



# Microfinance— Going digital while retaining the humane touch

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# Message from AMFI-WB

The 4th Eastern India Microfinance Summit 2018 is a very special one with its title “Microfinance—Going digital while retaining the humane touch”. In India, majority of poor are still excluded from financial services. Microfinance is a program to support the poor rural & urban people to pay its debt and maintain social and economic status in the villages. Microfinance is an important tool for improving the standard of living of poor. Microfinance market in India is expected to grow rapidly, supported by government of India’s initiatives to achieve greater financial inclusion, and growth in the country’s unorganised but priority sector.

The microfinance industry has seen tremendous growth over the past five years, growing at a 45% CAGR. It has witnessed rapid evolution with regulatory reforms post the Andhra Pradesh crisis in 2010 to regulate product, pricing and protection of customer interest. This included the growth of regulated NBFC MFIs - a special class of RBI regulated entities carrying out microfinance, the formation of the first ever Self-Regulatory Organisations (SROs) of the RBI, Aadhar based lending by NBFC MFIs and transformation of some of the entities into universal and small finance banks. The industry needs to get back to the basics and offer tools that can help it do that.

As we move into the 4th Eastern India Microfinance Summit 2018, technology is expected to play a pivotal role in the segment, given the intense nature of operations. The MFIs will have an additional set of technology proficient competitors such as Fintech-based small-ticket lenders and crowd funding institutions. Usage of e-payments and ATM cards by the microfinance clients for payment and disbursal of loans is making the task of microfinance service providers much easier and this is why they are concentrating majorly on increasing the clientele. The microfinance institutions are also adopting Management Information System (MIS) for managing client data, streamlining their data maintenance. With

the use of IT, the MFIs are also trying to simplify the process of lending small loans by making it more cost effective.

With this as the backdrop, AMFI-WB and KPMG have put together this report which showcases the microfinance industry as it is today and possible roadmap ahead to take a quantum leap with digital as its springboard. We are sure this report will stimulate further thought and dialogue, spurring a rich exchanges of ideas.

We hope this report is helpful and we welcome any thoughts you may have.

Warm regards



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**Chairperson**  
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Chandra Shekhar Ghosh

**Former Secretary**  
AMFI-WB



Kartick Biswas

**Secretary**  
AMFI-WB

# Message from KPMG in India

Microfinance in India, which started through the Self Help Group – Bank linkage model, has evolved significantly over the last two decades and reached nearly 26% penetration levels in the total addressable market in 2018. The industry had its share of ups and downs over the last decade and has emerged stronger over this period through enhanced controls, higher regulatory oversight and strength of the institutions.

Over the years, Microfinance Institutions (MFIs) have been providing small scale loans and financial services to individuals primarily in rural & semi-urban areas that have traditionally been excluded from the formal financial system due to multiple constraints including geographical presence, unavailability of formal financial history, etc. Given the strong drive towards financial inclusion by Government of India and RBI over the past decade or so, MFIs have assumed a key role in ensuring the reach of financial services to the target segments enabling them to undertake income generation activities, drive self-employment and overcome the economic barriers in a sustainable manner.

While the profile of the microfinance customer has not changed significantly, we have seen transition in various facets of the industry from product profiles, operating model, innovation across the lending value chain with technology playing a key role.

Microfinance institutions are increasingly catering to various credit needs and non-financial service needs of the customer (eg. Solar power, water, consumer durables, etc.) through various partnerships and have been able to improve the relationship value at a customer level.

Digital has changed the way financial services are being delivered in India and MFIs are no exception. Several MFIs have embraced Digital through their own investments or in collaboration with other firms. While Digital has helped improve operational efficiencies in internal processes, there is still significant humane touch for customer facing processes.

This paper highlights the evolution of various aspects of the microfinance industry and how the humane touch continues to be relevant for this industry.



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# Evolution of microfinance in India

Since independence, institutional credit catered primarily only to the upper classes of society. Around 70 per cent<sup>01</sup> of the total borrowing in the country was through informal sources.

The multitude of directly subsidised loan schemes launched by the government made a very limited impact, thus creating a dire need for an alternate source of formal credit.

It was this very need of credit supply to the needy income groups that drove policy makers to form the National Bank for Agriculture and Rural Development (NABARD) in 1982.

## Evolution of Microfinance in India

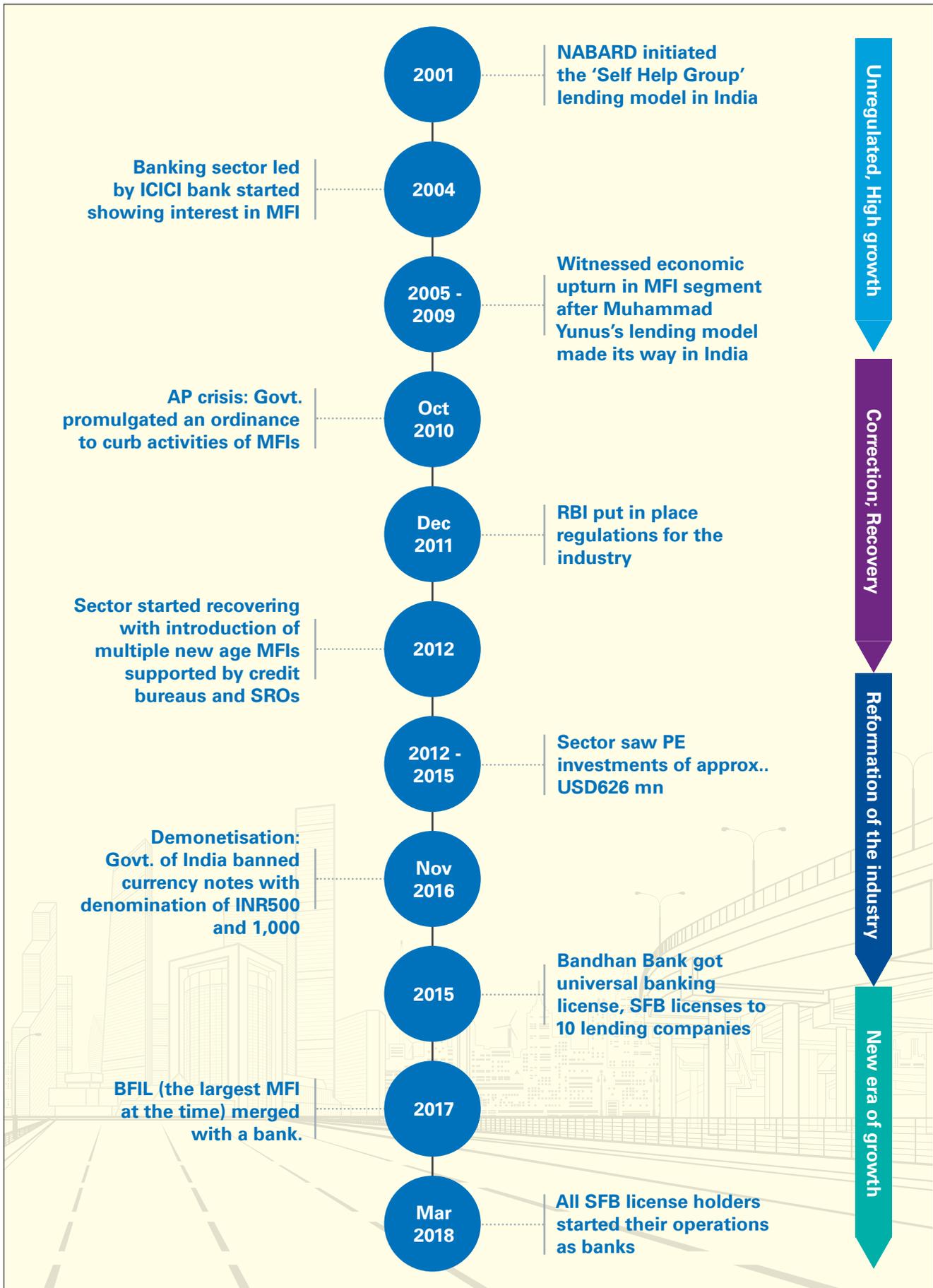
NABARD initiated the 'Self Help Group' lending model (Self Help Bank Linkage model which later evolved to the current hybrid Self help group (SHG) and Joint liability group (JLG) models) in India with the policy backing of the Reserve Bank of India and started linking the same to banks. The essence of the model was a move from paper-backed collateral to a socially-backed collateral from a group in geographical proximity. Approximately 7.87 million<sup>02</sup> poor families were brought within the fold of formal banking services as on 31 March 2002.



01. "Persistence of Informal Credit in Rural India: Evidence from 'All-India Debt and Investment Survey' and Beyond", RBI, May 2013

02. "Microcredit in India", GK Today, Oct 2009

Figure 1: Evolution of microfinance in India



Women constituted 99%<sup>03</sup> of micro-credit beneficiaries in the country and the social strata in the model ensured that the group paid back the loans.

The number of key players in this segment have grown to a significant size and the RBI, with the intent to de-risk the public companies, started allowing them bank licenses in order to help them diversify their portfolio.

One of the largest MFIs in India at the point in time, Bandhan, was granted a universal banking license in 2015<sup>04</sup>. In 2015, the RBI also granted small finance bank licenses to 10 lending companies, of which 8 were MFIs.

In 2017, BFIL (the largest MFI at the time) merged with a bank<sup>05</sup>. By March 2018, all the SFB license holders were operational.

This transition has led to a new question in the current market – will the majority of the MFIs (given there are four to five midsize players with a GLP > INR 3,000 crore<sup>06</sup>) survive the competition from banks and small finance banks given their lower cost of funds, no spread cap (MFIs to restrict their spreads to 10 per cent<sup>07</sup>) and no limit on maximum exposure to borrowers.

