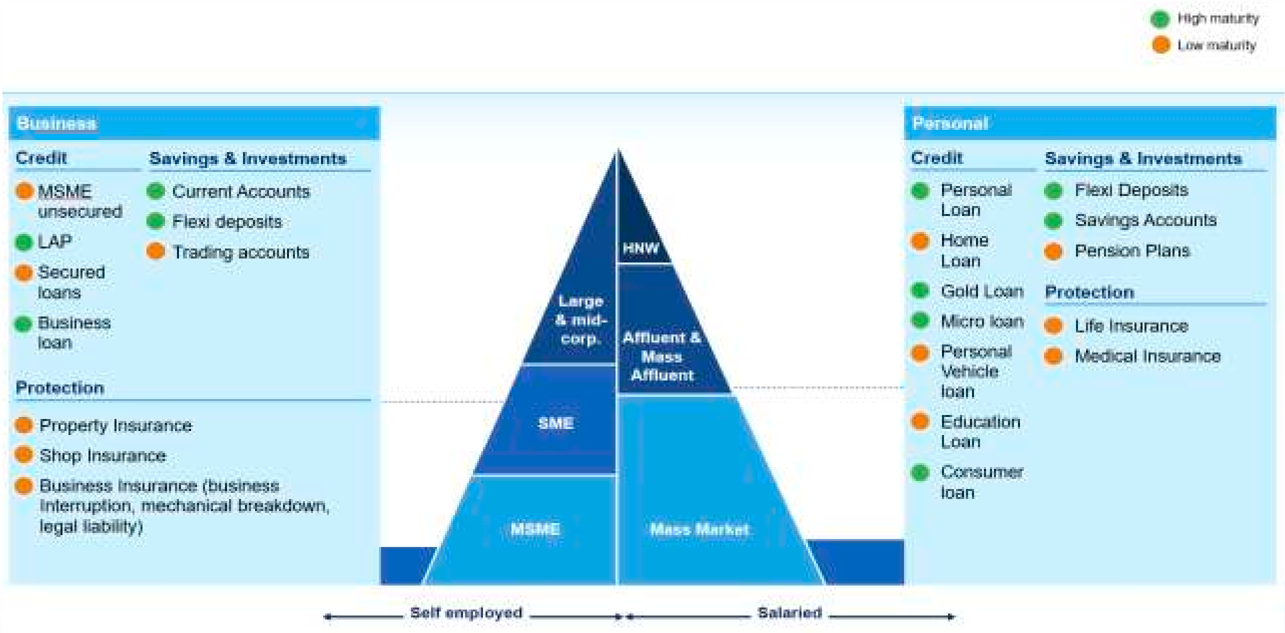

(Source: McKinsey mass market banking surveys)

- As a result, mass market revenues while comprising 30 - 40% of total retail banking revenue pools is growing at ~ 2x the rate of overall retail banking (Exhibit 6). Furthermore, significant untapped opportunity still exists to serve these customers who are still largely under-served by most financial institutions in the country (Exhibit 7).

Exhibit 6: Mass market banking growth and contribution


(Source: McKinsey Global Banking Pools)

Exhibit 7: Financial services opportunity in India




(Source: Customer surveys, RBI data on loan types)

## Key Discussion Points Under Topic 2

Several global players in this space have innovated and successfully built profitable mass market business models around three themes:

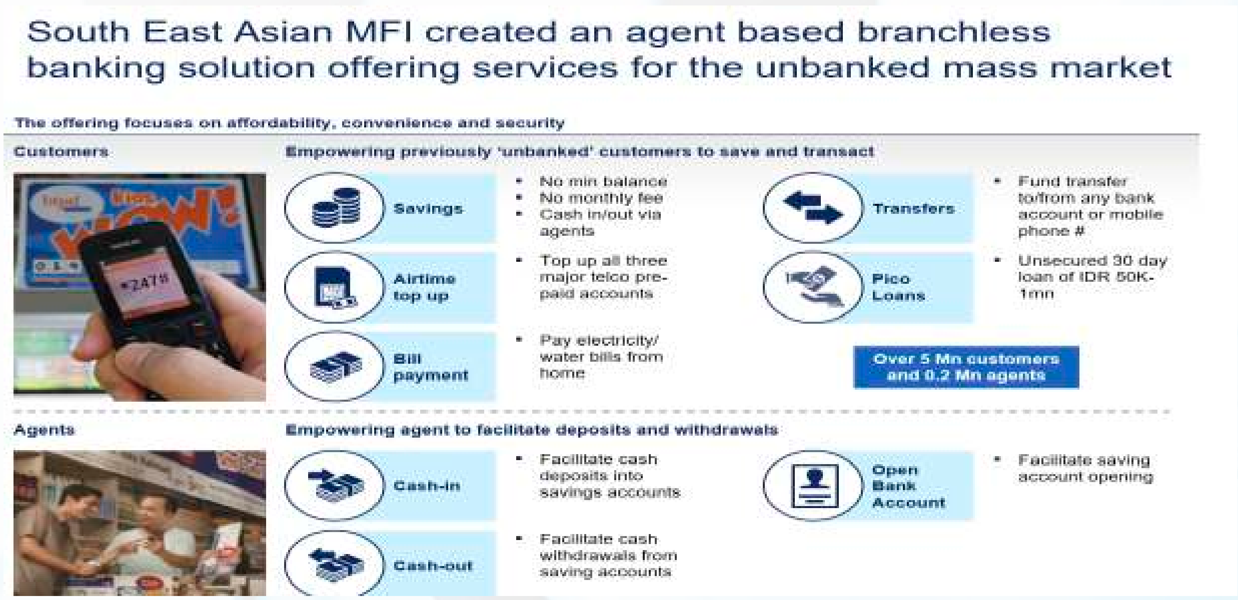
- Reinventing the business model for reach and access
  - Identify new customer segment/area
  - Deepen reach and relevance
- Transforming the operating structure
  - Redefine sourcing or collections methods
  - Improve efficiency of operations and reduce turn-around time (TAT)
  - Improve cross-selling opportunities
- Alliances and partnerships
  - Tie-up with others in the eco-system to gain efficiencies or increase reach

Shri Thomas also shared global models of players who have innovated along these lines to leapfrog growth (Exhibit 8,9).

Exhibit 8: Re-invented business model – American non-profit microfinance organization


(Source: CGAP, IESE Business School and Stanford Graduate School of Business Cases)

Exhibit 9: Example of a transformed structure – SEA mass market bank

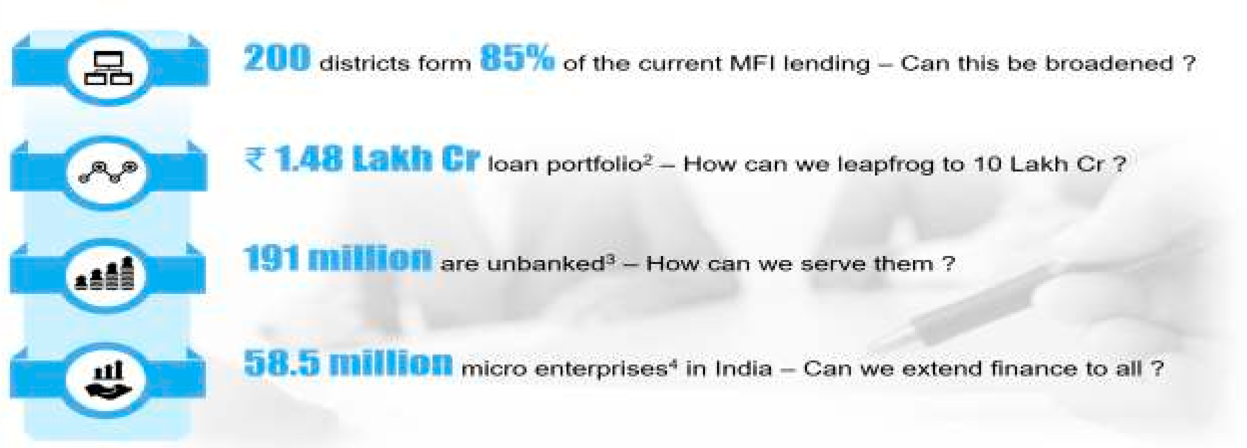



(Source: Press search)

## Key Discussion Points Under Topic 3

Shri Thomas laid some aspirations for the audience consideration on how mass market banking could chart its own unprecedented path (Exhibit 10).

