

## *Microfinance as the Next Wave of Financial Inclusion\**

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Shri Mohammad Mustafa, Chairman & MD, Small Industries Development Bank of India (SIDBI), Dr. Charan Singh, CEO and Director, Foundation for Economic Growth and Welfare, Mr. Gavin McGillivray Head, DFID India, other dignitaries, participants, Ladies and Gentlemen, Good Morning to all! I am very happy that senior bankers, sector specialists, academicians and practitioners are coming together on a single platform to deliberate on the Vision of Microfinance in India at this National Microfinance Congress and the means to achieve the same in the backdrop of an evolving regulatory, political and economic landscape. It is indeed a great pleasure to be amongst all of you here today.

This Congress is quite opportune and timely, as after nearly a decade and half of efforts in financial inclusion, where banks, Non-Banking Financial Companies (NBFCs), microfinance institutions (MFIs) and other financial institutions have played a significant role, today we are at an inflection point needing to unleash the next set of financial inclusion interventions for converting a large part of our population to efficient consumers of financial services. With the technological transformation taking place in associated areas, I see a significant role for the microfinance industry in this process, including in identifying, enabling and handholding a sizeable set of the last mile population to consume financial services rationally, to grow out of poverty and become productive citizens of the country.

The Indian microfinance sector has witnessed phenomenal growth over the past two decades. It is gratifying to note that both the number of institutions

\* Shri. M. K. Jain, Deputy Governor, Reserve Bank of India, Speech delivered at the SIDBI National Microfinance Congress 2019, Mumbai on November 26, 2019.

providing microfinance as also the quantum of credit made available to the financially excluded clients have increased significantly during this period. At this juncture, it is equally important to discuss the way forward. Therefore, I understand that the deliberations in this Congress will include emerging concerns / issues faced due to major changes in the sector in recent years; strategic drivers, trends and possible solutions for stimulating industry growth, innovative, futuristic and high-impact business models being adopted across the sector as also the opportunity areas of policy intervention and technological transformation in the industry.

### **Role of Microfinance in the Economy**

Microfinance, involving extension of small loans and other financial services to low income groups, is a very important economic conduit designed to facilitate financial inclusion and assist the poor to work their way out of poverty. It is argued that microfinance can facilitate the achievement of national policies that target poverty reduction, empowerment of women, assisting vulnerable groups, and improving standards of living.

The journey of financial inclusion in the past two decades has been one of intensive efforts and incremental experimentation. However, the quantum jump came when Pradhan Mantri Jan Dhan Yojana (PMJDY) was launched in 2014, which enabled achievement of the objective of providing bank accounts to adult population in almost every household. The reach of mobile phones and e-KYC (Know your customer) has ensured these accounts are accessible to those who have been included in the financial services milieu.

The Reserve Bank of India has been making sustained efforts to increase the penetration of formal financial services in unbanked areas, while continuing with its policy of ensuring adequate flow of credit to productive sectors of the economy and also ensuring the availability of banking services to all sections of people in the country.

Till two decades ago, on the supply side, the absence of technology and infrastructure was a major impediment as it restricted expansion of banking services to far-flung areas of the country comprising over 600 thousand villages. The institutionalisation of the framework of Business Correspondents (BCs) has been a major step towards enhancing access to banking services. The Reserve Bank advocated a combination of 'Brick and Mortar' structure with technology for extending financial inclusion in the geographically dispersed areas. With all these measures, the number of banking outlets in villages has gone up significantly.

The new banking entities (*i.e.* two new universal banks and ten small finance banks) have also helped to further the cause of financial inclusion in the country. Considering the strong linkage between financial inclusion and payment systems, Reserve Bank has also taken several steps including encouraging use of mobile banking, pre-paid instruments such as digital and mobile wallets, *etc.* For more than a decade now, banks have worked hard to sustain the momentum for achieving the objective of financial inclusion.

Financial inclusion is becoming a focus area for banks, NBFCs, Financial Technology (FinTechs) and other financial entities. Small Finance Banks have also been set up to further financial inclusion with a client base comprising mainly of migrant labour workforce, low income households, small businesses and other unorganised sector entities. Today, when it comes to financial inclusion and microfinance, there are several channels such as universal banks, small finance banks, micro finance institutions, BCs, *etc.* Therefore, as a country that is determined to achieve universal financial inclusion at affordable cost, this is a defining moment, and we should seize the opportunity.