Market players have indicated that MFIN is expecting the RBI to induce parity between the players in terms of regulatory norms restricting the Microfinance lending to avoid:

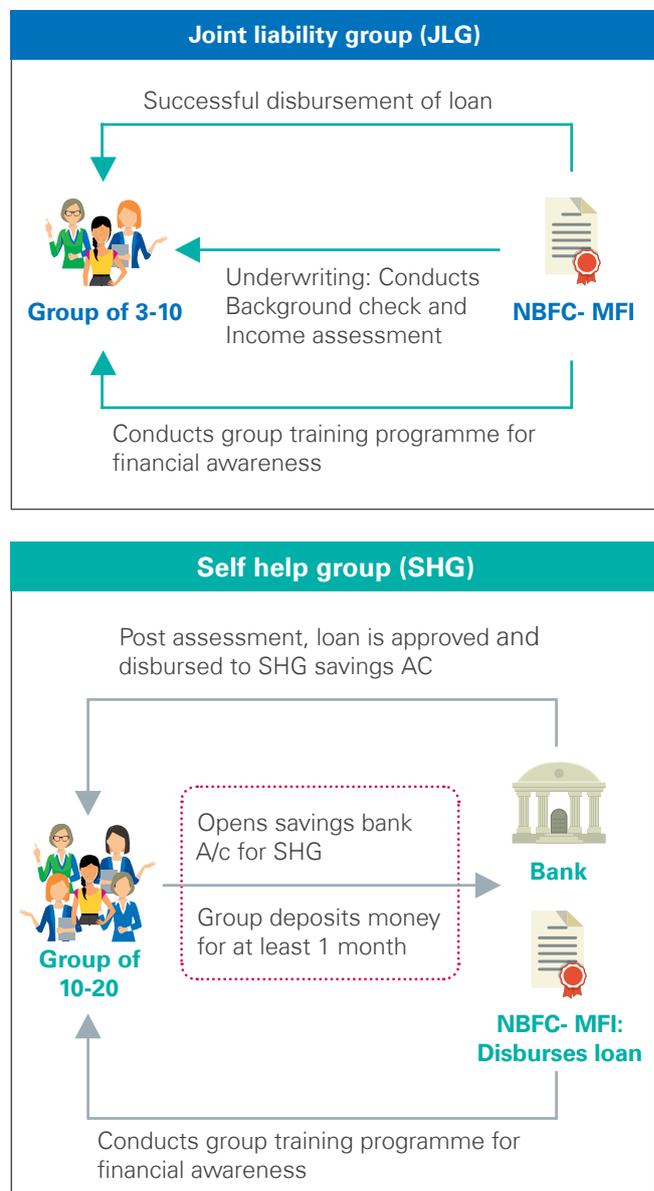
- over leveraging of the customer through various legal entities and
- to avoid unfair playing field for MFIs where they have to operate of marginal profits to survive.



## Comparison of Microfinance Lending models: JLG v/s SHG

Currently in India there are three models prevalent in the Microfinance Lending space – JLG (Joint liability group), SHG (Self-help group) and SHG Bank linkage. While JLG and SHG models are employed by NBFC-MFIs and Small Finance Banks, SHG bank linkage model is followed by commercial, corporate and regional rural banks. Over the decades, there has been an evolution of a hybrid model taking into consideration certain best practices and processes from each of the above two models SHG and JLG.

**Figure 2: Comparison of microfinance Lending models<sup>08</sup>**



03. "Microfinance lends a support to women entrepreneurs", Newspatrolling, Aug, 2018

04. "Bandhan Becomes India's Youngest Bank", The World Bank, Aug, 2015

05. "Indusind clinches largest MFI deal, takes over Bharat Financial", Times of India, Oct, 2017

06. "MFIN Micrometer, Q4,2018", MFIN, March 2018

07. "Master Circular- 'Non-Banking Financial Company-Micro Finance Institutions' (NBFC-MFIs) - Directions", RBI, July 2015

08. KPMG in India's analysis 2018 based on discussions with industry participants

**SHG model:** An SHG consists of a group of 10-20 members of a community who wish to take a loan for a common purpose like a micro enterprise or on an individual basis. Bank account opening for the group and for each member individually is mandatory in an SHG model. Post formation of the group, there is a cooling off period of around one month before loans are disbursed. Currently, fewer NBFC-MFIs adopt the SHG portfolio/ model as compared to the JLG model.

**JLG model:** A JLG consists of a smaller group of 4-10 members of a community for the purpose of individual loans. Bank account opening is not mandatory in a JLG model. Contrary to an SHG

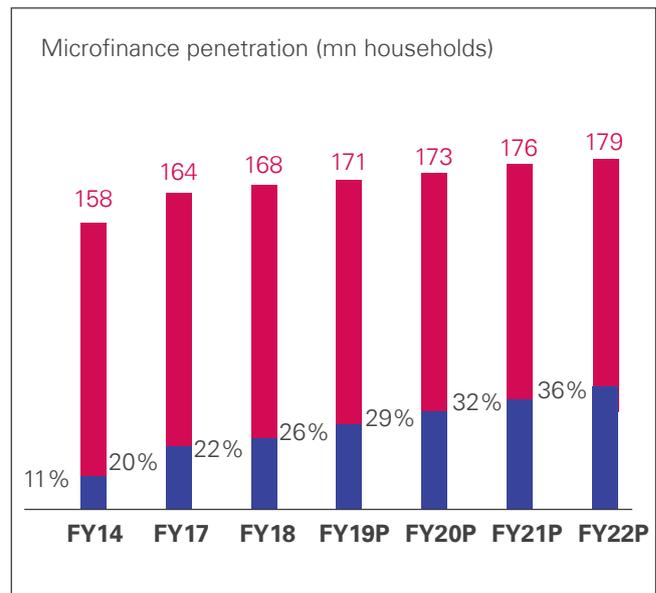
model, there is no cooling off period for loan disbursement and typical turn-around time is three to four days. Currently, most of the NBFC-MFIs adopt the JLG portfolio/ model.

Growth observed in Microfinance Lending in India over the last three to four years has been primarily on account of the JLG model as loan disbursement via this route has a significantly low turn-around time. Further, most Microfinance players also prefer to expand via the JLG route on account of its high scalability. However, the JLG model lacks the focus on inculcating a savings habit among its group members, which is at the core of the SHG model.



# Current state of microfinance lending in India

**Figure 3: Microfinance penetration in India<sup>01</sup>**



In FY18, the overall penetration of JLG/ SHG hybrid portfolio of the total addressable market was ~22 per cent<sup>02</sup> and is expected to increase to 35-40 per cent by FY22<sup>03</sup>.

In spite of the significant increase in outstanding GLP portfolio, the microfinance penetration is expected to remain low on account of overlapping loans and overexposure to individual borrowers.

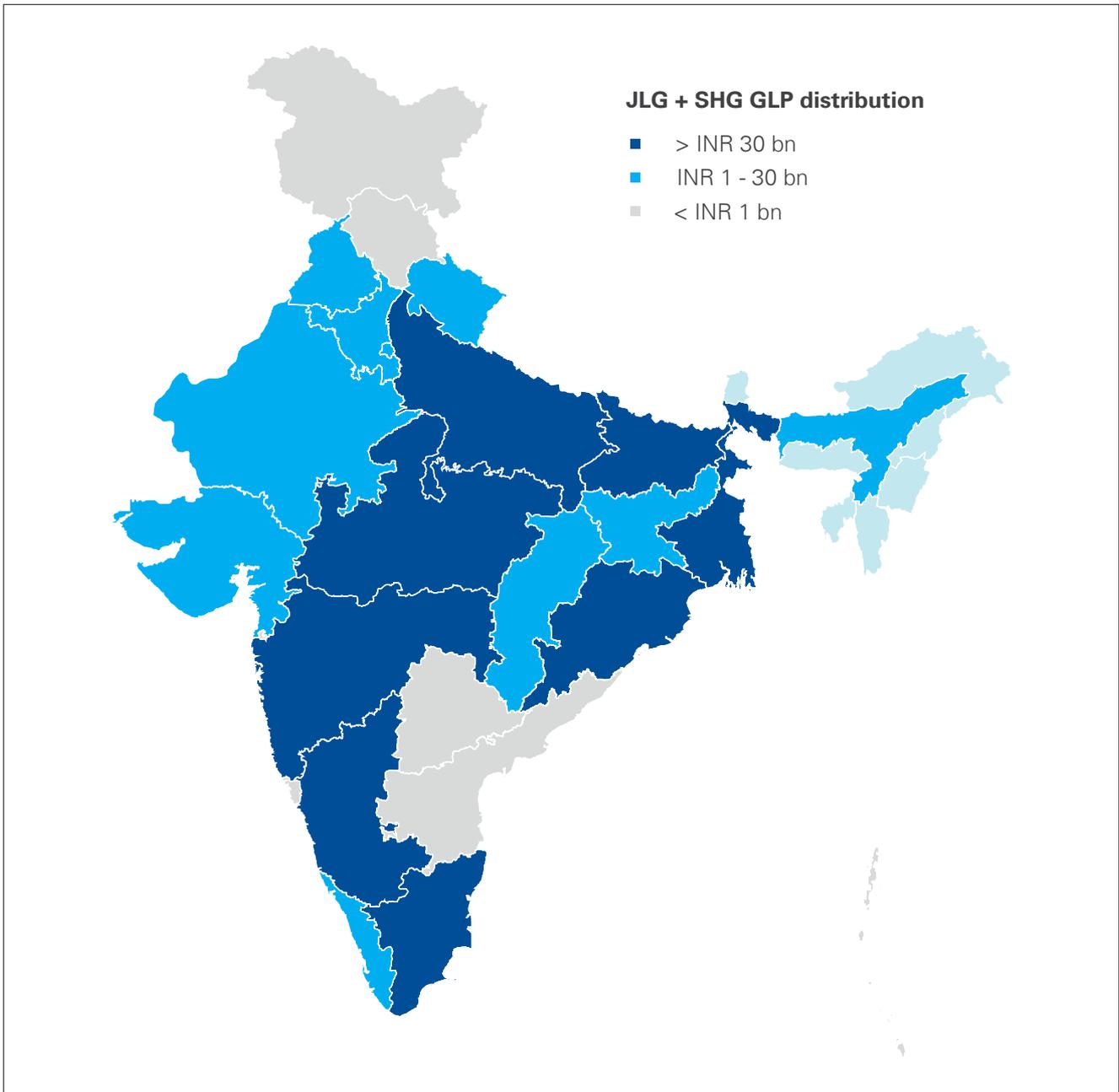
While states like Tamil Nadu, Karnataka and Odisha are likely to see high penetration levels of ~70 per cent<sup>04</sup>, a majority of the states in the rest of the country including key states in the northern and central region like Gujarat, Rajasthan, Maharashtra, Uttar Pradesh etc. which possess a significant potential for Microfinance growth are expected to remain underpenetrated, which gives a significant headroom and opportunity for Microfinance Lenders to grow.

