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Research Article

"Diminishing returns: Microfinance in the era of the pandemic"

Md Obaidul ola[1] Professor Kavita Chauhan[2] Dr Amir Afaque Ahmad Faizi[3*]

Abstract

Microfinance has been termed as the pioneer of Gender Equality and women empowerment by providing financial services and enabling entrepreneurial mindset in women. One of the key differences between the developing and the developed world has been the participation of females in the workforce as well as the household decision-making process. To achieve these twin objectives, the services of Microfinance have emerged as a significant tool. After its origin in comparatively poor countries such as Bolivia and Bangladesh, microfinance services have been used around the world; especially in the south Asian and Latin American regions. The evolution of these services has also been witnessing the economic development of the regions of its operation. The high repayment rate has resulted in the emergence of this sector as a lucrative business model. The recent pandemic, however, has jolted this sector by increasing overdue and portfolio at risk.

This paper, taking into consideration the existing literature in the field of microfinance and empirical pieces of evidence obtained primarily through publically available data, field accounts and investigative reports have attempt to analyze the impact of covid-19 on repayment of microfinance service providers and also suggest methods to overcome these bottlenecks. This paper will be useful for those scholars/academicians/practitioners who want to conduct further research in the field of sustainable financial inclusion models, with a special focus on microfinance.

Key-words – Microfinance, women empowerment, financial inclusion, economic development

Introduction

Microfinance, over the last 30 years, has emerged as a significant and sustainable tool to diminish poverty by facilitating financial services to the previously "Financially Untouchable" population[1]. The concept originated from Latin American countries and Bangladesh which provided the famous " Grameen Bank Model". The model is based on the creation of joint liability groups and facilitating social guarantees for loans. The nudge of getting an additional credit amount after successfully repaying the existing loan has acted as a catalyst for comparatively higher repayment rates of Microfinance institutes[2].

In India, microfinance services have gained popularity after the advent of the new millennium, keeping aside the existential crisis of 2009-10, popularly known as the *Andhra crisis*, the

[1]Research Scholar, Jamia Millia Islamia, New Delhi, Mail id: Obaidulola89@gmail.com
[2]Professor, Jamia Millia Islamia, New Delhi. Mail id: Kavitachauhan77@gmail.com
[3*]Director, Minority Welfare Department Bihar. Mail id: aaafaizi@gmail.com

microfinance services in India have proven to be a sustainable and profitable tool to eradicate poverty[3]. The passing of the Micro Finance regulation bill by the Indian parliament, regulation by the reserve bank of India, and promotion of microcredit schemes such as MUDRA has further facilitated the growth of this sector in India. In 2015, the reserve bank of India created a new category of banks termed *small finance banks* which have further provided a nudge for existing microfinance institutes to achieve sustainable business models so that those can be converted into small finance banks[4]. However, the pandemic hit the world when microfinance services were at their peak globally as well as in India. In India, more than 4 lakh people have died due to pandemic and a sizeable amount of the casualties belong to the vulnerable bottom of the pyramid group which is also the targeted segment for microfinance institutes. The pandemic and the subsequent lockdown has hampered the economy, specifically the unorganized sector, as a result of which, the repayment process of these institutes has suffered drastically. The paper attempts to analyze the problem faced by microfinance institutes because of the pandemic and the troubleshooting exercise performed by them.

2. Objectives of the Study

The objective of the paper is to analyze the problems faced by microfinance institutions because of the covid-19 pandemic. The assessment of feasibility and results of the steps taken by these institutes for managing this crisis is also one of the objectives of the paper. To achieve these objectives the paper attempts to first examine the evolution of microfinance services in India with the help of existing literature, thereafter analyzing the operational problems faced by these organizations after the start of the pandemic. Assistance of investigative reports published by different media sources and journals has been taken into consideration.