Several innovative measures have been undertaken by the Reserve Bank to facilitate the creation of a conducive environment and increase the level of penetration of the banking system to serve the unserved and underserved population for

achieving the objective of sustainable and inclusive economic growth. A co-origination model, which enables the scheduled commercial banks (excluding Regional Rural Banks and Small Finance Banks) to co-originate loans with the non-deposit taking systemically important NBFCs has also been rolled out for credit delivery to the priority sector. This is expected to boost lending to micro enterprises, small and marginal farmers, Self Help Groups (SHGs), *etc.*

In order to boost credit to the needy segment of borrowers, the Reserve Bank has also advised all Scheduled Commercial Banks (excluding Regional Rural Banks and Small Finance Banks) that bank credit to registered NBFCs (other than MFIs) for on-lending will be eligible for classification as priority sector under respective categories subject to certain conditions.

The Micro, Small and Medium Enterprises (MSMEs) form a vital component of the economy in terms of their contribution to employment generation, innovation, exports, and inclusive growth. In view of this, the Reserve Bank had constituted an 'Expert Committee on Micro, Small and Medium Enterprises' (Chairman: Shri U. K. Sinha) to identify causes and propose long-term solutions for the economic and financial sustainability of the MSME sector. The Committee has made various recommendations in areas such as legislative and institutional framework, access to finance, capacity building and new technological interventions for lending to MSME sector. The recommendations are being examined for implementation.

Since 2006, the Reserve Bank has adopted a planned and structured approach to address the issues of financial inclusion by focusing both the supply and demand side. Having spoken about the supply side, let me now discuss the equally important, but less focussed, demand side aspects of financial inclusion. With the growing formalisation of financial services, we must now intensify our efforts on the demand side, which is to focus on enhancing capabilities so that individuals in the low income groups are in a

position to not merely avail the offered services, but are also capable of demanding preferred products and services suitable to their needs / choices.

The Micro Units Development and Refinance Agency (MUDRA) is a case in point. While such a massive push would have lifted many beneficiaries out of poverty, there has been some concern at the growing level of non-performing assets among these borrowers. Banks need to focus on repayment capacity at the appraisal stage and monitor the loans through their life cycle much more closely.

The role and importance of the microfinance sector in our economy has also been steadily growing. According to the Bharat Microfinance Report 2019 prepared by Sa-Dhan, MFIs operate in 29 States, 5 Union Territories and 570 districts in India. The MFIs are also expanding into newer territories for reducing their concentration risk.

Tailored products for providing credit to those without a credit score, entrepreneurial and consumption credit, handholding, financial literacy, social occasion credits and insurance (life and non-life), are all waiting to be tapped in scale and size. Limited forays have been made but are yet to achieve their full potential.

The Reserve Bank defines Financial Inclusion as the 'process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular, at an affordable cost in a fair and transparent manner by regulated, mainstream institutional players'. The National Strategy for Financial Inclusion (NSFI) 2019-24 has been framed by us. It gives the Vision to make financial services available, accessible, and affordable to all citizens in a safe and transparent manner to support inclusive and resilient multi-stakeholder led growth.

### **Potential of Microfinance**

A major demographic change is taking place in our country with a huge and growing working

population. There is a big chunk aspiring to grow into the middle class with the support of institutional credit. Therefore, microfinance can play a big role in meeting their requirements and fulfilling their goals.

The credit needs of low-income groups range from emergency loans, consumption loans, business loans, working capital loans, housing, *etc.* In addition to credit, poor households would benefit from a combination of financial services, including savings, remittances, loans, micro-insurance, micro-pensions, and the like.

In today's world, technology is shaping the future of finance. All the key players are harnessing technology to provide an efficient experience to the end user. In the Indian context, improving the accessibility of financial platforms using FinTech is key. Therefore, designing suitable financial products that cater to specific needs of the financially excluded population, and provide facilities like digital onboarding, is vital in achieving the objective of financial inclusion.