Further, in mature markets like Tamil Nadu and Karnataka and also rest of the states where Microfinance network has been in existence, there has been an increased focus from lending institutions (non-MFI) in targeting the relatively elevated households with up-sale products like MSME finance, vehicle loans, and other consumer finance loans. Increasing exposures to this segment of populations and their vulnerability to external economic events, may possess an increased threat to the health of the sector and needs to be timely governed.

01. MFIN Micrometer reports FY14-18, KPMG in India's analysis 2018 based on discussions with industry participants
02. MFIN Micrometer reports FY14-18, KPMG in India's analysis 2018 based on discussions with industry participants
03. MFIN Micrometer reports FY14-18, KPMG in India's analysis 2018 based on discussions with industry participants
04. MFIN Micrometer reports FY14-18, KPMG in India's analysis 2018 based on discussions with industry participants

## Geography

Figure 4: Geographical distribution of Microfinance business in India<sup>05</sup>



Microfinance institutions operating under the JLG/ SHG hybrid model have traditionally had a large presence in south India, but players are now venturing into the lesser penetrated areas of central and east India, recognising the significant potential in these states.

Currently, the southern states of Karnataka, Tamil Nadu, western states of Maharashtra and Madhya

Pradesh, eastern states of Bihar, Odisha and West Bengal and northern state of UP have the highest gross loan portfolio of JLG/ hybrid SHG loans.

States of Rajasthan, Gujarat, Kerala and Chhattisgarh have a comparatively lower amount of loan portfolio base, but several players have realised the opportunity in these markets and are slowly expanding their networks in these areas.

05. MFIN Micrometer report FY18

Maharashtra and Bihar have the highest number of microfinance institutions operating under the JLG/ SHG hybrid model (27 microfinance institutions as on March 2018). The western and southern regions of the state are more attractive than central Maharashtra owing to its high density of MFIs in the region. Northern Maharashtra has the lowest density of MFIs in the state and growth is expected to come from this region.

After Maharashtra and Bihar, the states with the highest number of MFIs operating include Chhattisgarh – 21, Odisha Madhya Pradesh – 20. The highest branch network of microfinance institutions operating under the JLG/ SHG hybrid model is in the state of Karnataka.<sup>06</sup>

Eastern states of Odisha, Bihar and West Bengal have a large GLP base on account of key players like Annapurna who have a significant presence in these states a significant presence in these states.

In the past, one of the key considerations in selecting a geography to open new branches would be shortlisting of locations that needed assistance from a social upliftment point of view. Increasingly, the process adopted by leading NBFC-MFI players for selection of geographies to expand into rely heavily on the population and branch density of the said region with a focus on how profitable the proposed branch could be. The emphasis on venturing into locations that 'need' the financial support of these organisations seems to have reduced.



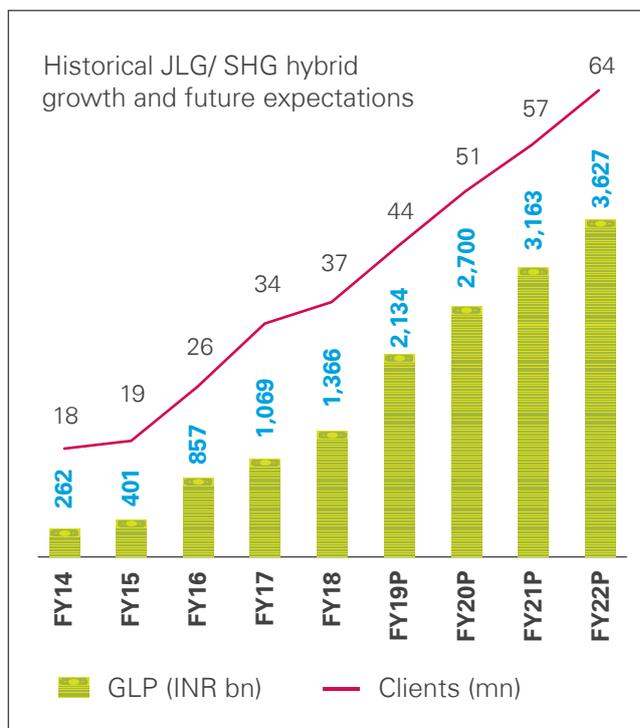
06. MFIN Micrometer report FY18



# Growth in microfinance portfolios

Growth is likely to come through a mix of higher ticket size loans in highly penetrated states and rapid addition of clients in underpenetrated ones

**Figure 5: Historical performance and future projections of Microfinance in India<sup>01</sup>**



The overall GLP is expected to increase at a CAGR of 28 per cent<sup>02</sup> from INR 1,366 bn in FY18 to INR 3,627 bn in FY22<sup>03</sup>.

GLP portfolio growth in the southern states of Tamil Nadu, Kerala and Karnataka are likely to remain at a CAGR of 20-25 per cent<sup>04</sup> over the next five years and will be primarily on account of higher ticket size loans given to customers with higher loan cycles.

States of Rajasthan, Gujarat and Madhya Pradesh are likely to have a higher growth rate of more than 30 per cent<sup>05</sup> since penetration is low at present in these states. As Microfinance players expand to these newer geographies, there will be an increased new client addition with lower ticket sizes and this can drive growth in these states.

01. MFIN Micrometer reports FY14-18, KPMG in India's analysis 2018 based on discussions with industry participants
02. MFIN Micrometer report FY18
03. MFIN Micrometer reports FY14-18, KPMG in India's analysis 2018 based on discussions with industry participants
04. MFIN Micrometer reports FY14-18, KPMG in India's analysis 2018 based on discussions with industry participants
05. MFIN Micrometer reports FY14-18, KPMG in India's analysis 2018 based on discussions with industry participants

Historical growth in GLP was fueled by client additions as well as increasing client exposures in mature Microfinance states like Maharashtra and Tamil Nadu, while future growth is expected to be driven by client additions in new, underpenetrated geographies

From FY14 to FY18, the JLG/ SHG hybrid portfolio of these institutions grew at a rate of 51 per cent from INR 262 bn to INR 1,366<sup>06</sup> bn fueled by increasing private equity investments in the sector from 2012 to 2015. The number of clients has also increased from 18 mn in FY14 to ~37 mn in FY18<sup>07</sup>.

States like Tamil Nadu and Karnataka which are mature Microfinance markets on account of a higher literacy rate and higher awareness about Microfinance loans and products have a higher penetration of 40-50 per cent<sup>08</sup>.

Historically, their growth was been fueled equally by increasing average exposures as the loan cycles in these states are higher as well as client additions.

States like Gujarat and Chhattisgarh, which have a low penetration of JLG/ SHG hybrid loans, have shown a significantly high growth rate in GLP over the last five years which has been primarily fueled by client additions in these states. Over the next 5 years, client additions are expected to nearly double from ~37 mn at present to ~64 mn<sup>09</sup> in FY22 as per discussions with industry experts.

While the branch network of MFIs has increased from ~9.7k in FY14 to ~10.1k in FY18, the number of employees has grown from ~66.9k in FY14 to ~82.0k in FY18. The average loan amount disbursed per account has increased at a CAGR of ~12 per cent from ~INR 14.3k in FY14 to ~INR 22.2k in FY18<sup>10</sup>.