Exhibit 10: Aspirations for the industry




(Source: Micro-meter, MSME reports)

To achieve these aspirations, the industry must move to transform itself into its 'next avatar' by considering adopting 4 imperatives:

- Reduce cost-to-serve by 60-80 percent:
  - Leverage widespread agent and ecosystem partner networks
  - Make self-service/assisted digital onboarding a reality to maximize throughput; offer smartphone-enabled banking
- Offer full suite of financial services seamlessly to customers:
  - Provide financial planning and advisory
  - Offer flexible long-term savings products and investments/insurance
  - Offer pre-approved payday loans, working capital loans/credit lines
- Expand reach and access to the customer's doorstep:
  - Design a banking outlet (agent)/BC-driven doorstep service ecosystem
  - Penetrate into remote rural areas by leveraging agricultural partner networks and BCs
- Seamless onboarding by leveraging tech and data-driven underwriting:
  - Leverage new data to enable quick decisions (e.g., Telco, e-Vahaan etc.)
  - Leverage advanced analytics, e.g., cash-flow and bank statement analysis

## 2. Technical Session I: Adjusting to the New Normal - Lessons Learnt from Demonetization

The Microfinance Sector has been susceptible to various external shocks over the years. Post de-monetization, the microfinance sector experienced a disruption resulting into a significant rise in Portfolio at Risk (PAR) / write-offs. This led to adjustments in the overall operating model, especially with respect to customer segments, regional strategies, field organization models and product/collection strategies. With more and more composite players coming into the market the concept of 'group' lending is also undergoing a subtle redefinition.

This session was to deliberate on the shifts in the business model as a result of demonetization and the challenges thereof, and how MFIs and other players are responding to this change.

Shri Sandeep Sabharwal, Client Director, McKinsey & Company, conducted a brief presentation on the impact of demonetization and the learnings adopted from it. This was followed by a panel discussion constituting several industry leaders;

- Shri Samit Ghosh, Founder & CEO, Ujjivan Financial Services
- Shri Udaya Kumar Hebbar, MD & CEO, Grameen Koota
- Shri Sadaf Sayeed, CEO, Muthoot Microfin Ltd
- Shri Govind Singh, Founder, Utkarsh Small Finance Bank
- Shri Alok Misra, Professor, Management Development Institute (MDI)
- Shri Srinivas Bonam, Head – Inclusive Banking Group, IndusInd Bank.

During the discussion, it was shared that business models catering to the customers at the bottom of the pyramid are most susceptible to shocks. The reasons for this are

- Given they are part of the "informal economy" they experience high volatility in cash flows
- They are a close-knit community by occupation and sector.
- These customers are highly prone to "herd" behaviour and are easily influenced by rumours.

Demonetization disproportionately affected this sector due to factors such as:

- The MFI portfolio was severely stressed for two to three months due to the segment's high reliance on cash collections (over 90 percent of the portfolio).
- While most customers faced a significant short-term crunch in their income, several customers were swayed by local influencers to renege on their loan promise completely.
- MFIs faced a unique dilemma of "wait versus recover" as the cost of recovery threatened to exceed the outstanding value of the loan.
- MFIs were also exposed to a logistics problem of handling bulky and cash-intensive transactions.

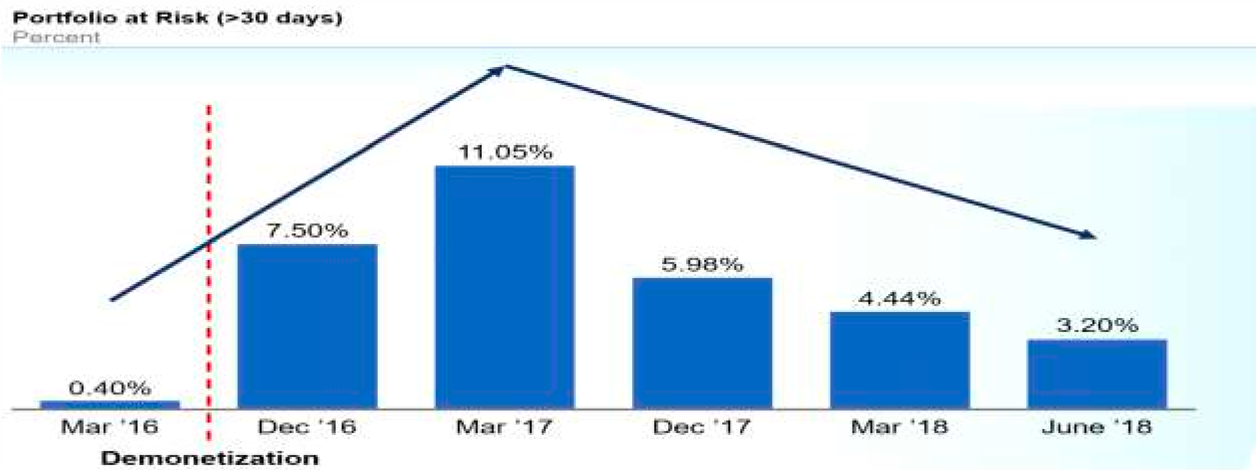
While growth in the sector received a temporary set-back, it has returned to its original trajectory indicating the fundamental demand for credit (Exhibit 11).

Exhibit 11: Loan amount outstanding trend


(Source: Micro-meter reports)

While PAR rates have remained at a higher level (Exhibit 12) in aggregate, the new lending book has shown repayment performance in line with historical best-in-class levels. Also, the old, affected book is showing a slow, long-tail of repayments given the ongoing attention and engagement.

Exhibit 12: PAR (>30 days) trend




(Source: Micro-meter reports)

Different entities in the microfinance and mass market banking sector responded and recovered differently during the demonetization wave. Institutions that recovered faster and displayed better-than-average collection performance were able to do so by following key success factors:

- A targeted micro-market strategy:
  - Clear catchment area and radius of funding to ensure adequate operational coverage
  - Cautious approach to new, unpenetrated markets and minimized geographic concentration
- Clear engagement with local influencers/"ring-leaders":
  - High engagement with customers instead of ignoring or incentivizing them
  - Problem-solving and arriving at a solution with customers, e.g., revised repayment dates
- Minimized operations risk:
  - Synchronized but independent lines of defence for sales, credit, operations and collections
  - Adherence to sourcing norms, batch verification, stringent diligence of KYC, etc.
- Strong collections architecture:
  - Frequent customer touchpoints/visits
  - Disbursement and collections by same person
  - Proximity /neighbourly connect with the customer

Going forward, given the nature of the mass-market and the high sensitivity to potential structural shocks, financial institutions could consider building "defence" mechanisms across four key themes:

- First alert mechanisms
  - Setup of a central monitoring team to analyze sudden changes in behavior – repayment delay, increase in PAR, etc.
  - Setup floating rapid response teams (RRT)
- Minimized credit risk
  - Use analytics to determine drought predictions, crop harvest patterns, construction growth rates, etc.
  - Use credit bureau data to predict default patterns
- Better geographic distribution
  - Identify markets which are under-penetrated and beyond the 'top 5' states.
  - Distribute portfolio across a cluster of states to avoid region-specific shocks (like drought, political disruptions, etc.).
- Stronger customer engagement:
  - Conduct at-scale campaigns that are similar to what AMFI (Association of Mutual Funds in India) did for mutual funds in India.
  - Conduct localized awareness programs to bust myths on loan waivers.
  - Educate customers on the consequences of defaulting on loans.

Key takeaways from the panel discussion included -

- Demonetization was a difficult situation for MFIs, pushing most of the businesses' PAR rates beyond 1 percent for the first time.
- Prudent MFIs managed the shock by ensuring credit discipline, maintaining independent lines of defence, actively engaging with the community and moving to a monthly/weekly cycle of collections.
- It is often impossible to predict black swan events in advance and design policies around them. Hence, MFIs could create a corpus to protect against risks that come from such events and ensure they have excess capital on the balance sheet to survive in such situations.
- Staying close to the customer emerged as the most important measure (hire locally, engage customers beyond the loan via skill building, financial advisory, etc.).

