Study on
MSME and Micro Housing Lending By Microfinance Institutions (MFIs) & Small Finance Banks (SFBs)

Centre for Research on Financial Inclusion and Microfinance (CRFIM)
Bankers Institute of Rural Development (BIRD), Lucknow
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Director’s Message

Micro, Small and Medium Enterprises (MSMEs) have emerged as one of the strongest drivers of economic development, innovation and employment in the country. The share of MSME in All India GDP has remained constant at around 30% for past 5 years. Estimated number of MSME units in India is around 6.33 crore providing employment to approximately 11 crore workers. MSME contributed 49.8% and 49.5% of total exports from India during 2019-20 & 2020-21 respectively. Despite a significant contribution in Indian economy, access to finance is still a critical barrier to growth for MSMEs. As per IFC-Intellecap report, estimated credit gap of Rs. 25.8 trillion (USD 397 billion) exists in the MSME sector in India. In order to enhance the credit flow in the sector, RBI recently introduced various policy measures, viz. Co-Lending by Banks and NBFCs to Priority Sector, introduction of Priority Sector Lending by NBFCs, One-Time Restructuring of Loans to MSMEs, Interest Subvention Scheme for MSMEs, Interest Subsidy on Export Credit etc. However, progress is not so encouraging.

Further, access to basic housing is considered to be one of the key indicators, out of the seven deprivation criteria indicated in Socio Economic Caste Census (SECC). Census 2011 estimate a shortage of 18.78 million housing in the country. Out of which, 96 percent belongs to Economically Weaker Section and Lower Income Group. Several reports have indicated that at present there is a shortage of 25 to 30 million houses in India.

Considering the importance of the MSME and micro-housing sectors, the present study, “MSME and Micro Housing Lending by Microfinance Institutions (MFIs) & Small Finance Banks (SFBs)” has been conducted by BIRD, Lucknow to ascertain the various sources of finance used by micro and small entrepreneurs in India and challenges faced by clients. The study also assessed the demand for micro-housing loan among the borrowers of MFIs and SFBs. The findings of the study are based on a sample size of 117 Micro & Small Enterprises (MSEs) and 64 clients eligible for micro housing from two MFIs, viz., Cashpor Microcredit and Repco Micro Finance Ltd. and two SFBs, Equitas Small Finance Bank Ltd. and Utkarsh Small Finance Bank covering two districts, Varanasi (Uttar Pradesh) and Chennai (Tamil Nadu).

The study has been conducted by the team of Centre for Research on Financial Inclusion and Microfinance (CRFIM) at Bankers Institute of Rural Development (BIRD), Lucknow. I congratulate them and also thank all the stakeholders and agencies for their responses and experiential inputs for the study.

I sincerely hope that the readers and sector players shall find the findings and recommendations of this study useful for the policy making and designing of appropriate financial products for the specific needs of these two sectors.

Shankar A. Pande
Director

Acknowledgement

The study on "*MSME and Micro Housing Lending by Microfinance Institutions (MFIs) & Small Finance Banks (SFBs)*" has been conducted by Centre for Research on Financial Inclusion and Microfinance (CRFIM), Bankers Institute of Rural Development (BIRD), Lucknow.

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The study is the result of extensive field work and documentation by Dr. Bhawani Singh Rathore, the then Research Officer, BIRD and Shri Tamanud Ghosh, Research Officer, BIRD, Lucknow, ably assisted by other staff of BIRD. We acknowledge their efforts and record our appreciation for the insights and data brought in through the report. The report has been reviewed by Smt. Jothi Srinivas, DGM/Faculty Member, BIRD whose valuable suggestions have helped in bringing the report in present form. We record our appreciation for her contribution to this work.

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Deepmala Ghosh
CRFIM In-charge

Executive Summary

MSME and Micro Housing segments have traditionally been under-served by the MFIs. Over the last few years, some of them have initiated several pilot initiatives for acquiring and providing services to MSME clients through group and individual mode. Similar has been the case with micro housing offerings. However due to regulatory restrictions, they have not been able to scale up these initiatives.

With new regulations from the Reserve Bank of India enabling development of a BC partnership between commercial banks and MFIs, it gave them opportunity to scale up such initiatives. Further, with some of these MFIs transforming into SFBs, the regulatory constraint no longer exists. With this, the role of MFIs and SFBs in the MSME and Micro Housing segment will be crucial given that in spite of the traditional financial institutions serving the sector, there is under-penetration in most geographies.