06. MFIN Micrometer reports FY14-18, KPMG in India's analysis 2018 based on discussions with industry participants

07. MFIN Micrometer reports FY14-18, KPMG in India's analysis 2018 based on discussions with industry participants

08. KPMG in India's analysis 2018 based on discussions with industry participants

09. MFIN Micrometer reports FY14-18, KPMG in India's analysis 2018 based on discussions with industry participants

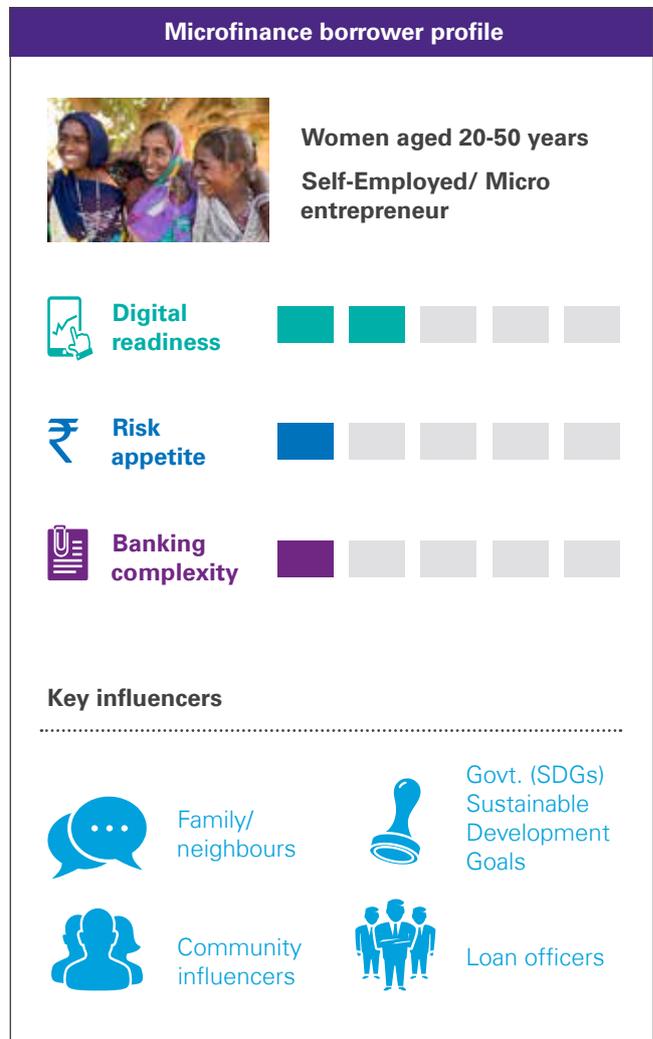
10. MFIN Micrometer reports FY15, FY18

# Customer profile - Microfinance



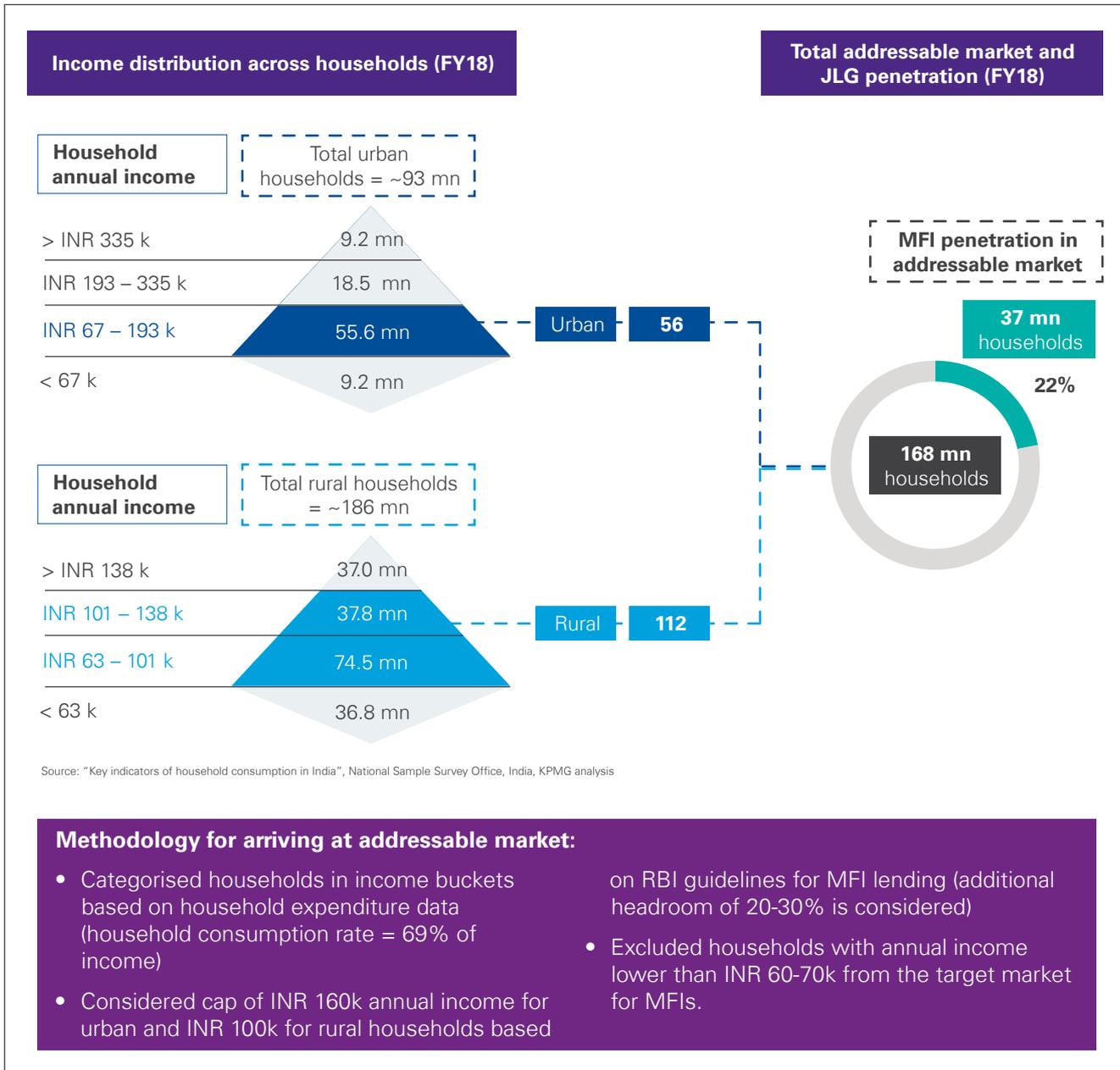
The genesis of microfinance in India has been to uplift the poor and accord better lifestyles through support in the form of credit and other financial products. The target customer segment for the microfinance players are low income households in urban and rural areas. With a large number of households (~164 million households in India) being the addressable market for the Microfinance domain the segment offers a huge potential. Most of the segment has been historically catered to by the informal market however, with increase in awareness, better products, large scale penetration of Aadhar and increase in Microfinance reach the formal market is growing.

**Figure 6: Target segment characteristics**



**Figure 7: Addressable market for microfinance in India<sup>01</sup>**

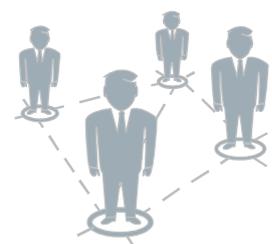
The following diagram shows the penetration levels and the estimated potential for the addressable market.



The microfinance market is primarily segmented basis the group size and geography as shown in the following table with typical needs of the target segment as shown below:

**Customer segmentation**

Geographies	Typical group size	Key product needs
 Rural and Semi urban	Midsized (JLG) or Large size (SHG)	Credit, Insurance
 Urban	Individual (Migrant labourer/ Self-employed)	Credit, Savings, Insurance and Remittances



01. MFIN Micrometer reports FY14-18, "Key indicators of household consumer expenditure 2011-12"-National Sample Survey Office June 2013, KPMG analysis

# Key characteristics of the microfinance products



## Value proposition

### Provision of micro loans

Offer financial services and inculcate the habit of savings amongst the households excluded from the traditional financial system.

Microfinance players offer Specialised products and solutions aligned to unique needs of Rural women customers

Microfinance players lend to the target segment in cycles and customer moves gradually from the seeking income generation loans to seeking consumption loans. There is a high level of personal connect with the borrower before, during and after the loan disbursement. In terms of the kind of products that have evolved are loans these are for livelihood or income generation loans, farm loans, small business loans, water and sanitation loans, loans for purchase of solar lamps, other consumer durables etc. Typically these products have shorter duration and frequent and smaller repayment cycles.

As SFBs evolve after their recent operationalisation, the product offerings could extend to products such as farm equipment, value chain financing, SME loans, education and gold loans, affordable housing loans etc. depending on the success that SFBs have with raising low cost deposits and longer term borrowings to be able to offer longer duration products.



Figure 8: Microfinance products<sup>02</sup>

	Description of product	Avg. ticket size (INR)	Avg. tenure (months)	Avg. yields
	<b>Income generating loan:</b> Loans to support business enterprises and income enhancement of clients by funding working capital, purchase of fixed assets, etc.	L1 ~25l; L2 ~40k L3 ~60k	<b>12-18</b>	<b>19-25%</b>
	<b>Education loan:</b> Meet borrowers' children's school fees due and student loans to those pursuing job oriented courses	30k - 50k	<b>24-48</b>	<b>18-22%</b>
	<b>Agriculture loan:</b> Loans given to farmers for meeting expenses related to cultivation, purchase of tractor, fertilizer, seeds, etc.	30k - 50k	<b>12-36</b>	<b>18-23%</b>
	<b>Home improvement loan:</b> Loans to avail water connections, construction of toilets, repair or replacement of roof, walls, floor, etc.	25k - 45k	<b>12-36</b>	<b>19-24%</b>
	<b>Consumer loan:</b> Loans to purchase consumer durables such as cooking stoves, water filters, LPG connection, solar lights etc.	10k – 20k	<b>12-36</b>	<b>19-24%</b>

## Developing an ecosystem for the target segment

The key areas that need attention are training of customers on livelihood or occupation related training and skill development, financial literacy, healthcare, water & sanitation, education etc. in order to develop a sustainable model of microfinance.