- MFIs could collaborate during such exigencies to collectively deal with the challenges that usually accompany black-swan events.
- A brand building exercise could be undertaken by the industry (SROs). This is beneficial not only during the normal course of business but becomes all the more important and critical during times of stress so that organizations in the sector are not looked upon suspiciously.

## 3. Technical Session II : Future of Pure Play MFIs in India and Sustainability Challenges

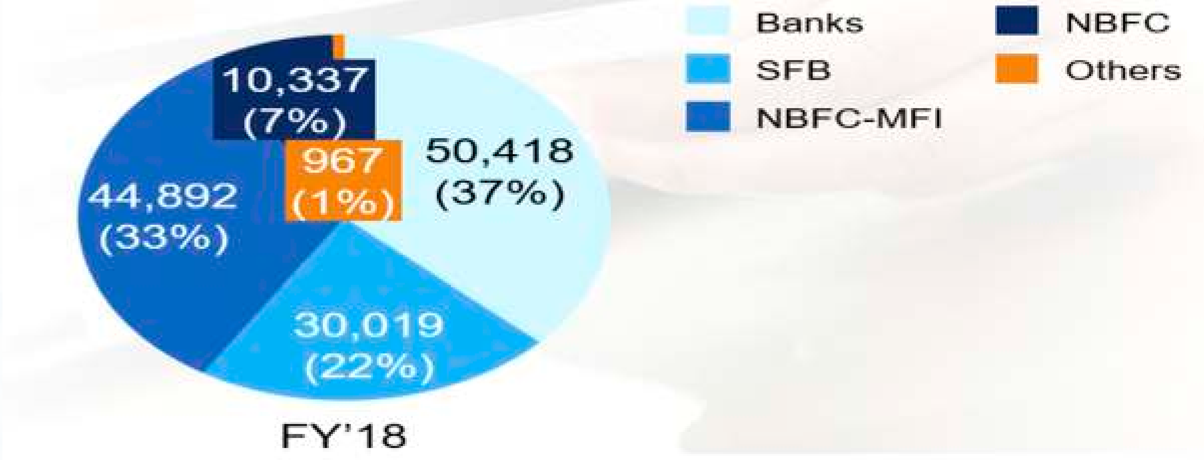
With changes in the banking landscape, eight MFIs have turned into SFBs, one into a universal bank and the largest MFI in the country is set to merge with a commercial bank. In recent times, pure play MFIs are facing significant challenges—increasing competition, lack of affordable funding and capital, limited resources/capacity, gaps in product innovation, etc.

Shri Malcolm Gomes, Partner at McKinsey & Company, delivered a brief presentation on the future of pure play MFIs in India. To deliberate further, he led a panel discussion constituting a group of experts

- Shri Devesh Sachdev, CEO & Director, Fusion Microfinance
- Shri Manoj Kumar Nambiar, MD, Arohan Financial Services
- Shri Tamal Bandyopadhyay, Consulting Editor, Mint
- Shri Brij Mohan, Microfinance Sector Expert
- Shri R Baskar Babu, MD & CEO, Suryoday Small Finance Bank
- Shri Abhijit Maitra, President & National Head, ISB & MFIG, Yes Bank.

It was discussed that the microfinance industry continues to grow with pure play MFIs leading the way. While banks account for 37 percent of the total portfolio, NBFC-MFIs account for 33 percent of the portfolio (Exhibit 13)

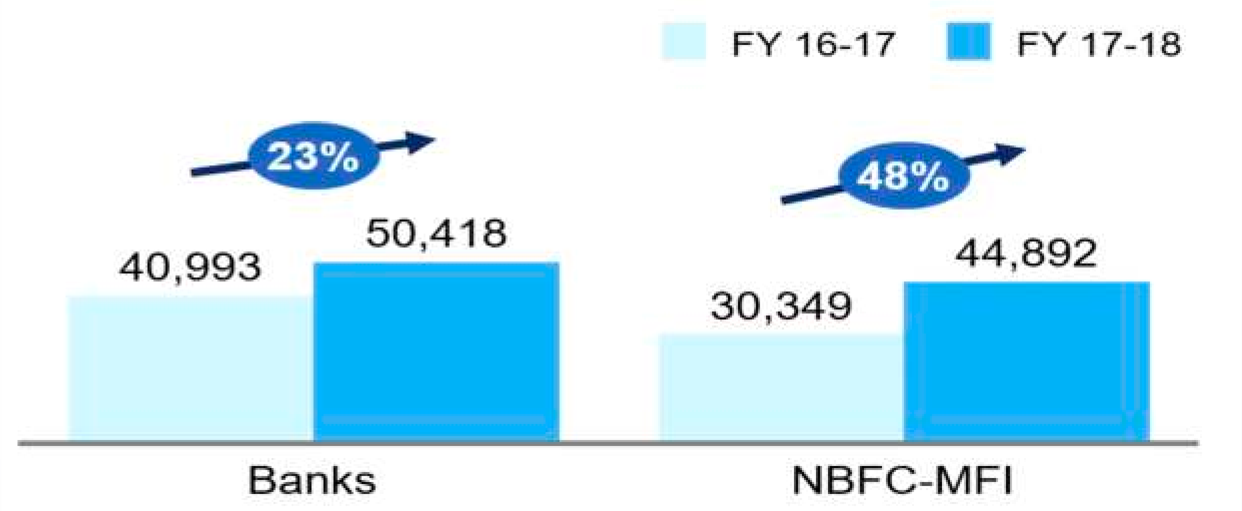
Exhibit 13: Share of microfinance portfolio in FY'18




(Source: Micro-meter reports)

However, interestingly, NBFC-MFIs have so far bucked the trend by clocking double growth rate as compared to banks. (Exhibit 14)

Exhibit 14: Growth of NBFC-MFIs vs Banks




(Source: Micro-meter reports)

However, the landscape has been shifting quickly. The industry is witnessing shifts primarily along three key dimensions:

- Competitors:
  - Large MFIs have been granted SFB licenses.
  - MFIs have been acquired by established banks.
- Customers:
  - Income in rural areas, and subsequently requests for higher loan amounts and additional needs have increased.
  - Credit and financial awareness, availability of richer credit bureau data and third party data have increased.
- Evolving ecosystem:
  - Alternate players/forms of lending in the organized sector, e.g., pay-day loans, etc., have emerged.
  - Digital and cashless methods of payment and transactions are gaining popularity.

Given this changing landscape, MFIs may need to consider some specific shifts in their operating model. Among others, few potential areas for consideration are as follows –

- Use predictive data to customize product offerings and decide customers' 'propensity to pay'.
- Leverage digital trails and algorithms to analyze a user's community behaviour, e.g., phone usage patterns, to reveal sophisticated insights.
- Reach out to the missing middle micro-segment for additional lending scope, e.g., customer's broader household.
- Increase MFI's use of digital and cashless mechanisms for disbursements as well as collections.
- Keep a hawk eye on collections to ensure swift and prompt action in case of PAR increase.
- Free up time to engage with customers on financial planning/broader needs.
- Explore MFIs that are acting as substitute for banks in rural areas and that are providing a wide range of products.
- Tie-up with players to co-lend consumer durables, two-wheelers, home improvement materials, medical needs, etc.

As we move forward, three action areas could be addressed by pure-play MFI players along 3 dimensions –

- Reinvent the business model
  - Expand the customer base from "women only" to the entire household.
  - Use the existing distribution network as a "supermarket".
  - Increase credit offerings to the MSME micro-segment.
  - Ring-fence the MFI customer base and engage deeply to prevent poaching by competition
- Transform the operating structure
  - Explore new avenues for raising funds, e.g., wholesale markets to manage the cost of funds.
  - Stick to a sound operations risk model, i.e., source within catchment areas, proper due diligence, etc.
  - Set-up a strong collections monitoring framework

- Build alliances and partnerships
  - Use latest technology e.g., mobile app, digital presence, customized local content, etc.
  - Offer innovative financial products/ bundles in partnerships

Key takeaways from the panel discussions, included –

- Many players are looking for opportunities to become a bank to derisk, especially from political issues.
- Based on ground complexities and local nuances, commercial banks may find it difficult to dominate the MFI space.
- There are plenty of opportunities for players to co-exist right from a Section 8 MFI to universal banks—MFIs must truly understand their sources of competitive advantage.
- MFIs may not be able to completely avoid certain risks that come with elections, demonetization, loan waivers, etc.
- MFIs must continue to drive partnerships and operating model shifts to drive down cost-income (digitization, analytics), and operate in a truly agile and nimble manner to insulate itself from local shocks and disruptions.
- Plenty of innovations are happening in this space—advanced bio-metrics, satellite fields, drought and cropping patterns, advanced analytics and psychometric assessments.
- Players must also innovate in the suite of financial products offered to customers given evolving client aspirations and preferences.

