Executive Summary

Efforts to expand financial inclusion have been remarkably successful in recent years, fueled by innovative communications technologies. Financial services participants at the base of the pyramid have especially benefited. Encouraged by central banks and regulators around the world, financial institutions have driven this revolution by leveraging channels such as digital payments and e-money solutions to reach unbanked and under-banked population segments.

Microfinance institutions (MFIs), which have been hamstrung by regulatory pressures and operational costs, could benefit significantly from recent technological innovations and market developments. They have an opportunity to explore a segment of the market previously inaccessible to them.

In this paper, we discuss the operating model, revenue growth and product development opportunities that MFIs can consider to serve this segment. While the paper focuses on the India market, the concepts are applicable to similar markets in Asia Pacific and Africa with similar customer profiles.
AN UNTAPPED MARKET

Large segments of the Indian population still do not have access to banking services. Banks have intensified their efforts to reach the unbanked, in an effort to tap the estimated market potential of $24.4 billion. Figure 1 details the estimated rise in incomes of low-income groups across the world.

Historically, banks have faced various challenges in their attempts to provide loan services in rural markets and economically weak geographic areas. Obstacles include high operating costs and lack of collateral. MFIs gradually stepped in to fill this gap, as they are able to provide loans without collateral. As a result, borrowers throughout India, particularly in rural areas, have formed self-help groups to obtain loans from MFIs to gain working capital to start a business or engage in other entrepreneurial activities.

Microfinance is a crucial source of financial services for entrepreneurs and small businesses that do not have access to banking and related services. MFIs have realized relative success; however, large segments of the world remain unbanked.

The Rise of Fintechs

In recent years, several fintechs have emerged to support a variety of non-traditional lending approaches. Many peer-to-peer (P2P) business models have emerged in this space. These lending models are set to disrupt the status quo, especially in the small business space.

Income Growth in Emerging Markets

The average daily income for the first and second economic quintiles of national populations is on the rise.

![Average Daily per Capita Income (USD)](image)

Alternative lenders are filling a critical gap for business segments that traditional banks have not pursued. Potential benefits for these lenders include:

- New asset classes.
- Transparency.
- High returns.
- Diversification.

**AN MFI-P2P MODEL**

We believe MFIs can leverage alternative lending models by launching a P2P lending platform, supported by a powerful analytics engine. Given their expertise in rural markets, these organizations are well positioned to successfully facilitate a marketplace for semi-urban and rural investors and borrowers.

A P2P service platform would enable MFIs to service ultra-small loan requests (token size of Rs100 to 2,000) with very short tenures (one to 10 days) were previously untenable due to the high operational costs involved in recollection. The range of services that MFIs could offer in this segment include:

- Emergency loans (for medical/family emergencies).
- Working capital loans for small vendors (hawkers).
- Very short-term loans (one-day loans, etc.).
- Loans for college students to meet their immediate needs.
- Month-end bridge loans.
- Education loans.

MFIs can act as intermediaries between lenders and borrowers, and charge both parties for the service (see Figure 2).

After providing some basic details, lenders would enroll with the P2P site. Following registration, using P2P for Microfinance Services

![Figure 2](image-url)
lenders would be able to browse through borrower profiles and assess the various risk-reward levels that the site offers (see Figure 3).

Lenders would assess borrowers on factors such as rate of return, credit history, etc. After both parties agree to the terms and conditions imposed by the MFI, the amount would be disbursed to the borrower.

Similarly, borrowers would enroll with the P2P site after furnishing basic details. After registration, borrowers would make a loan request that includes information such as the intent of the loan, tenure and interest rate that the individual is willing to pay, etc. The MFI would calculate the borrower’s credit score using its scoring model, powered by the analytics engine. The engine would consider parameters such as credit history, employment history, family history, etc. to arrive at the credit score (see Figure 4).

The analytics engine could also be leveraged by the MFIs for cross-selling products and services to customers based on parameters such as occupation, employment sector, credit history, etc. This information could also be used for lead generation.

**BUSINESS USE CASES**

Two business cases can help illustrate the potential of digital payments technology to solve longstanding challenges for MFIs.

**Case 1:** Operating costs - including disbursement and recovery - have been a pain point for MFIs. This has prevented them from serving customers with very short-term loans. Also, not all rural consumers have a mobile device to access digital solutions.

To get around this hurdle, an MFI can create a group of borrowers or potential borrowers.
under a leader. The leader acts as a touchpoint for customers using digital payments. Disbursement and money recovery can be done via the leader, which would work with digital wallet service providers such as Paytm and MobiKwik. This will reduce operational costs for the MFIs (see Figure 5).

Case 2: While MFIs have a range of measures in place to ensure loans are put to productive use, there are still instances of customers using a loan for purposes other than those for which it was disbursed. Digital technologies can help MFIs ensure proper use of the loan. For example, if a loan is sought for purchasing certain mer-
Merchant, Borrower, Lender Examples

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chandise, MFIs can partner with online retailers/merchants or with small neighborhood retail stores (known in some regions as “kiranas”) with access to digital wallets. The retailers could deliver the merchandise directly to the borrower rather than disbursing cash (see Figure 6, previous page).

Figure 7 lists some examples of the players in the MFI-P2P model.

RISK MITIGATION MEASURES FOR LENDERS

MFIs currently have several risk mitigation measures in place, including:

• Offer group loans only.
• Peer pressure and individual repayment assessment.
• Initial margin requirements in the form of gold, real estate, etc.
• Requirement of a guarantor or other collateral, such as a post-dated check or jewelry.
• Use of the Critical Rating Index (CRI) or a similar quality assessment tool.

Given that in a P2P platform most lenders will be from urban areas, MFIs can put in place additional measures, such as offering compensation in the event of a default or creating a capital requirement fund.

LOOKING FORWARD

MFIs have successfully penetrated the rural market over the past two decades. It is time for them to take advantage of the digital initiatives disrupting the market right now and serve a broader customer base. This will enable them to secure both top- and bottom-line growth in the segment. A marketplace lending model should attract investors as it offers them more options. Lenders are always on the lookout for new investment options, which should make the MFI-P2P model a success.
REFERENCES


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