The present study seeks to elucidate the role which can be played by the MFIs & SFBs to serve the credit needs of the sectors, viz., Micro & Small Enterprises (MSEs) and Micro Housing. The study is important as it relates to assessing the financing aspects in the sectors which are important for the development of socio-economic activities in the country. The study includes survey of 117 MSEs and 64 clients eligible for micro housing (*For the purpose of the study, eligible clients refers to matured micro borrowers having accessed 2/3 cycles of credit*) selected from two MFIs, viz., Cashpor Microcredit and Repco Micro Finance Ltd. and two SFBs, Equitas Small Finance Bank Ltd. and Utkarsh Small Finance Bank from two districts i.e. Varanasi (Uttar Pradesh) and Chennai (Tamil Nadu).

Some of the key findings of the study with respect to the role of MFIs & SFBs in the **MSE segment** are as follows:

- Unlike MFIs, SFBs were offering MSME loans through individual mode of financing. They have better outreach in terms of the number of states covered. However, so far they have not scaled up the business and outreach in terms of branches and number of loans offered, which is needed to be enhanced.
- MFIs in the sample offer loans only through group mode, whereas SFBs offered loans to individual or firm. SFBs basically serves the called 'missing middle', which is above the one served by the MFIs, hence have higher loan sizes. It is observed that the BC mode of financing had helped MFIs such as Cashpor which offer higher size loans to the enterprises through off-balance sheet assistance from SIDBI.
- It was found that the portfolio quality was significantly poorer for SFBs in comparison to MFIs. It can be attributed to the individual lending mode which was riskier than the joint liability contracts for the unsecured business in this segment. The rejection ratio of the loans was also found to be high.
- Further, the average rate of interest charged by SFBs (17.5% p.a.) was higher than MFIs (15.7% p.a.), given the high cost and risk involved in lending individually.

- SFBs charged higher processing fees (2%) and have longer average processing time (13 days) in comparison to the MFIs (1%, 11 days) given their stringent due diligence requirements.
- Barring Equitas, which offered CC/OD facility, others offered only composite loans fulfilling the working capital and investment requirements of the enterprises.
- Some of the prominent challenges faced by MFIs & SFBs in extending credit to MSE segment were: high risk involved in lending, multiple lending, KYC requirements and high cost of intermediation.
- In the sample, it is seen that only four out of 117 enterprises surveyed had bank loan outstanding apart from loans from MFIs & SFBs. This indicates that MSE segment served by MFIs & SFBs did not have access to bank loans and hence relied on MFIs/SFBs and NBFCs for their loan requirements.
- The study classified the various life cycle stages of enterprises surveyed according to the years of commencement, viz, Start-up (less than two years), Survival (within two to five years), Growth (within five to ten years) and Sustenance stage (completed more than five years). It is observed that out of the 117 enterprises studied a large number of enterprises in the sample were at the growth stage (38%), followed by those in the survival stage (32%) and a few (14%) enterprises were in the sustenance stage. Further, a significant proportion (45%) of the enterprises were engaged in wholesale trading, 38% were engaged in service sector and only 17% were in manufacturing sector. As far as registration of the enterprises is concern, 60% were registered under Shop/Establishment Act. In addition to that, 38% were also registered with Development Commissioner (DC), MSME and only 31% were having GST registration. This shows that enterprises need to be made aware of the importance of registration so that they can get benefits of the Government schemes.
- The study observed that enterprises had used multiple sources of credit. About 49% of enterprises were indebted to MFIs followed by SFBs (41%). However, this may be due to the sample was drawn from MFIs & SFBs. In addition to loan from MFIs & SFBs, 26% of the enterprises reported the use of funds from personal savings, 15% reported use of bank loans. About 6% also accessed loan from friends or family member and only 1% accessed credit from NBFCs. This shows that MFIs & SFBs have an important role to play in this segment given that enterprises have limited access to commercial bank loans and heavy reliance on personal savings.
- It has been found that there is a pattern in movement of the enterprises from MFI loans to SFB/Commercial Bank loans as they move up in the life cycles. In the start-up phase, majority of the enterprises (84%) were dependent on MFIs followed by personal savings (42%). However, in the growth stage the credit needs of enterprises were mostly been served by SFBs (55% of enterprises) followed by commercial banks (23%). This indicates that MFIs performed a key role through their group mode of lending for supporting at the initial stage (start - up) of the enterprises whereas SFBs played a significant role in growth stage by meeting higher credit requirement of the sector.
- An analysis on demand for credit requirement of the enterprises revealed that 50% expressed demand for loan for the purpose of operating expenses which includes purchase of raw materials for their business. Thirty eight percent demanded credit for capital expenditure which includes expenditure related with the purchase of fixed assets, like machines. The remaining 12% didn’t respond in this regard.
- The average loan requirement for the working capital was found to be Rs 5,72,373 and that of capital expenditure was Rs 2,34,159. Since many of the enterprises were into trading business there was usually high demand for working capital by the enterprises. The demand for loan varied among

the various life cycle stages of enterprises. It increases from start-up stage to survival stage and is highest in the growth stage which further reduces in the sustenance stage as growth plateaus.