## 4. Day-1 Closing Session: Learning from Global MFI Experience

Day 1 of SIDBI's National Microfinance Congress 2018 ended with a session featuring international microfinance experts

- Shri Daniel Rozas, Senior Microfinance Expert, European Micro Finance Platform, Luxembourg
- Shri Jason Meikle, Deputy Director, Pact Global, Myanmar.


They shared their experience and ideas on the various developmental aspects of microfinance and key innovations in the development sector that are now defining the business of lending around the world. The session was moderated by Shri S.P. Singh, GM, SIDBI.

Shri Meikle remarked that Myanmar is younger to India when it comes to MFI experience. Majority of people live in rural areas, level of education is low and only 25 percent of people have bank accounts. About 50 percent of working population can be classified as MSMEs or farmers. Pact Global's methodology includes building rapport with community and ensuring all transactions happen at village level (no need for customers to travel outside). They focus on building client resilience through credit, savings and quasi-insurance products. Besides serving customers, the institution also supports local NGOs to help them develop their institutional capabilities. Most of the operations are centred around areas that are not prone to regional violence.


Shri Rozas shared that a study of global markets showed that "high penetration and multiple borrowings go hand in hand." He compared MFI models across several countries. For example, in Kyrgyzstan institutions were protected from macro-economic shocks for a long time due to restrictions related to foreign currencies. In Jordan 30 percent of Jordanian residents are non-citizens who take credit from informal sources, signifying opportunities for MFIs. In countries like Cambodia this is an opportune time for MFI growth. The key question arises across these nations is that how do the countries self-regulate their MFI sector? He laid down emphasis on independent institutions that focus on metrics, monitoring and sanctions to play this role. Centralized dashboard at the institution level that publishes MFI performance (business and governance) through metrics to ensure that due diligence is done at all times.

## 5. Day-2 Opening Session: Key Priority Areas of the Sector including the Geographical Expansion Opportunities

Day 2 of the congress began with a session on the key priority areas of the sector, including geographical expansion opportunities. Featuring a panel comprising

- Shri Aalok Gupta, MD & CEO, MUDRA
- Shri Manoranjan Mishra, CGM, Department of Non-Banking Regulation, RBI

The session saw several questions on the policy and regulations in force. The discussion was moderated by Shri Prakash Kumar, CGM, SIDBI.


In this session, the panel discussed that:

- SROs must be well-governed organizations whose members must be proud and see value in their membership. They should serve their purpose by promoting financial literacy and brand awareness.
- While the primary aim of MFIs is to focus on the underserved, the aim of regulations is to enable quality and impactful growth. Every regulation could be measured against its aim of customer protection, orderly growth and institutional resilience.
- Market mechanisms thus far have been unable to set interest rates correctly and hence, there has been a formulaic approach and guidance to control the margin spread.
- The qualifying assets limit of 85 percent has been a useful threshold to ensure MFIs maintain their focus on the intended segment. The regulators are open to reviewing this limit in reasonable intervals.
- Additionally, the limit for individual borrower lending of INR 1.6 lakh also requires timely calibration and is subject to review over sufficient passages of time.

- Lenders today share information manually. MFIs could consider setting up a task force to automate the sharing of information with regulators.
- The microfinance sector needs to penetrate deeper especially in geographic areas identified by the NITI Aayog for serving the underserved and the unserved. Challenges related to geographical expansion can be overcome by using data and collaborations amongst businesses and industries, education, etc. Regulators and policymakers would rather encourage MFIs to expand geographies as a part of their DNA and business plan than offer any incentive to do so.
- MFIs could build countercyclical buffers to withstand event shocks.
- The responsibility of customer education and financial literacy could be led by customer groups as well as borrowers and SROs. Responsibility cannot be fixed on only one side, i.e., with policymakers.

While the session saw deliberations on multiple aspects, especially regarding interest rates and the criteria for qualifying assets, the panellists indicated that as long as the key objectives of orderly growth and customer interests remain at the fore, regulations and policies can be subject to review and could be modified accordingly.



## 6. Technical Session III: Digital Vision for Mass Market Banking

Fintech companies today are transforming the financial inclusion space in India and the world. This session discussed how technological disruptions and new-age fintech companies could collaborate with the microfinance business model to take mass market banking to the next level. Shri Ajay Kumar Kapur, DMD, SIDBI, moderated a panel discussion constituting key industry experts

- Shri Sharad Sharma, Co-founder, iSPIRT Foundation
- Shri Alok Mittal, Co-founder & CEO, Indifi
- Shri Arun Nayyar, CEO, NeoGrowth Credit Pvt Ltd
- Smt. Sucharita Mukherjee, Co-founder, Kaleidofin Pvt Ltd.

Shri Sharad Sharma, presented on the Credit democratization and India's opportunity to leapfrog as a result. He began by laying down that the era of cash-flow lending is very much here and the mass market banking sector could experience disruptive growth if they think about innovating on micro-loans via shorter tenure loans (Exhibit 15)

Exhibit 15: Key features of a cash-flow based small ticket loan


(Source: iSPIRT Presentation)

With a case example of how a small cash-flow based intra-day loan could be disbursed, the session laid out the fundamental pillars of how technology is required for credit growth. Seven key steps emerged, with each step requiring a solution by small teams who can develop complex and scalable solutions using combinatorial innovation (Exhibit 16)

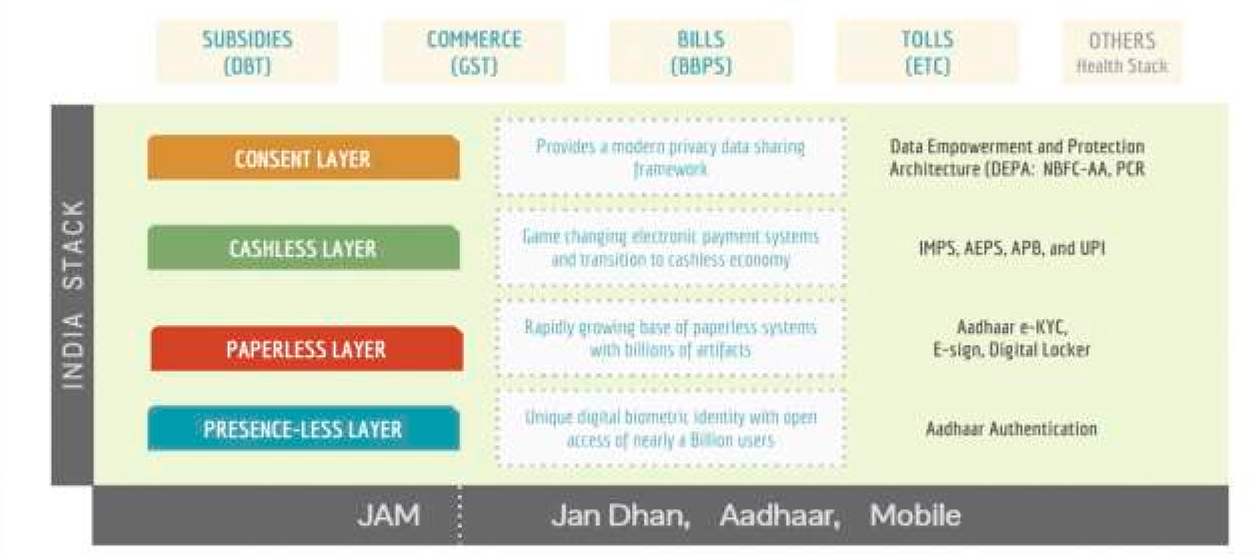
Exhibit 16: Small loans enabled by multiple co-ordinated solutions


(Source: iSPIRT Presentation)

Shri Sharma also mentioned that the foundational elements of creating this data and lending eco-system is being laid brick by brick – with key elements already in place.

