Small MFIs: Future Survival and Sustainability Challenges
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The Microfinance sector in India plays an important role in promoting financial inclusion, particularly in remote and rural areas. These population segments are served by both small and large MFIs, of which 8 have been granted in-principle licenses to establish Small Finance Banks (SFBs). As the landscape of the sector changes it becomes imperative to deliberate on the fast-changing dynamics for smaller MFIs. For the context of the discussion, we define small MFIs as NGO-MFIs (Not for profit) whose outstanding portfolio is less than Rs.50 Crore\(^1\). These MFIs have reported a Leverage/Debt-Equity ratio less than 2.6 as against the industry Median of 3.2.

**Stake in Business\(^2\)**

As per data reported in the Bharat Microfinance Report 2016, the total number of clients served by MFIs stood at an all-time high of 399 Lakhs (March 2016). The industry saw a year-on-year growth rate of 7.5% in client outreach. Of this, only 11.1 Lakh (2.78%) clients came under the small MFI bracket in 2016. In the year 2014-15, the same bracket was serving around 13.1 Lakh borrowers.

In 2015-2016, the Gross loan portfolio of these small MFIs was Rs.1,033 crore, which is 1.6% of the industry. In the preceding year, the portfolio was Rs. 1,107 crores (2.2% of the industry). The change in numbers is largely due to graduation of some MFIs to the large MFI category.

As personnel costs contribute to 24% of the total expenses incurred by MFIs, we can see that the efficiency and capacity of small MFIs is relatively low. On an average big MFIs have one staff \(^3\) for every 318 borrowers. The average for small MFIs is 156 only. The ABCO (active borrower per credit officer) average for small MFIs stands at 308, against 530 for bigger MFIs. This reflects that large MFIs are being able to leverage their economies of scale from technology as well as efficiency in operations to service a larger client base. However, less number of active clients per loan officers indicates that smaller MFIs can dedicate more time to each client.

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\(^1\) These could include few start up NBFC- MFIs as well but defined with the limit of outstanding portfolio

\(^2\) Based on the data reported by Sa-Dhan in Bharat Microfinance Report, 2016

\(^3\) Calculated on total number of staff and not loan officer
Changing Landscape

- **Banking Licenses**: 10 entities have been granted in-principle licenses for Small Finance Banks, of which 8 are large MFIs. Bandhan was granted a universal bank license and has commenced operations as well.
- **Priority Sector Lending Certificates**: Introduced in April 2016, this scheme provides a platform to enable trading in the certificates through its core banking solution (CBS) portal (e-Kuber). All scheduled commercial banks (including RRBs), urban co-operative banks, small finance banks (when they become operational) and local area banks are eligible to participate in trading.
- **Channel for Govt Programmes**: Reserve Bank granted NBFC-MFIs general permission to act as channelizing agents for distribution of loans under special schemes of central/state government agencies exempting such loans from the qualifying assets criteria.
- **Financial Inclusion and Digitization**: Nabard supports a dedicated Financial Inclusion Technology Fund (FITF) for meeting the cost of technology adoption for financial inclusion.
- **Increasing collaboration of Fin-Techs and Financial Institutions**: Numerous platforms and products like Peer to Peer Lending, RuPay Cards

Primarily, smaller MFIs are very local in their operations and thus have significant understanding of the needs of the customer base. They are closely involved with their clientele and are aware of their aspirations. They are well placed to support them with customized products and services. These connections also allow borrowers to be assisted, guided and mentored in challenging economics situations, including occurrences of disasters. A recent IFMR LEAD study on ‘Disaster Risk Reduction’ practices in the Indian microfinance sector found that even though there are no sector level protocols clearly defining MFIs roles during disaster, some MFIs have developed their own ad-hoc processes to support the borrower in such grave situations. Fair service provision to borrowers is a matter of concern in the industry, and with growing competition these small MFIs can prove to produce successful models to cater the diverse needs of clients.

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<th>Challenges</th>
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| **Affordable Funding and capital** | ✓ There is lot of competition as the donors have varied options to offer financing  
✓ The Small MFIs need to develop profitable and sustainable business models |
| **Competition** | ✓ Retention of existing clients as the other financial institutions expand their operations  
✓ Problem of over Indebtedness as different sources of credit become available in the market |
| **Resources/Capacity** | ✓ Lack of human resource capacity to innovate in business and support the operations  
✓ Product innovation gaps to meet competitions |
| **Risk Management** | ✓ Social issues like political, unauthorized agents/imposters  
✓ Internal controls, operational efficiency and capacity building of their field staff |

The sustainability of small MFIs is very important to support the inclusive nature of our financial ecosystem. Following measures can be taken to support the same:

- **Assessment and Documentation**: It is important to understand the needs of these small MFIs and how their existence in the sector supports the diverse needs of the customers and its impact.
- **Funding and Capital support**: Affordable funding support for these MFIs has to be provisioned in order to ensure that they continue to sustain in the market
- **Product Innovation**: As client needs and competition changes in the sector, it is important that there is support from different stakeholders to give space for product innovation and diversification.
- **Scope of Collaboration**: The small MFIs can partner and collaborate with other key stakeholders like big MFIs, Payment Banks, Small Finance Banks, Fintech to explore potential opportunities to improve business and services.

Given this changing landscape, it is important to acknowledge the important role played by small MFIs in the ecosystem, and support them in remaining sustainable.