❖ An inquiry into the constraints faced by the enterprises in accessing credit from various institutional sources revealed that a significant proportion (31% of enterprises) felt that collateral for lending was one of the major challenge in accessing credit. Among the various sources it was more pronounced in case of SFBs (22%) as compared to commercial banks (8%) and NBFCs (1%). About 17% said that high rate of lending in MSE segment was a challenge to access institutional credit. Agency wise comparison revealed that it is higher in case of SFBs (12% of enterprises reported) as compared to the other financing agencies. Procedural complications also cited as a challenge for accessing credit from institutional sources. As reported by the enterprises it was higher in case of commercial banks (14%) as compared to other financing agencies. The other challenges as highlighted by enterprises in accessing institutional credit were documentation requirement (13%), lengthy processing time (10%), lack of knowledge about available schemes (8%) and high processing cost (7%). Overall, agency wise comparison indicated that challenges were more pronounced in case of commercial banks. Very few enterprises have reported any problem in sourcing credit from MFIs.

Key findings of the study with respect to the role of MFIs & SFBs in the Micro Housing product are as follows:

❖ The two MFIs viz., Cashpor and Repco studied, were not extending micro housing product. However, they were keen to include it as a part of their portfolio.

❖ The SFBs (Utkarsh and Equitas) were having exclusive micro housing product but have low outreach in terms of the number of clients. The product portfolio was also found to be small. The targeted clients for the Utkarsh was households with minimum income of Rs 1.25 lakh p.a. for salaried class and Rs 1.80 lakh p.a. for the self-employed. Whereas Equitas SFB targeted its existing customers with proven track record for selling micro housing product. The average loan outstanding was found to be Rs 6.32 lakh and Rs 1.75 lakh for Utkarsh and Equitas respectively.

❖ The overall rejection rate of the micro housing loans by the SFBs was very high (15%). Major reasons for the rejection were: low eligibility, low CIBIL score, high over-indebtedness and issues related to the property.

❖ Some of the major challenges faced by the SFBs in this segment were: high pricing of the loan, lack of proper documentation, high cost of delivery, inherent risk in assessing income level, difficulty in repossession, non-availability of specific pockets in urban areas where it is desired, lack of awareness and lower repayment rates.

❖ High variation was observed in the income level of the sample borrowers eligible for micro housing loan (n = 64). This suggests that the segment is heterogeneous and there is a need for different product offerings as per the client requirement.

❖ In order to ascertain the future house building or renovation plan of the borrowers, the study assessed the ownership and also pattern of existing housing of the borrowers. This revealed that out of 64 borrowers surveyed, 68% were having own houses, 31% were staying as tenant and remaining 1% didn't responded in this regard. The pattern of housing showed that 59% were having pucca house, 25% were staying in semi-pucca and remaining 16% were living in kuccha house. This indicates the requirement of funds for a significant proportion of borrowers either to build/ purchase/renovation for a house.

- Further, as far as basic amenities in the households are concerned, it is observed that 37% households did not have kitchen and 31% households did not have a toilet in the house. When we analysed the availability of rooms in the house, it is seen that majority (72%) of the borrowers were having one or two room house, remaining (28%) were living in a house that have more than two rooms. An analysis on years of staying in the present house showed that significant proportion (50%) were staying in the same house for more than 10 years. Hence the existing condition of the households emphasizes the need for fund for construction or purchase of house, additional rooms, toilets or kitchen to fulfil their requirements.

- The borrowers' perception on existing household's pattern revealed that majority (64%) were not satisfied with their current housing pattern. Out of which 24% expressed inadequacy in number of bedroom condition in the house. About 14% were not satisfied with the dining facility. 29% borrowers have found inadequacy of common area, 50% were not satisfied with the present livestock shed in the existing house. About 27% expressed inadequacy of space for economic activity in the house.

- In the sample, out of the 64 borrowers studied, 17 (27%) have attempted some sort of housing related activity during the last three years which includes repair of existing house, purchase of land, purchase of constructed house. Among them, majority (70%) relied on personal savings followed by source of funds from friends or relatives (18%). About 12% of the borrowers had utilised the income generation loans offered by MFIs/SFBs/SHGs for their housing related activity (6% from SHGs and 6% from MFIs & SFBs).

- Future housing development plan of the borrowers studied (n=64) indicated that 88% (56 out of 64) borrowers expressed the need for such plan for diverse activities. About 28% desired to construct an additional room, 25% wanted to purchase a new house and 19% reported the willingness to construct a new house. 11% planned to repair their exiting house, 3% expressed to purchase land and remaining 2% wanted to build kitchen.