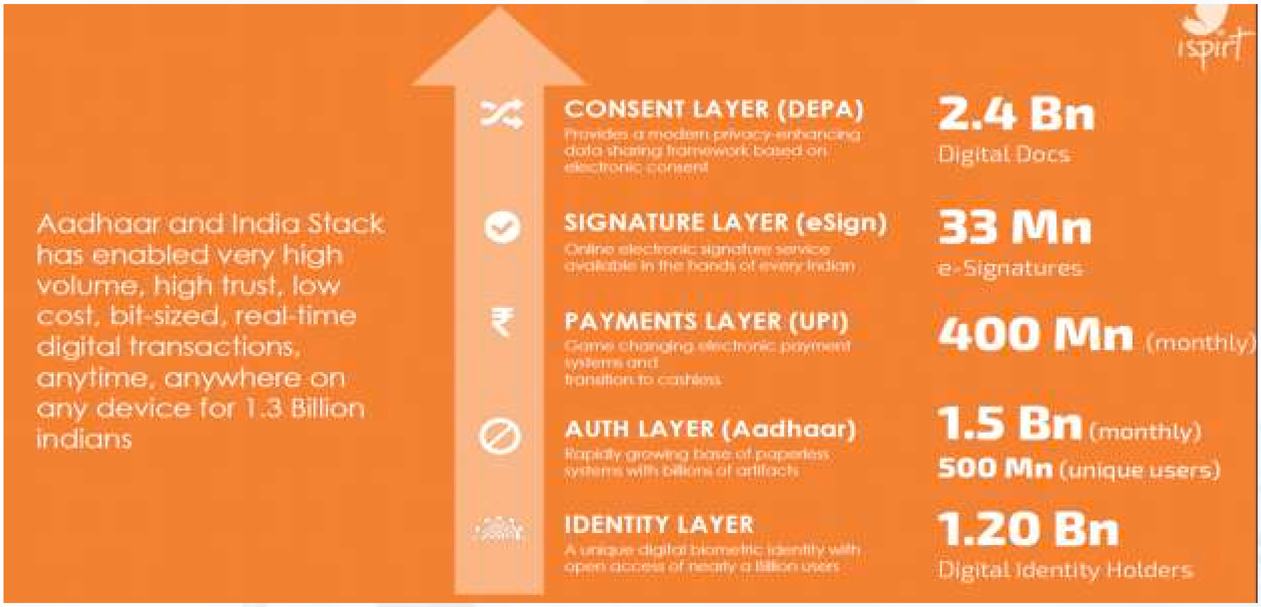
He discussed the India Stack frame-work and highlighted how along with Aadhar it has the potential to revolutionize mass market banking. (Exhibit 17,18)

Exhibit 17: The India Stack frame-work




(Source: iSPIRT Presentation)

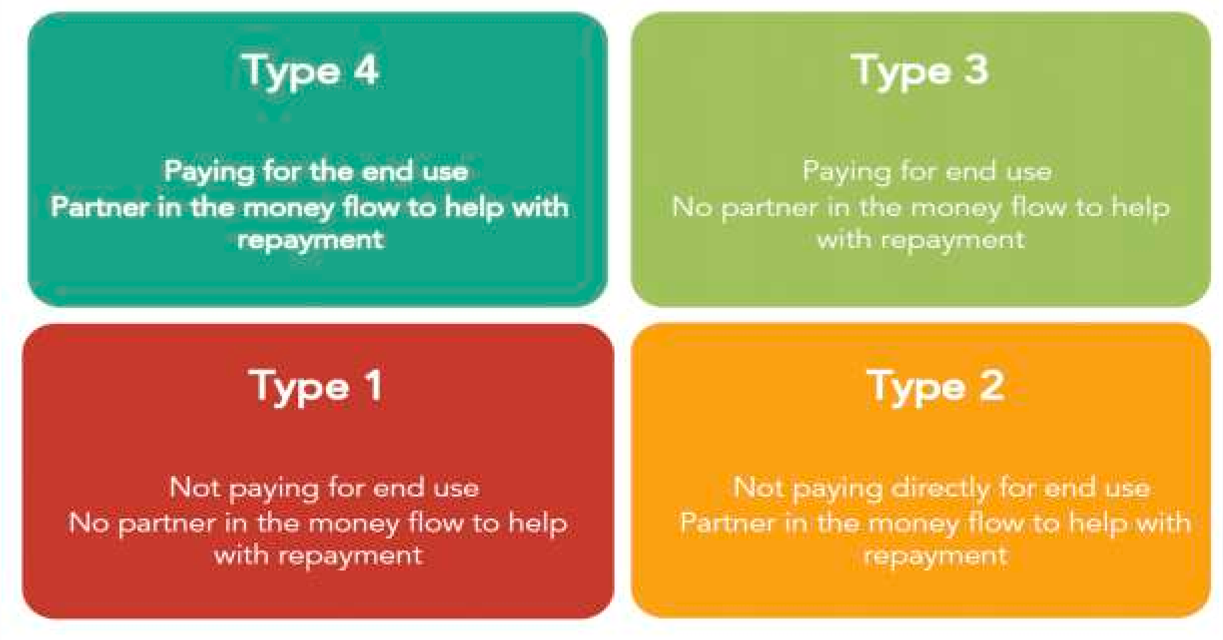
Exhibit 18: Adoption of multiple layers




(Source: iSPIRT Presentation)

It was also discussed, that given the rapid growth in digital and financial services, 4 types of loans have emerged, and credit and innovation could move towards enabling all four categories of loans (Exhibit 19)

Exhibit 19: New types of loan products are taking centre-stage




(Source: iSPIRT Presentation)

In this session, the panel discussed:

- Progressive tenure for loans is the way forward. It is important to build a ladder starting with short tenures and move towards longer tenures and bigger amounts based on the richness of data. This will help serve customers with no credit history. Cost of doing such transactions will be low, especially for type-4 loans since cash flow is tied to the repayment of loan.
- JAM trinity and India Stack data can enable flexible loans and product design. With the existence of a credit bureau, nearly 400 million records are available at present. To serve these customers better, we can shift tenure, say from a two-year loan to a two-month loan. This shift can be made, and customers can be underwritten individually with the proprietary data owned by institutions and publicly available data.
- Ecosystem lending is critical to ensure money is flowing through the same business channel. This has many benefits— new relationships do not need to be built with the borrower and the risk of fraud reduces. Ecosystems also provide richer data.

- The era of cash flow-based lending is here, where the collateral is cash flow. To democratize credit for everybody, it is very important to bring down the cost of transactions—cash-flow lending will help do this.
- Technology and data are paving the way for contactless lending. This can be done through mobile data, district knowledge, etc. Hence, streams of data make it easy to automate lending.

The session deliberated on the multiple ways fintech companies are reaching clients, the various modern underwriting techniques being used and how, as a result, the cost to serve is coming down. The panellists unanimously agreed that the financial sector is gradually moving towards cash flow-based lending and that the developments taking place in the mass market banking sector were leading towards the ‘democratization’ of credit in the country.