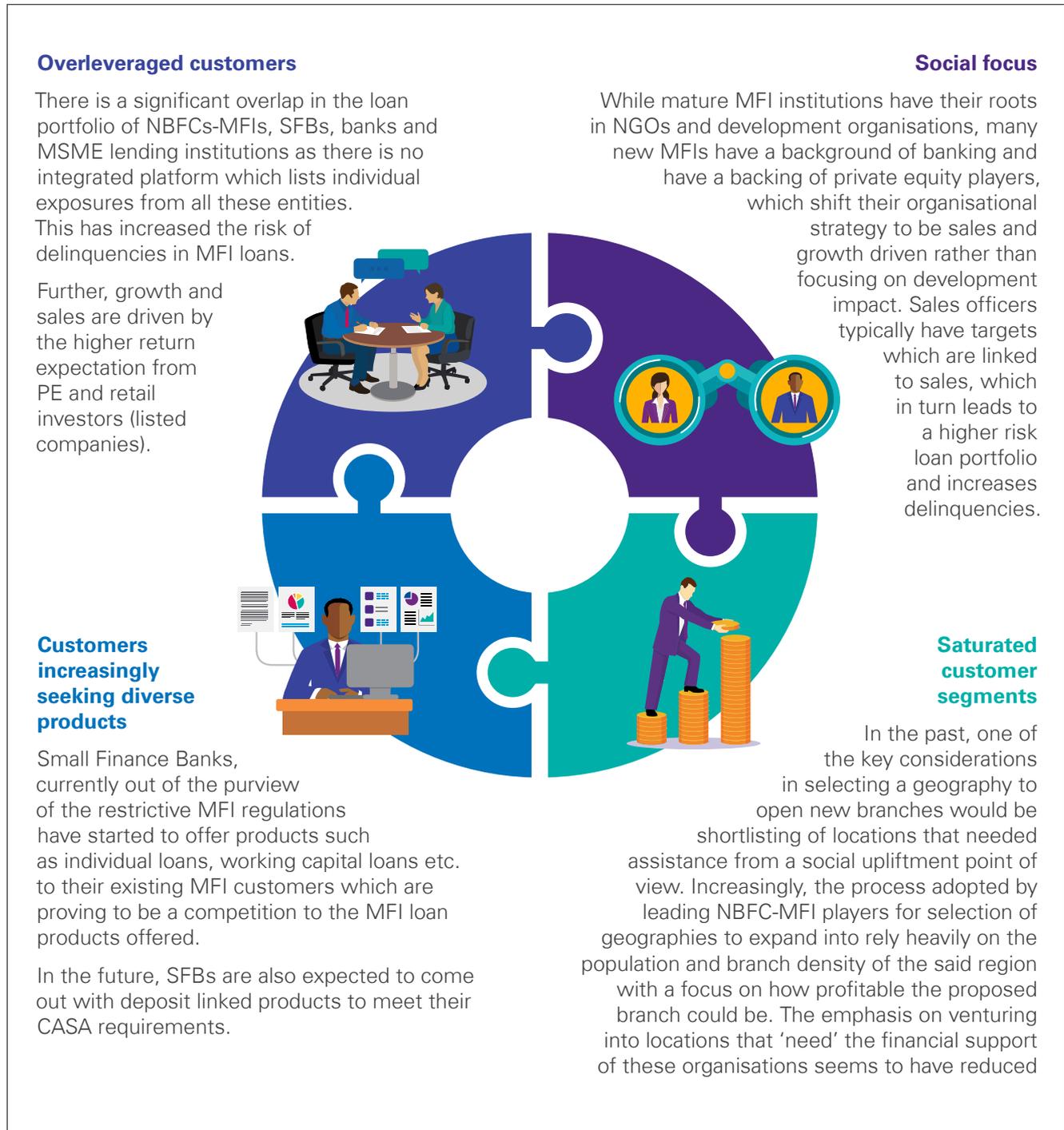
Microfinance players are delivering these trainings as a strategic initiative, however, an entire ecosystem can be created to include a broader set of stakeholders for instance, large corporate through their CSR initiatives, Government of India, NGOs, , Fintech providers, insurance players and local bodies may work towards putting together an ecosystem for improving financial literacy and improving access through user friendly and low cost digital platforms thereby, enabling livelihood generation opportunities in order to uplift the rural poor in a targeted manner.



01. KPMG in India's analysis 2018 based on discussions with industry participants

## Challenges/key risks

Figure 9: Challenges and risks for microfinance in India



## Product profile transition

NABARD initiated the 'Self Help Group' lending model in India with the policy backing of the Reserve bank of India and started linking the same to banks. The essence of the model was a move from a paper-backed collateral to a socially-backed collateral from a group in geographical proximity. Approximately 7.87 million poor families were brought within the fold of formal banking services as on March 31, 2002. Women constituted 99 per cent of micro-credit beneficiaries in the country and the social strata in the model ensured that the group paid back the loans.

Over time however, the products offered by these institutions have been driven by different organisational and investor goals. The social focus has slowly been shadowed by the desire to simply have a larger book size, increased profitability and a more finance driven focus. MFIs and SFBs must not forget the mission/objective of why their organisation was founded and must exercise discretion while lending aggressively to the target customers.

The below table depicts 'the how', and the drivers for the lending model to shift from an individual lending model to a group lending model and also how it circles back to an individual based lending model.

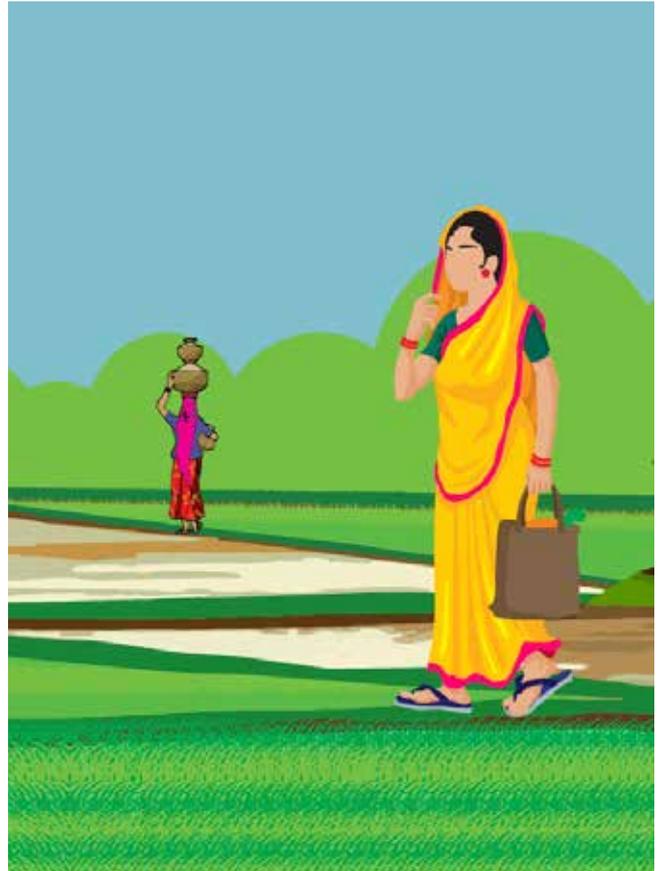


Figure 10: Product profile for microfinance in India

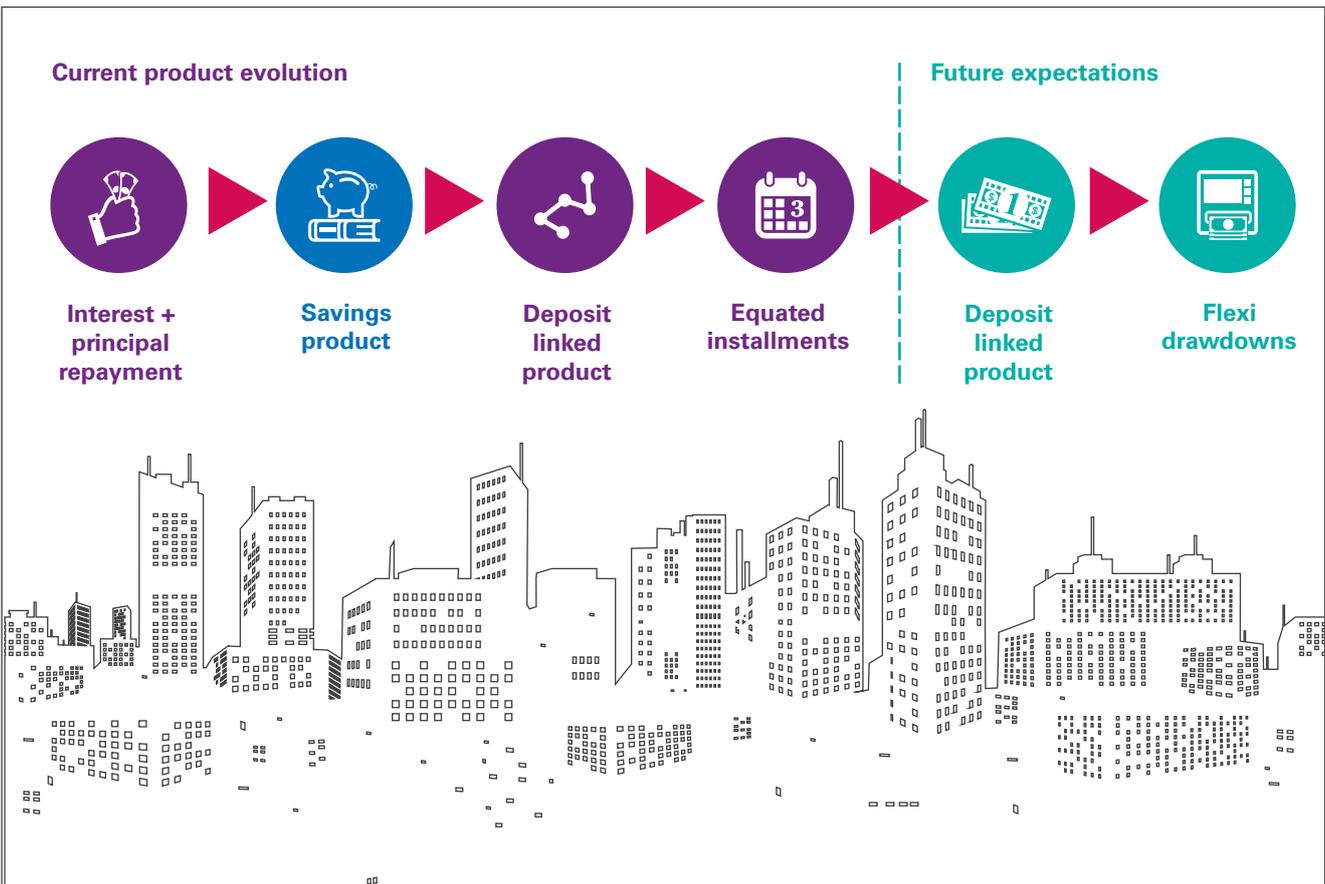
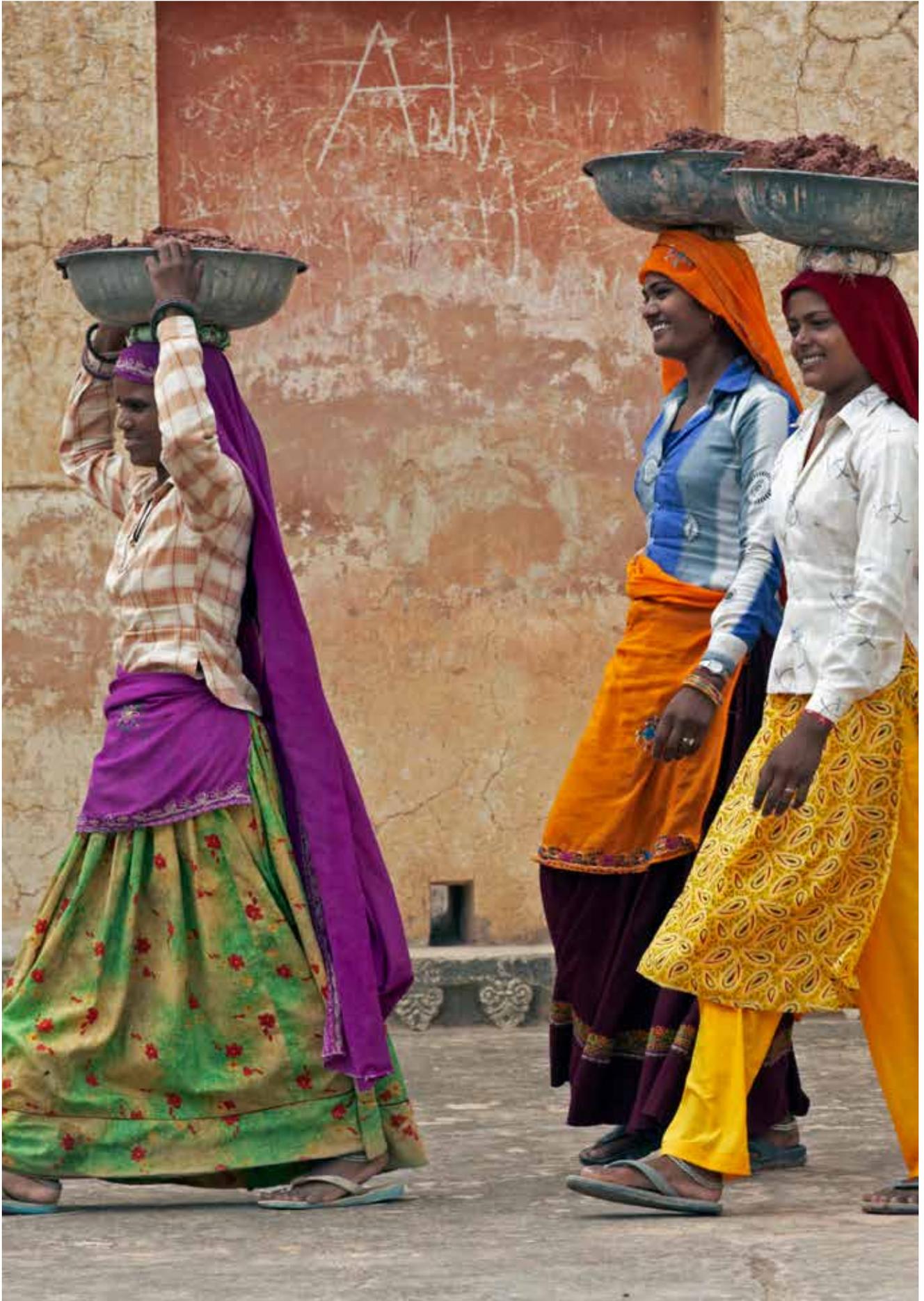