- The average fund requirement for housing related activity was found to be Rs. 11.50 lakh. Out of which loan requirement was Rs. 9.80 lakh. However, it has varied among various purposes. It was highest in case purchase of house (Rs. 21.00 lakh) and lowest for building additional room (Rs. 2.00 lakh). This indicates the high demand for credit for the diverse housing related activities among the borrowers of SFBs/MFIs.

- Clients' preferences on source of funds for housing related activity showed that a significant proportion (50%) relied on MFIs & SFBs as a preferred source of fund. However, this may be due to the sample being drawn from MFIs & SFBs. About 43% desired to avail loan from banks or housing finance companies due to their low interest rate as compared to SFBs, 5% wanted to access fund from friends or relatives only 2% wanted to accesses loan from their employer. This indicates that MFIs & SFBs can play an important role for meeting the housing requirements of this segment.

- Further, client preferences for the terms of repayment of the loan indicated that majority (76%) were comfortable in repaying their monthly instalment within a range of Rs. 4000 to Rs. 5000 for housing loan. About 15% were reported Rs 1000 to Rs. 2000 as the preferred monthly instalment range. 6% desired to repay monthly instalment range of Rs. 3000 to Rs. 4000 and remaining 3% are comfortable in repaying the monthly instalment of housing loan at a range of Rs. 2000 to Rs. 3000. It is observed that there is a positive correlation between monthly income and preferred monthly instalment. Households with less than Rs. 10000 monthly income were comfortable in repaying their household loan instalments within the range of Rs. 1000 to Rs. 2000.

- ❖ In the sample, majority (96%) of borrowers were comfortable in monthly repayment of their instalment followed by half yearly and annual installment (2% in both the cases). Borrowers' preference on monthly repayment of instalments may be due to the reason for their familiarity with the monthly frequency as they were the regular borrowers of the micro-enterprise loans of MFIs & SFBs.
- ❖ Thus the study observed that MFIs & SFBs can play an important role in the micro housing segment by reaching out to newer clients at the missing middle segment and in retaining the existing clients.

Based on the findings, the study has attempted several policy suggestions for the growth of the concerned sectors. The recommendations of the study in the sectors are as follows:

A. MSEs Segment:

- ***Encouraging Registration of MSEs:*** Given that unregistered enterprises cannot partake in the various Government schemes, registration can be incentivised by offering rebate on processing fee and spreading better awareness of the Government programs like interest subvention scheme for GST registered enterprises.
- ***Need for CC/OD limit:*** MSEs rely on composite loans to fulfil their working capital requirements which is significantly high in comparison to the investment credit requirement. Under such a circumstance, CC/OD limits will help MSE to withdraw and deposit money as per their requirements.
- ***Faster and Convenient Approvals under CGTMSE scheme:*** Once the loan is sanctioned, the lender applies to CGTMSE for a guarantee cover. This is the security on the loan that is used to settle claims with the lender in case of default. The guarantee cover is 85% of the default amount for loans up to Rs 5 lakh, 75% for up to Rs 50 lakh and a uniform 50% if the credit exposure is above Rs.50 lakh and up to Rs.100 lakh. The scheme entail cumbersome paperwork and long processing time. Therefore the study suggests for formation of fast track committee for faster approval of loans under CGTMSE scheme in order to meet the immediate credit requirement of enterprises.
- ***BC mode of financing for MSE loans:*** New regulations from the Reserve Bank of India enabled the development of a BC partnership between commercial banks and MFIs, intended to pair the market knowledge and lending expertise of MFIs with the resources and financing of larger banks. In a typical BC model, the MFI focuses on acquiring and evaluating clients, while the loans are booked on the balance sheet of the bank. Therefore it is suggested that banks may extend credit to MSEs with a BC partnership of MFIs to enhance the outreach in the segment. MFIs may also be encouraged to extend credit in MSEs Segment with the similar model.

B. Micro Housing Segment:

- ***Designing of Suitable Loan Product:*** The study observed a significant demand for micro housing loan among the clients of SFBs and MFIs. Further, the demand and purposes are also diverse in nature. So, there is need for categorizing of housing credit demand based on purposes, repaying capacity, source of income and specific needs. Therefore study suggests to design the variety of micro housing products to serve the diverse housing credit needs of the borrowers.
- ***Use of Non-Traditional data to Assess Credit Worthiness:*** It is seen that lower repayment rates, high cost of service, inherent risk in assessing income level of borrowers due to irregular flow of income are the major challenges in extending micro housing credit. Therefore as risk mitigation strategy, SFBs & MFIs may use the non – traditional data points like utility payments, etc. to judge the repayment capacities of the borrowers.