## 7. Technical Session IV: Challenges for Going Beyond Microfinance and Serving the Missing Middle Segment

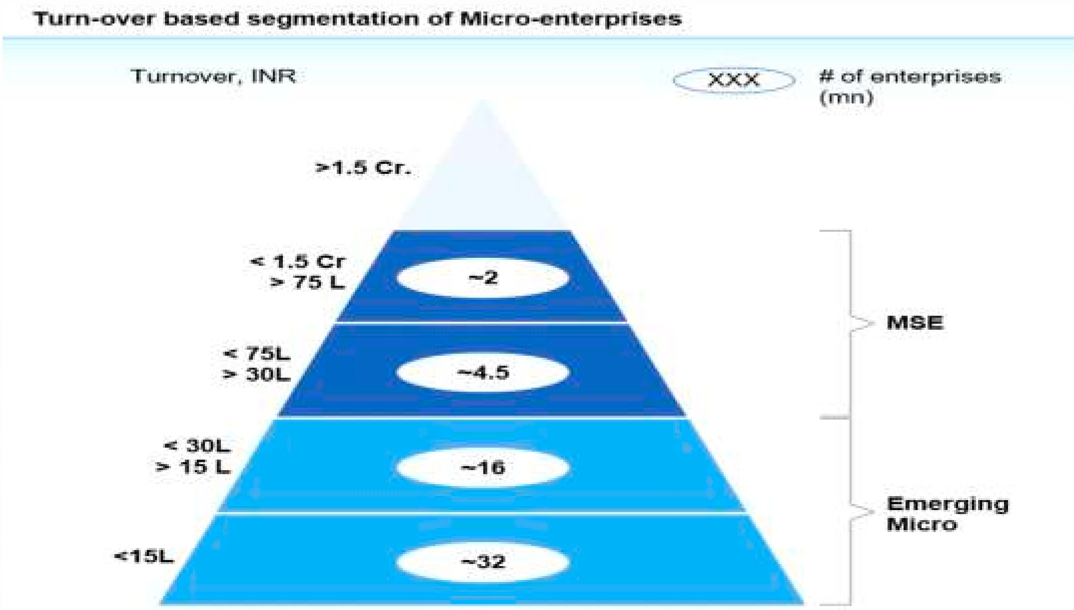
Despite receiving multiple cycles of microfinance loans, beneficiaries have been largely failing to graduate to a level where they can receive bank loans. Lending to the missing middle, i.e., a segment (loans > INR 0.50 lakh and up to INR 10 lakh) just above microfinance where instruments of social collateral may be absent, faces many challenges, viz. lack of formal accounting, lack of data due to non- registration in tax systems, difficulty in ascertaining cash flows, etc., which make the assessment of credit risk a difficult exercise.

To kick-start the discussion on this topic, Shri Himanshu Singh, Partner at McKinsey & Company, delivered a brief presentation on how serving the missing middle micro-segment could ensure financial inclusion and the growth of the SME segment in India. He moderated a panel discussion constituting key industry leaders

- Shri Rajeev Yadav, MD & CEO, Fincare Small Finance Bank
- Shri Brahmanand Hegde, Executive Vice Chairman, Vistara Financial Services
- Shri Sanjay Sharma, MD, Aye Finance Private Limited
- Smt. Praseeda Kunam, Co-founder & CEO, Samhita Community Development Services
- Shri M S Sriram, Professor, IIM Bengaluru
- Shri Thirunavukkarasu R, COO, Kinara Capital

It was discussed that the MSME segment can be further categorized based on the turnover of such enterprises (Exhibit 20). The emerging micro segment was found to comprise the bulk majority of the "missing middle".

Exhibit 20: Segmentation of MSME based on turnover




(Source: Dept. MSME, CRISIL)

It was also discussed that the MSME spectrum is not homogenous – different segments have different characteristics and hence they have different needs. To serve the emerging micro – a different approach would be needed compared to the traditional MSME lending business. (Exhibit 21)

Exhibit 21: Varying characteristics of the MSME segment

| Key characteristics | **Emerging Micro** *generates enough cash/ earns average to above average profits* | **Micro and Small** *Well established and looking to grow bigger / open other units* |
|---|---|---|
| Offering variety | Multiple offerings | Full range of offerings |
| Customer base | Sufficient local base | Large customer base |
| Staff | Owner + 1-2 Staff | 5-10 staff |
| Documentation | Limited (bills etc.) | Complete (tax, reg. etc.) |
| Age | Usually > 2 years | Usually > 10 years |

(Source: McKinsey MSME survey)

Given the historical under-penetration in the sector, a large financing gap exists in the emerging micro ecosystem. This which means that informal players step in to offer credit to customers in this segment, often at higher rates of interest to satisfy the needs. The typical characteristics of entities in this segment include:

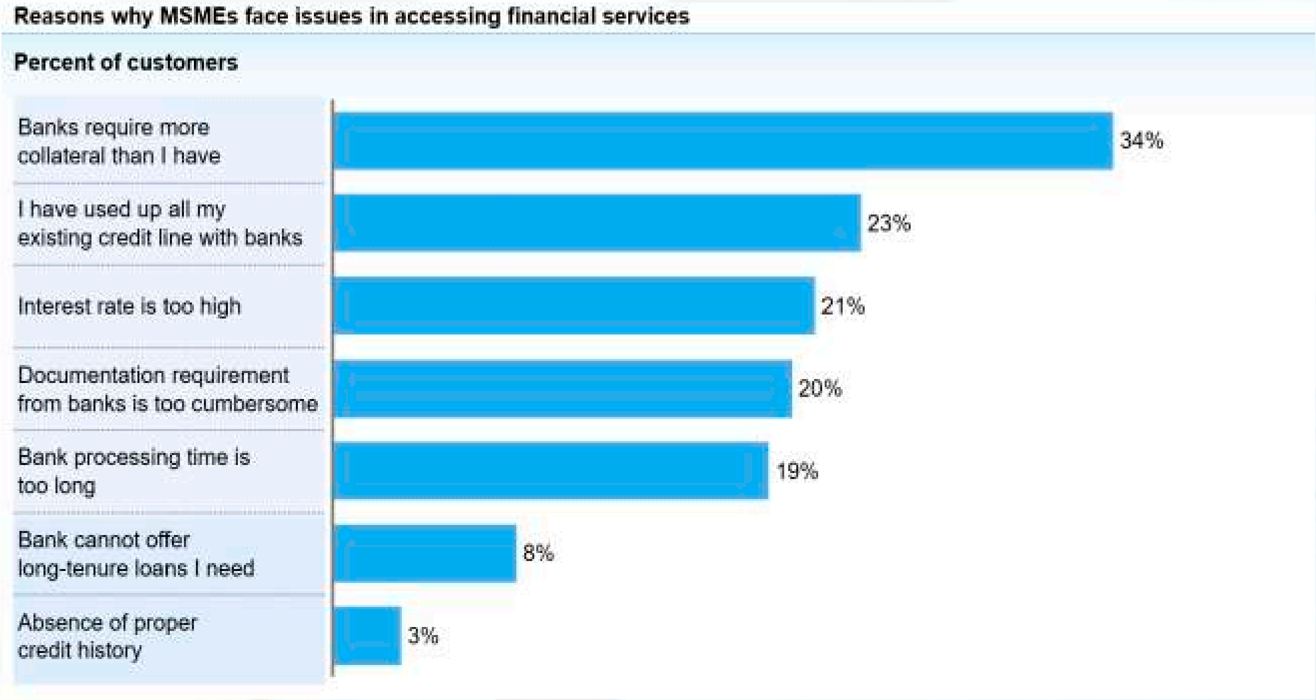
- Nearly 60 percent of all MSMEs in emerging markets lack access to credit.
- Formal sources of finance include banks and non-banking institutions.
- Informal sources include both institutional sources such as moneylenders and chit funds, and non-institutional sources such as family, friends and family businesses.

It was observed that financial transactions with non-institutional informal sources are typically:

- In the form of debt and not bound by any contractual agreement.
- Do not insist on any immovable collateral and rely on personal reputation or social collateral.