Table 11: Product profile transition with key drivers

 Model	 Drivers of the shift	 Pros of the model	 Cons on the model
<b>Interest + principal repayment</b> <b>Interest for the period + adhoc principal repayment</b>	<ul style="list-style-type: none"> <li>Very high interest rates led to a scenario where borrower could only repay interest</li> <li>Any lump sum cash available was used against principal</li> </ul>	<ul style="list-style-type: none"> <li>Quick TAT</li> </ul>	<ul style="list-style-type: none"> <li>High interest rates</li> <li>Principal was never repaid leading to constant in-debtness</li> </ul>
<b>Savings product</b> <b>Lending was out of saved pool and prepayment in interest plus principal</b>	<ul style="list-style-type: none"> <li>Government reforms brought about this product where a group of people pooled in their savings and lent out of that</li> <li>Formal institutions were not comfortable with the segment</li> </ul>	<ul style="list-style-type: none"> <li>Savings habit was developed</li> <li>Group decided the value of amount to be lent out of their savings – no over leveraging</li> <li>Lower lending rates</li> </ul>	<ul style="list-style-type: none"> <li>Delayed process</li> <li>Not everyone had access to the loan</li> <li>Probabilities of group politics and internal feuds</li> </ul>
<b>Deposit linked product</b> <b>(certain EMIs were held back with the lender and only a net amount was disbursed – higher effective IRR)</b>	<ul style="list-style-type: none"> <li>A need for third party lender was felt who could lend without any bias and to all the group members at the same time</li> <li>Since these were unsecured loans, some part of the loan was held back as deposits to limit risk</li> </ul>	<ul style="list-style-type: none"> <li>Quicker turnaround as compared to savings model</li> <li>Everyone got a loan</li> </ul>	<ul style="list-style-type: none"> <li>Effective rate earned by lenders was higher than what is highlighted in sanction letter</li> <li>Multiple hidden charges and fees led to limited transparency</li> </ul>
<b>Equated installments</b> <b>Defined repayment schedule with EWIs/EMIs</b>	<ul style="list-style-type: none"> <li>Owing to lack of transparency, Malegam committee mandated a transparent system where EMI in line with rates on the sanction letter was payable</li> </ul>	<ul style="list-style-type: none"> <li>Transparency of lending rates</li> </ul>	<ul style="list-style-type: none"> <li>The habit of savings was not given any weightage</li> </ul>
<b>Deposit linked product (future expectations)</b>	<ul style="list-style-type: none"> <li>With SFBs in the market, they are expected to launch deposit linked products to meet their CASA requirements</li> </ul>	<ul style="list-style-type: none"> <li>Inculcation of savings habit</li> </ul>	<ul style="list-style-type: none"> <li>Effective rate earned by lenders was higher than what is highlighted in sanction letter</li> <li>Multiple hidden charges and fees led to limited transparency</li> </ul>
<b>Flexi drawdowns (future expectations)</b>	<ul style="list-style-type: none"> <li>Microfinance target markets, especially urban markets are maturing. There may come a time where they can drawdown high volume principals and are required to repay only the interest like cash credit limits</li> </ul>	<ul style="list-style-type: none"> <li>Higher drawdown limits</li> <li>Greater flexibility to borrowers</li> </ul>	<ul style="list-style-type: none"> <li>Principal was never repaid leading to constant in-debtness</li> <li>Credit assessment will be on only interest since lenders would not prefer principal repayment from borrowers</li> </ul>



# Operating model transformation



Microfinance growth has been historically driven by growth in the number of branches across different geographies. The competitive intensity is growing in this domain with the emergence of a large number of Microfinance players as well as with the larger MFI players becoming Small Finance banks with lesser restrictions. The pressure on yields is expected to increase and hence, it is essential to revisit the value chain in order to achieve scalability at a lower cost.

Leveraging technology in a planned manner across the value chain while retaining the human element of the microfinance model to enable the shift of focus from operations to the customer will be key to a profitable growth in the future.

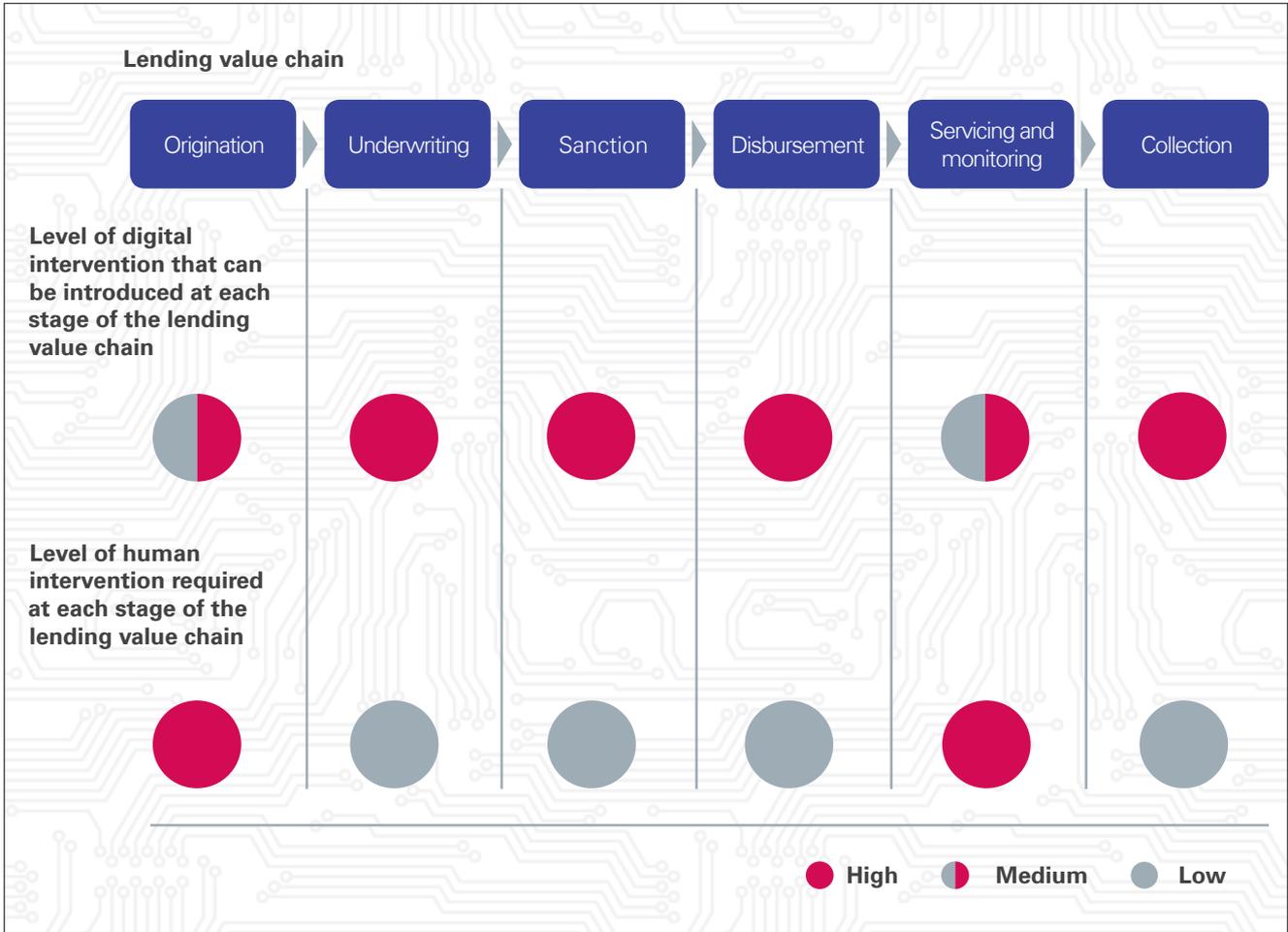
While implementation of core banking systems and loan management systems are underway at many Microfinance players, there is a need to digitise across the value chain focusing on customer onboarding, underwriting, collections and governance mechanisms.