The goal of universal Financial Inclusion can be achieved only through synergistic efforts between the mainstream financial entities and other players like MFIs, Fintech *etc.* as they play a complementary role in championing this cause. Therefore, banks and NBFCs need to explore the possibility of establishing business collaboration among themselves, and with FinTech firms as it could be pivotal in accelerating the agenda of financial inclusion through innovation. In addition to incorporating emerging technology faster into their businesses, the entities engaged in microfinance could also look at collaborating with FinTechs and other entities who can help them mine customer and transaction data, cross-sell products and introduce new customer-centric products and services, and streamline operations. They will also have the opportunity and need to raise the digital literacy of their customers that is not highly informed and aware and, therefore, can be susceptible to frauds.

## The Way Forward

Thanks to the growth of the internet and mobile phones, today we are seeing an explosion of data in several sectors of our economy. Likewise, in microfinance, a lot of formal and informal data is becoming available in the form of digital footprints by low income customers who also transact on e-commerce platforms and use the internet. These digital footprints are being used by leading banks and online lending firms to lend to individuals and micro and small enterprises. Artificial intelligence (AI) and machine learning are also finding greater application in the Indian banking and financial services industry.

It is interesting to see that leading e-commerce companies have tied up with banks and NBFCs to offer working capital loans to their suppliers at competitive terms. Most of the suppliers are micro and small entrepreneurs

The introduction of Goods and Services Tax (GST), which is one of the largest and most significant tax reforms in the world, is also helping formalise the informal economy in a significant way. As a result of a much-improved digital footprint, individuals engaged in proprietary businesses, micro and small enterprises, now become attractive clients for banks and NBFCs, thereby reducing their dependence on informal sources of funds. The cost of credit for the micro and small enterprises will also decrease significantly as lending will shift from collateral-based to cash flow-based.

While opening a new world of opportunities, the application of technology in finance has its own share of risks and challenges for the regulators and supervisors. Early recognition of these risks and initiating action to mitigate the related regulatory and supervisory challenges is key to harnessing the full potential of these developments. This also brings in the need for a transparent, technology and data-driven approach. Similarly, systemic risks may arise from unsustainable credit growth, increased inter-connectedness, pro-cyclicality, and financial risks manifested by lower profitability. Data confidentiality

and consumer protection are major areas that also need to be addressed.

## Summing up

To sum up, the microfinance sector is undergoing a multitude of changes amidst growing competition, rising expectations of masses, technological advancements and an evolving regulatory landscape. The sector is, therefore, expected to widen the horizon beyond micro credit to transform the livelihoods of the borrowers. Being constantly mindful of the technological transformation in the banking and financial services industry, the sector must continue to pursue the adoption of innovative, futuristic and high-impact business models. The focus of the sector must be on Digital Microfinance.

Keeping in view the need to increase transparency, address customer-centric issues and safeguard the interests of low-income customers, microfinance lenders must put the interests of their clients first and implement the Code for Responsible Lending and the Code of Conduct in both letter and spirit. Redressing consumer complaints quickly and effectively should be on top of the agenda for MFIs and the Self Regulatory Organisations (SROs).

The Microfinance institutions must broaden their client outreach to reduce concentration risk and to serve a wider clientele base. From a financial inclusion perspective, they should also critically review their operations to ensure that some of the regions do not remain underserved.

While the growth of the microfinance sector in the past few quarters has been quite healthy, we must be cognizant of the vulnerability of the sector to factors such as external developments, technological changes, event risks and income inconsistencies of the borrowers. The growing use of technology would give rise to operational risks and there would be concerns related to client data protection which would need to be addressed.

Banks, NBFCs and financial institutions are well placed to innovate in cutting-edge technologies



be it Artificial Intelligence (AI), machine learning, blockchain *etc.* SIDBI could handhold the micro finance providers in this process, specifically with regard to lending to the micro and small enterprises, in areas such as alternate credit scoring methods, predicting probability of default, *etc.* With fast changing technology, SIDBI could also take the lead in hosting an ecosystem, within a well-defined regulatory sandbox, to create an infrastructure, which will reduce the turnaround time and provide customer-centric products with robust risk mitigation. This could also act as a crucible to test cutting-edge products for micro-entrepreneurs and a vehicle to provide feedback to regulators.

I am sure that the deliberations at this National Microfinance Congress would seek to arrive at concrete action points for time-bound implementation towards the betterment of the microfinance sector.

I wish the Microfinance Congress and its participants all the very best!

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