Due to the non-contractual nature of transactions, many micro enterprises prefer informal sources. The challenge of lending to the missing middle is, hence, dual—on the demand side, MSMEs face problems in accessing credit (Exhibit 22)

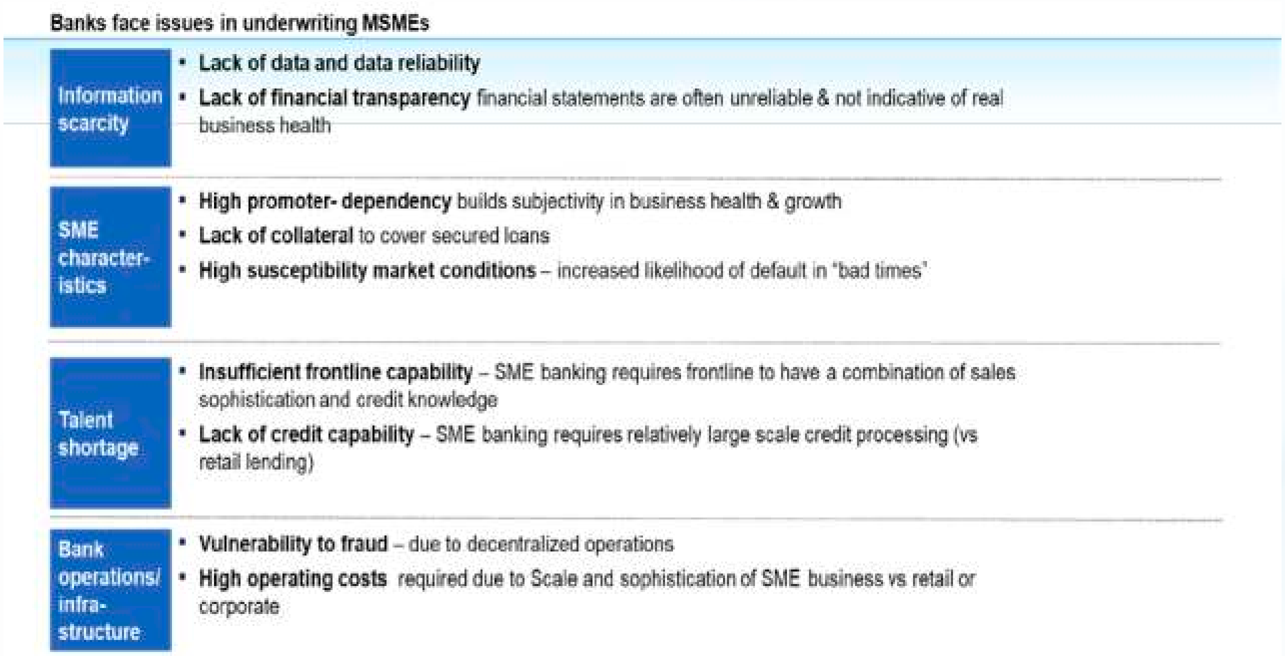
Exhibit 22: Issues faced by MSMEs in accessing finance




(Source: McKinsey MSME surveys)

Similarly, on the supply side, financial institutions face problems in underwriting and understanding risk profiles. Typical issues faced include information scarcity, SME characteristics, talent shortage, or poor operational infrastructure (Exhibit 23) –

Exhibit 23: Gaps in supply of finance




(Source: McKinsey MSME surveys)

Some key suggestions to start lending to this segment through formal sources emerged during the session. These include:

- Regulatory interventions
  - Create a marketplace for MSME securities for working capital needs
  - Increase as well as relax regulations for sources of funding to lenders
- Credit risk assessment
  - Extend the gathering of data by the credit bureau for loans. SME scoring can incentivize repayment.
  - Create a master dataset that cuts across multiple government entities, e.g., RoC, ITR, excise, CRILIC, credit bureaus, etc.
- Business model
  - Create the right product offering and under-writing architecture to profitably serve the segment.

– Create digitally-enabled processes including e-KYC, e-Sign and e-Mandate.

In this session, the key points that the panel discussed include:

- Understanding cash flows and treating it as tool that is reflective of the situation on the ground is critical when serving the missing middle.
- It is important to use technology to reduce TAT of loans especially since customers are often only concerned with the amount of loan and how quickly it is offered.
- The "missing middle" segment is massive - the group is predominantly based in rural India and are involved in activities beyond agriculture, which opens up more opportunities for financial institutions.
- There could be a lot more collaboration between banks, NBFCs and fintechs primarily because scale is a big competitive advantage.
- A lot of information today needs to be integrated with credit bureaus for loan information, legal data on customers, etc. Hence, there is a need for speedy, integrated information to reduce risk.
- Advisory services are a big requirement and include selling or marketing opportunities, technology, help with machinery, managing account books and GST, etc. This will be a win-win for both financiers and borrowers.

## 8. Valedictory Session

The valedictory session began with a summary of the various topics of discussions and deliberations over the last two days of the congress. The summary was presented by Shri Malcolm Gomes, Partner, McKinsey & Company, Shri Ajay Kumar Kapur, DMD, SIDBI, and Shri Prakash Kumar, CGM, SIDBI.


The valedictory address was delivered by Smt. Rosemary Sebastian, Executive Director, RBI. She guided the audience on many critical factors including:

- Several players in the industry coexist for a reason and there seems no looming threat to MFIs if they are aware of their competitive advantages.
- It is important to stay aware on the guidelines pertaining to the co-origination of loans. Institutions could share feedback on this process with regulators and policymakers.
- It is important that financial institutions keep the Fair Practices Code in mind when doing business and must be mindful of non-coercive recovery methods. Some practices to be followed in this regard include loan cards in vernacular language, train field staff to check for the existing debt of borrowers, etc.
- Players must not look to somebody else for training but could be involved in the whole process themselves. Only then can last-mile trainings happen. The responsibility for training cannot be relegated to one person or agency and needs to be a combined and coordinated effort.
- MFIs concentration in states is quite skewed today. Institutions need to work in newer areas to truly serve their purpose.

In totality, she guided the audience on the process of loans co-origination, and cautioned organizations to stick to the Fair Practices Code. She concluded her speech by reminding the audience that mass market banking is not just providing credit but is also a tool for the country's economic development.

## Key Takeaways from the Congress

The congress had some key overarching takeaways for mass market banking players, policy makers and regulators. These include:

- The mass market banking industry has created meaningful impact. However, significant untapped opportunities still exist for "micro banking" across credit, savings / investments, protection and payments products.
- An effort needs to be made to onboard "informal" to "formal" sources and to introduce requisite "ladder" propositions to meet customers' needs effectively, e.g., daily loans, weekly loans to help clients upgrade themselves, etc.
- A space and role for all types of entities - banks, NBFCs, SFBs, MFIs, etc. to participate in the mass market banking space exists. It is important for entities to collaborate to offer a "supermarket" to customers.
- Shifts in regulations, technology and data ecosystems are facilitating new mechanisms for customer access, operating models and seamless onboarding and underwriting

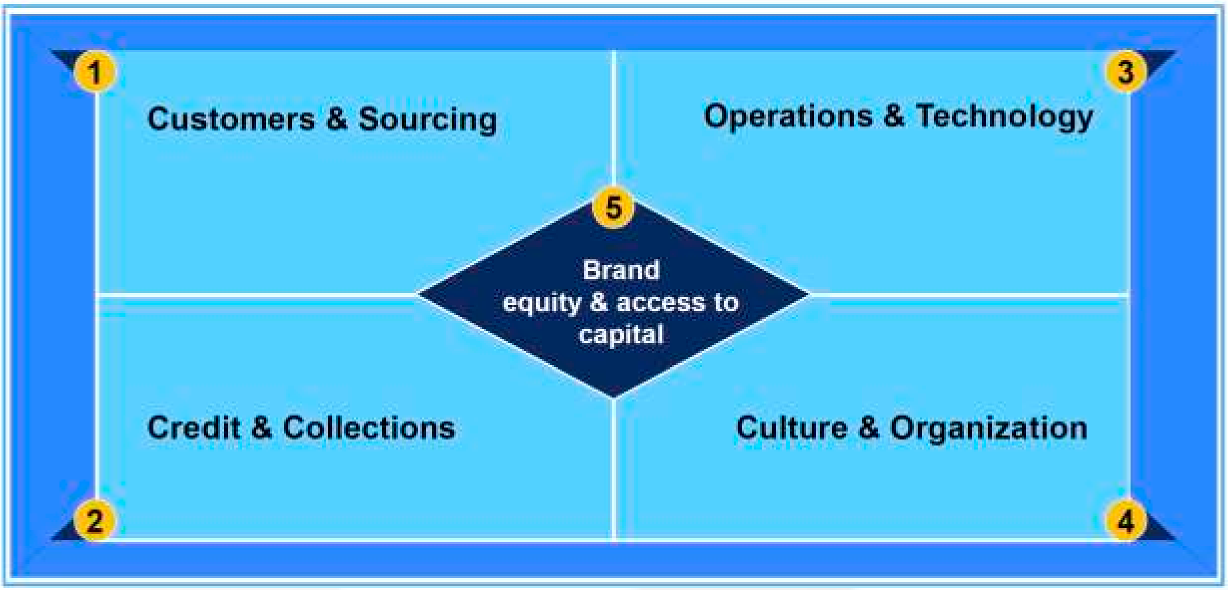
Some key challenges were also brought to light which need to be addressed. These include:

- Formally "recognize" all entities that are operating in the mass market space to ensure credibility with all stakeholders. This is essential to ensure geographic expansion of players in areas that are underserved.
- Adherence to governing codes and common standards by all mass market banking players, e.g., exposure norms, sanctity of credit bureau reports, etc.
- Access to reliable and stable sources of funding, especially for smaller MFIs. This will help provide countercyclical support in times of stress.
- Clearly capture and articulate the "impact" story to engage all stakeholders, especially during shocks.
- Need to bring about clarity around the usage of public goods / infrastructure to ensure there is a sustained 'cost-to-serve' for mass market entities. Adherence to governing codes and common standards by all mass market banking players, e.g., exposure norms, sanctity of credit bureau reports, etc., is difficult today.
- Access to reliable and stable sources of funding, especially for smaller MFIs, should be a priority. This will help provide countercyclical support in times of stress.