The focus of technology strategy needs to be increasing operating efficiency, reduction of cost, arranging wide cross-sell, and data analytics with clear goals.



## Key elements of the lending value chain

Table 2: Lending value chain



## Illustrative elements in the value chain

(Blue marked fields represent advanced stage of maturity and grey marked cells represent pilot stage for Microfinance players)

Table 3: Illustrative elements in the lending value chain

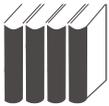
Origination	Underwriting	Sanction	Disbursement	Servicing maintenance	Collections
<ul style="list-style-type: none"> <li>Lead management</li> <li>KYC</li> <li>Data entry</li> <li>Document collection</li> </ul>	<ul style="list-style-type: none"> <li>Bank and financial statement analysis</li> <li>Credit bureau check</li> <li>Field investigation</li> <li>Alternate credit scoring models</li> <li>Geotagging FI visits</li> </ul>	<ul style="list-style-type: none"> <li>System generated sanction letter</li> <li>SMS</li> </ul>	<ul style="list-style-type: none"> <li>Disbursement modes: Credit to Wallet, NEFT, Cheque payment, Smart Card</li> </ul>	<ul style="list-style-type: none"> <li>Branch service</li> <li>Door step services</li> <li>Call-centre</li> <li>Self-service kiosks</li> <li>Online portals</li> <li>Mobile apps</li> <li>Chat bots</li> <li>Social media apps</li> </ul>	<ul style="list-style-type: none"> <li>Branch based collections</li> <li>Field collections</li> <li>PDC</li> <li>NACH</li> </ul>

## Origination stage

The origination stage refers to the lead generation and management, group formation, KYC, documentation and understanding of the customers' reason for borrowing.

Various Microfinance players like BFIL have deployed personal digital assistants (PDAs) which are hand held devices to collection/ sales officers to carry out

activities such as collection of customer information, monitoring of borrower activity, etc. This is likely to increase the operating efficiency of employees by reducing the amount of paper work and minimising human errors<sup>01</sup>. The following table shows how a Hi tech and Hi touch model are brought together to deliver an excellent customer experience.

	Human touch	Digital interventions	Key benefits	Examples
 <p><b>Lead management</b></p>	<ul style="list-style-type: none"> <li>Customer referrals/</li> <li>Word of mouth/</li> <li>Local marketing initiatives/</li> <li>Customer meetings</li> </ul>	<ul style="list-style-type: none"> <li>System based lead capture, follow-ups, dedupe , allocation and monitoring</li> <li>Leveraging geo tagging to monitor customer meetings and visits</li> </ul>	<ul style="list-style-type: none"> <li>Improved governance</li> <li>Improved understanding of customer needs</li> </ul>	<ul style="list-style-type: none"> <li>Annapurna's tie-up with Artoo for making onboarding processes more efficient</li> </ul>
 <p><b>KYC, document collection and customer case creation</b></p>	<ul style="list-style-type: none"> <li>Minimum human touch required for KYC, documentation</li> <li>Higher engagement in understanding the potential borrowers ability to pay</li> </ul>	<ul style="list-style-type: none"> <li>Leveraging technology to carry out KYC and documentation</li> <li>Real time bank account verification</li> <li>System assisted assessment of clients' case for securing the loan</li> </ul>	<ul style="list-style-type: none"> <li>Improved governance</li> <li>Reduction in sales effort</li> <li>Reduction in TAT</li> <li>Reduction in subjectivity in capturing relevant data</li> </ul>	<ul style="list-style-type: none"> <li>Players like BFIL provide a Personal digital assistant in order to reduce TAT and improve overall governance</li> </ul>

## Underwriting stage

With a high number of new to credit customers, there is an element of subjectivity in the loan appraisal process. With technological interventions robust mechanisms are emerging which are aiding in reducing the manual effort required in analysing the strength of a case and supplementing the decision making process through additional data points, which are non-traditional in nature, but have a fair correlation with the persons' ability to pay. With

the onset of this, the underwriting model is moving from eligibility to evaluation of ability to pay. For instance, AU Small Finance bank started processing Consumer Durable loans via a straight through digital process wherein the credit underwriting, decision making and disbursement happens on the same day. Similarly, the company also provides two-wheeler loans through self-assisted digital modes via a mobile app while analytics is leveraged for credit making.

	Human touch	Digital interventions	Key benefits	Examples
 <p><b>Underwriting</b></p>	<ul style="list-style-type: none"> <li>Field investigation (mostly in-house)</li> </ul>	<ul style="list-style-type: none"> <li>Alternate credit scoring models</li> <li>Geotagging of field visits</li> <li>Credit bureau check (CRIF High mark or Equifax)</li> </ul>	<ul style="list-style-type: none"> <li>Reduced TAT</li> <li>More credible field investigation due to system based tracking</li> </ul>	<ul style="list-style-type: none"> <li>Creditmantri offers solutions based on alternate credit scoring models for customers who are mostly New to credit</li> </ul>

01. [http://www.ijstm.com/images/short\\_pdf/1481782563\\_181ijstm.pdf](http://www.ijstm.com/images/short_pdf/1481782563_181ijstm.pdf)

## Sanction and disbursement stage

Cashless disbursement of microfinance loans provides various advantages over cash-based disbursement including reduction in operational cost for the Microfinance players, lower turnaround time, reduced frauds etc. In Q1FY19, ~87 per cent of the total loan amount disbursed was through the cashless mode<sup>02</sup>. Microfinance lenders like Bharat Financial Inclusion (BFIL), Belstar and Madura Microfinance are leading the shift towards the cashless route of disbursement.

While this reduces TAT from 3-4 days to a few hours there are additional benefits achieved such as reduction in cash reconciliation efforts, reduction in Cash management costs and operational risk mitigation. Besides, this with complete digitisation of the disbursement process, the group transparency has improved due to each member getting the correct amount of loan.

Following table represents the impact of digitisation of disbursement process:



Human touch	Digital interventions	Key benefits	Examples
<ul style="list-style-type: none"> <li>Decentralised credit sanction</li> </ul>	<ul style="list-style-type: none"> <li>Movement of cash based to cashless form of disbursements</li> </ul>	<ul style="list-style-type: none"> <li>Lower TAT</li> <li>Reduced frauds</li> <li>Avoidance of group politics</li> </ul>	<ul style="list-style-type: none"> <li>MFIs like Bharat Financial Inclusion (BFIL), Belstar and Madura Microfinance are shifting towards the cashless route of disbursement.</li> </ul>

## Servicing and maintenance

Range of self service options are available in order to reduce the costs of servicing the customers. In case of the customer segments under consideration the servicing requirements call for higher human intervention however, the back end processes can be automated to a large extent.

Currently the service delivery is branch based or field based as the target segment requires an assisted mode of service. While this may be continued, gradual migration to self-service modes can be put in place for instance, self-service kiosks, online portals or simplified mobile phone applications etc.

Albeit, the service will require high human intervention therefore digitisation of the internal processes can be undertaken with gradual movement to self-service modes.

Training field officers is an important part of the operations of a Microfinance player and can greatly impact the process of collection and disbursement. The increasing smartphone penetration in India has enabled various Microfinance players in collaboration with Fintech players to provide app based e-learning to field officers on various topics like financial literacy,

banking basics and management skills. Sonata Finance in collaboration with Grameen Foundation India introduced G-LEAP, an e-learning app for its staff<sup>03</sup>.



02. <https://www.thehindubusinessline.com/money-and-banking/how-digital-disbursement-boosts-rural-loans-of-microfinance-institutions/article24936717.ece>

03. <http://mfindexia.org/blog/>

## Collection model transition

There has been a lot of positivity in the microfinance sector post the gloom that demonetisation brought upon the sector. The sector had seen some turbulence but now the confidence has been re-instated and the sector has continued to grow more active over the past year.

**Figure 11: Collection model transition for microfinance players in India**

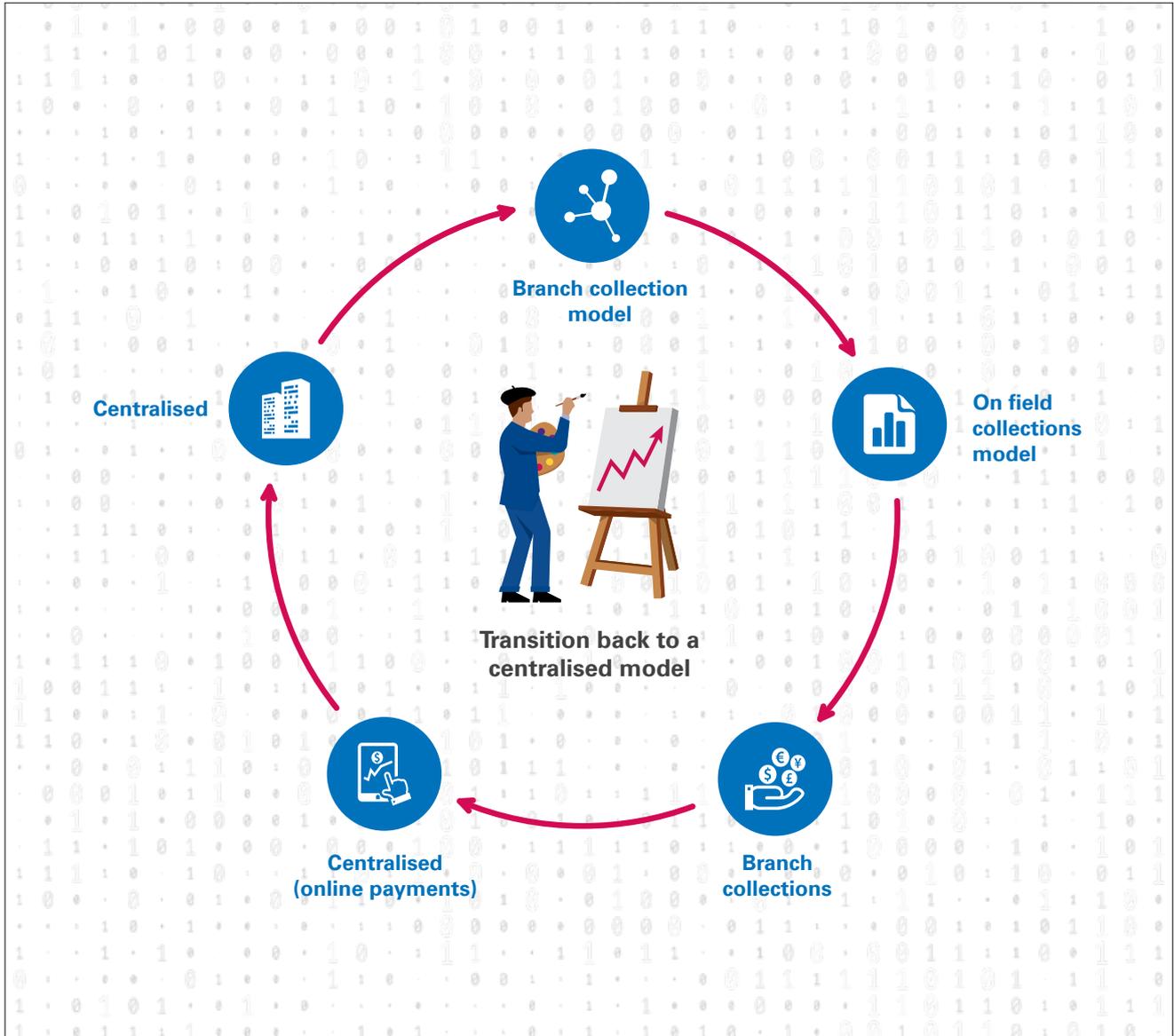


Table 4: Collection model transition with key drivers

 Model	 Drivers of the shift	 Pros of the model	 Cons on the model
 <p><b>Centralised</b></p>	<ul style="list-style-type: none"> <li>Collection in the office by money lenders</li> </ul>	<ul style="list-style-type: none"> <li>No cost of collections</li> </ul>	<ul style="list-style-type: none"> <li>No social pressure on the borrower to repay</li> <li>Coercive measures were used in absence of social pressures</li> </ul>
 <p><b>Branch collection model</b></p>	<ul style="list-style-type: none"> <li>Part of SHG model</li> </ul>	<ul style="list-style-type: none"> <li>Everyone who borrowed in the group paid at the branch (SHG group meeting)</li> <li>No cost of collections</li> </ul>	<ul style="list-style-type: none"> <li>None</li> </ul>
 <p><b>On field collections model</b></p>	<ul style="list-style-type: none"> <li>Part of Microfinance players initial models where a field officer went from group meeting to group meeting to collect</li> </ul>	<ul style="list-style-type: none"> <li>Social pressure on borrowers to repay led to high collections</li> </ul>	<ul style="list-style-type: none"> <li>High operating costs</li> <li>Inefficient for the borrower to meet weekly/fortnightly</li> </ul>
 <p><b>Branch collections</b></p>	<ul style="list-style-type: none"> <li>To improve on operating efficiencies</li> <li>To allow borrowers to continue their daily operations without any interruptions</li> </ul>	<ul style="list-style-type: none"> <li>Higher operating leverage</li> <li>Borrowers do not lose earnings for any time frame</li> </ul>	<ul style="list-style-type: none"> <li>Limited connect between lender and borrower</li> <li>This segment needs personal connect to segregate this from personal loans – branch collections limits the same</li> <li>Purpose of creating social pressure from non-repayment in front of a group is defeated</li> </ul>
 <p><b>Centralised (on line payments)</b></p>	<ul style="list-style-type: none"> <li>To compete with banks and decrease the spread gap between lending and borrowing rates, Microfinance players may opt to digital means of collections in matured markets</li> </ul>	<ul style="list-style-type: none"> <li>Low opex – branch staff to focus only on sales leading to higher growth</li> </ul>	<ul style="list-style-type: none"> <li>This may lead to Microfinance players product gaining features of personal loans which are a) unsecured b) paid online - may lead to delinquency levels of ~7 – 10 per cent similar to personal loans</li> </ul>

# Evolution going forward



While the industry awaits regulatory parity, there are expectations of consolidation in the market to allow for:

## 1. The next wave of growth for Microfinance players –

- Hitherto, Microfinance players have grown their disbursements rapidly at a CAGR of ~50 per cent in the last 3 years, with the potential available in the microfinance sector this growth will continue however, this will also call for growth in relatively underpenetrated regions in North, East and the centre
- This will also serve as an important factor in reducing the concentration risk of customers and geographies
- Microfinance players are evaluating growth through geographical expansion, product portfolio expansion and cross selling other allied products such as insurance.

## 2. Importance of an allied ecosystem for Microfinance players

- As the competitive intensity increases, the pressure on NIM will increase considerably and the need for credit plus products assumes importance
- The Microfinance players can help improve social impact through distribution of products at a lower costs for solar lamps, LED bulbs and lights, sanitation products, purifiers, etc. through strategic tie ups
- Other protection and savings products such as insurance and mutual funds on a low cost platform

## 3. Regulatory and risk implications for Microfinance players

- The microfinance sector awaits parity in terms of restrictions related to lending when compared to small finance banks
- However, the entry of small finance banks has impacted pricing, ticket sizes, product features and repayment behaviour
- Risk framework needs to evolve with entry into products with different features, repayment cycles, product terms (with some products with a slightly longer loan duration)
- At a customer segment level, there is a need for a single credit bureau that will report all exposures of the particular customer segment and provide the lenders with an overall

realistic view of the repayment capabilities. The industry could benefit from following a common code of conduct for the customer segment (account opening, repayment, bank account, KYC, transactions monitoring – purpose)

#### 4. Collaboration with Fintech firms

- Technology is expected to play a pivotal role in the segment given the intense nature of operations. Microfinance players will have an additional set of technology proficient competitors such as Fintech-based small ticket lenders and crowd funding institutions
- With competitive forces becoming more dominant, the pressure on margins will

increase and therefore the use of technology will be critical to building a profitable and scalable model

- Fintech interventions such as geotagging, alternate credit scoring underwriting mechanisms, API banking, the value chain elements such as underwriting and disbursements can be digitised to a large extent
- A combination of Hi tech and Hi touch model can be put in place an operating model that caters to the need for the business to deliver a low cost operating model and need for delivering the desired level of human assistance and awareness creation by the target segment.



# About AMFI-WB

AMFI-WB is an institution which endeavours to promote and develop microfinance in the state of West Bengal. Founded as a self-regulatory organisation, and registered as a Public Charitable Trust in 2010, AMFI-WB encompasses a community of microfinance organisations that operate in West Bengal.

It was formed to deliver better services to the poor, thereby helping these populations improve their standards of living. AMFI-WB envisions a community of microfinance institutions who are committed to initiating a significant change in the lives of the poor, especially women. AMFI – WB currently caters to around 60.75 lakh poor women by providing them with financial services, especially micro credit. With a membership of 27 Micro Finance Institutions especially micro credit through approximately

14,600 employees who hail from a lower economic background.

Their primary goals include: encouraging MFIs to maintain healthy relationships with banks, ensuring that MFIs stay on track and focused with the guideline prescribed to them, and mediating between various government officials and other important sector stakeholders. AMFI – WB regularly conducts stakeholder meets at the district level, management development programs for its members, microfinance industry-related seminars and workshops, and member meetings on matters of mutual interest. Some of the major initiatives/events recently conducted include the 2nd Eastern India Micro Finance Summit 2016 and HR Workshop on Legal Issues with the MD/CEO/HR personnel of all MFIs.

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# Snapshot of Microfinance in Eastern India

States	Count of NBFC-MFI	GLP (Rs. Cr)	Clients (lakh)	Branches	Loan amount disbursed (Rs. Cr)	No. of loans disbursed (lakhs)	Average loan amount disbursed per account (Rs.)
Assam	14	1,601.0	8.9	356.0	585.0	2.20	26,034.00
Jharkhand	18	1,703.0	9.0	350.0	663.0	2.60	25,215.00
Bihar	30	6,286.0	32.0	1,225.0	2,401.0	10.00	24,705.00
Meghalaya	5	-	-	-	-	-	-
Mizoram	2	-	-	-	-	-	-
Odisha	23	6,510.0	33.0	1,189.0	2,292.0	8.70	26,495.00
Nagaland	-	-	-	-	-	-	-
Sikkim	3	-	-	-	-	-	-
Tripura	8	-	-	-	-	-	-
West Bengal	17	5,260.0	26.0	946.0	2,209.0	8.80	25,095.00
<b>Total</b>	<b>120</b>	<b>21,360.0</b>	<b>108.9</b>	<b>4,066.0</b>	<b>8,150.0</b>	<b>32.30</b>	<b>25,232.20</b>

Source: "Micrometer: Data as of 30 September 2018" published by MFIN



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