- The "impact" story should be clearly captured and articulated to engage all stakeholders, especially during shocks.
- There should be clarity around the usage of public goods/infrastructure to ensure there is a sustained 'cost-to-serve' for mass market entities.

Driving sustainable growth of the mass market banking sector could involve discussions around five key dimensions (Exhibit 24):

Exhibit 24: 5 dimensions of interventions




(Source: Microfinance congress summary)

### 1. Customers and Sourcing

- Mass market banking institutions need to explore additional geographies and markets to increase reach and access via a "ladder" of products
  - Customers need to be offered inclusive "micro-banking" products, i.e., along with loans, it is important for institutions to offer low cost insurance products (e.g: Pradhan Mantri Fasal Bima Yojana)
- Partnerships, e.g., co-origination of loans by banks and NBFCs for lending to priority sectors, needs to be actively operationalized
- Focus on customer education and literacy initiatives, e.g., understanding the impact of credit bureau scores, needs continual efforts
- Consider reviewing the current regulation that limits two MFIs for each borrower to cap only on the total amount of lending to a client.

- Incentivize using a calibrated approach to expand to aspirational districts, given the cost to serve could be high with limited returns

2. **Credit and Collections**

- Explore the roll-out of short tenure micro-loans instead of the traditional 18-month loans to meet evolving customer needs.
- Unify and harmonize bureau data - link SHG databases to consumer level databases and allow NGOs to report data into bureaus.
- Consider the creation of a public utility to report ‘masked’ non-traditional sources for a customer, i.e., a “data surrogates report”.
- For the missing middle, consider innovations like title insurance to expand the eligibility criteria for credit.

3. **Operations and Technology**

- Leverage the full stack of public goods available, e.g., UPI and BBPS, to drive large-scale efficiencies.
- Create a robust 360-degree view of customer data to determine all the financial exposures / relationships of a customer.
- Standardize integration architecture with third-party, approved data sources that leverage utilities, e.g., Digi-locker.

4. **Culture and Organization**

- Enhance the role of training (learning and development) to maintain cultural and operational discipline (especially gender sensitivity)
- Ensure FIs adhere to the minimum acceptable code of conduct laid down by SROs – expand the role of SROs in promoting a common culture and branding

5. **Brand Equity and Access to Capital**

- In times of crisis/shocks, design mechanisms to control rumours and ensure only information from credible sources (DFS, RBI, etc.) is followed.
- Come together as an industry to create and popularize an “impact report”. This could be done by running brand communication on success stories, etc.

- Create a structured channel of engagement with district authorities / police to ensure they understand that “MFI lending is a legitimate business” – (including Section 8 companies)
- Ensure governing bodies and SROs act as the “bridge” between capital markets and mass market enterprises for funding.
- Consider re-look at certain rules pertaining to:
  - The amount of loan cap for an individual customer (currently INR 1.6 lakh)
  - Calculations of capital adequacy ratios and eligibility criteria (85 percent) of qualifying assets
  - Loans to tier-2 NBFC-MFIs by banks as non-PSL classification

To action on the points above, coordinated efforts will be needed not only by industry participants (SFBs, MFIs, banks) but also with key stakeholders including regulators, SROs, bureaus and ecosystem partners (fin-techs, social service groups, etc.).

Below are key considerations for stakeholders that emerged from the discussions:

### 1. Mass-market banking players

- Players could go “beyond lending” and offer a full-suite of micro-banking products (e.g.: insurance, payments, deposits, basic investment advisory)
- Product innovation could unlock significant growth given the underlying needs of the segment – consider offering short tenor, flow-based loans in addition to the traditional 18-month loans
- Consider automation of information sharing and flow of information with policy-makers, regulators and other stake-holders
- While cost is important, consider wider financial benefits of spreading the inclusion net to under-served districts. Technology and analytics can potentially make cost-to-serve viable
- Players could intensify their focus and investments in training, development of work-force given the sensitivity of the customer base that they engage

**2. Policy makers and regulators**

- Consider creation of a structured channel of connect between MFIs and district authorities that can help insulate these businesses against local or structural shocks; necessary to build the dialog of "MFI lending as a legitimate business"
- Regulators could setup a continuous review cadence and dialog with the industry on certain rules to reflect changes in on-ground realities; some of the rules that were discussed were:
  - 2 MFI criteria and amount of loan cap for customers
  - Definition for capital adequacy ratios and qualifying assets
  - Classification of PSL for bank loans to Tier 2 NBFC-MFIs

**3. Broader Financial Services ecosystem (SROs, bureaus)**

- SROs could create and popularize "impact reports" – run brand communication efforts on success stories of the industry etc.
- Bureaus could organize players to create a public utility – a database that could provide non-tradition proxies ("surrogates") – to bring down cost to source and improve accuracy of screening customers
- The bureaus could harmonize and unify data across SHGs and individual customer data – to create a "one-view" for the MFI customer

Over the course of the congress, it became increasingly evident that a common forum for this sector to come together and deliberate was so far not present, with discussions held in isolated clusters. There has been significant interest shown in creating a regular cadence (annual) for the participants to jointly brainstorm and represent their recommendations to continue driving growth in this most critical financial services sector - mass market banking.

# *A Glimpse of SIDBI National Microfinance Congress 2018*


Hebbar
Sadaf Sayeed


Govind Singh
Sandeep
Samit Ghosh


Mukherje
SHRI ALOK MITTAL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## About SIDBI

Small Industries Development Bank of India (SIDBI), established under an Act of the Parliament in 1990, acts as the Principal Financial Institution for Promotion, Financing and Development of the Micro, Small, and Medium Enterprises (MSME) sector. Over the years, through its various financial and development measures, the Bank has touched the lives of people across various strata of the society and impacted enterprises over the entire MSME spectrum.

The Banks's footprint as on date includes 9 Regional offices, 69 Branch offices and 18 Resident Representative Offices (RRO), which includes an enhanced RRO setup, aimed at improving outreach.

In the context of the changing MSME lending landscape, the role of SIDBI has been realigned through adoption of SIDBI Vision 2.0. Vision 2.0 envisages an integrated credit and development support role of the Bank by being a Thought Leader, adopting a credit-plus approach, creating a multiplier effect and serving as an aggregator, in the MSME space.

In line with Vision 2.0, during the year, the business strategies have been reoriented, along with putting in place strategic business initiatives & product/operational improvements, various structural initiatives have been embarked upon and the digital drive has been invigorated.

## SIDBI in Microfinance space

SIDBI has been a pioneer in the micro-finance space by providing financial assistance, in the form of equity/ quasi equity, term loans and grant support to Micro Finance Institutions (MFIs) while advocating and implementing various responsible lending practices. As an industry leader, SIDBI has been working continuously towards enhancing the corporate governance and operational efficiency of MFIs and enabling smooth flow of adequate credit to the micro finance sector through various interventions. Till March 2018, the Bank has developed the capacity of more than 100 MFIs and provided financial support to them to the extent of INR 17,561 crore, benefitting 381 lakh people, mostly women.

## Partners

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