3. Evolution of microfinance services in India

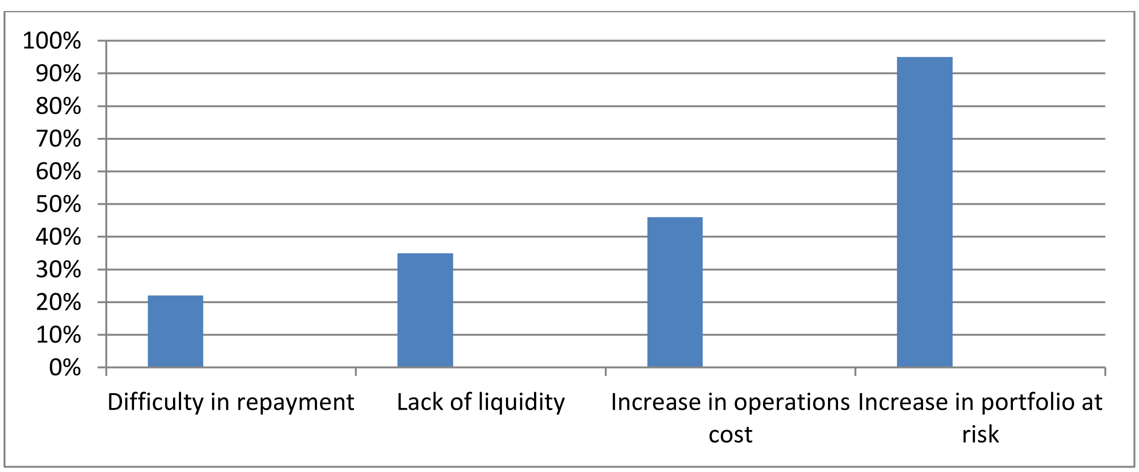
Microfinance Institutions originated in India around 2001-02, when several Indian bankers, driven by the success of the Grameen Bank of Bangladesh, started their ventures. SKS, Spandhana Spoorty, Ujjivan financial services, Bandhan and Janalaxmi are some of the organizations which started around this phase[5]. Since this was a comparatively new sector, initially it provided big returns to the investor as well as several financial benefits to the customers. However, things turned unfavorable when in 2009-2010, the microfinance firms were blamed for farmer suicides in Andhra Pradesh. The local administration of several districts, blamed the microfinance institutions of aggressive lending and recovery practice, thereby creating negative publicity for the sector[6]. The sector, however, revived after some years because of adjustments in business process, regulation of reserve bank of India, and passing of microfinance regulation bill. In 2014, along with the Joint liability group model, several institutions also started providing Individual loans to loyal customers. Later, they also started providing these services in the open market. In 2015, the reserve bank of India further provided a boost to this sector by announcing a new category of banks; namely, small finance banks. These banks were designed to provide wholesome banking services to the segment which is generally termed the *microfinance segment*. However, the situation took a bleak turn after the onset of covid-19.

4. Covid-19 and Microfinance

The covid-19 pandemic hit the globe in December 2019, when, for the first time, the news of a mysterious and fatal disease in Wuhan, china began to spread up[7]. The virus hit India in February 2020. As a matter of precaution, the govt of India announced a strict complete lockdown in March 2020. The lockdown completely jolted the economy, as a result, the GDP growth was recorded at -24% for that quarter. The lockdown was subsequently lifted in September 2020 and the economy began to operate under the new covid protocols. However, in March 2021, the pandemic resurfaced and this time the impact was even more fatal. By April 2021; almost entire India was under lockdown again. As of August 2021, India was still recording a large number of active cases of covid-19 with states such as Kerala, Maharashtra, Karnataka, and Tamil Nadu under partial lockdown[8].

Before, the advent of the pandemic; the microfinance industry was at a peak. As per the state of the sector report published by SA-DHAN in 2019; the microfinance institutions were serving around 40 million customers and the rate of borrowing from the informal and unorganized sector had fallen sharply from around 34%in 2002 to around 29%[9]. This displays the success of the microfinance sector in providing financial services to the segment ignored by big lending houses and commercial banks. However, the pandemic has changed the condition of this sector. It has created certain problems. The pandemic has hampered the repayment rates of microfinance, as the majority of the client are those who are working in the unorganized sector or are micro-entrepreneurs, lockdown had completely stopped their cash flow as a result of which they are unable to repay their installments. Also, several hindrances have been created in supervision and monitoring of the groups by field staff as a result of social distancing and other covid-19 protocol norms.

The people living at the bottom of the pyramid are more vulnerable to the pandemic as these are the people who are generally involved in low-paying jobs such as petty shops, maids, security guards, semi-skilled /unskilled laborers, etc. This has resulted in either voluntary delay in the collection of repayment installments by microfinance institutions or default on the part of customers. Even after the removal of lockdown, many of these people were still not able to generate their job and livelihood back, as a result, the pandemic has generated a large number of long-term overdue to the microfinance industry. As a precautionary measure, microfinance institutions have temporarily halted expansion and are doing reduced and limited landing, which has resulted in the transfer of several of these borrowers back to the unorganized moneylender.



Source: CGAP

As it can be analyzed from the above graph, while around 22% of the microfinance institutes complained about the difficulty in repayment due to operational and administrative limitations, a whopping 95% of the organizations recorded an increase in the portfolio at risk which emphasizes the severity of the issue.

5. Covid-19 and Microfinance Clients

The occupational profiling of the customers/clients of microfinance institutions in India is vivid and dynamic. The pandemic has different implications for different sectors. While it has jolted industrial production and home service jobs such as maid etc. have been diminished; people involved in professions such as having a grocery store, cab driving, etc. have gained significance due to the lack of options and surge of demand of this products[10]. Therefore those microfinance customers, who are having small business establishments such as grocery shops etc, are more likely to opt for loans for business development, working capital purchase purposes. While customers who are involved in tourism, hotels, manufacturing units are prone to divert their existing loans for consumption requirements and multiple borrowing. As a result, the clients who have more recently taken loans are more likely to default as they are prone to shift their loan amount towards consumption requirements. As a result, the situation in this sector may further deteriorate.

6. Remedial measures

To tackle pandemic CGAP has recommended several steps to microfinance institutions to remain viable and sustainable. The following are some of the steps taken by microfinance organizations after the pandemic:

6.1) **Short–term leniency on repayment**- As the majority, of the customers, are under stress, stressing too much on timely repayment will further increase the stress and misery of the customers and will also create a negative image of the microfinance sector which might result in Andhra crisis like situation. As a result, almost all the microfinance institutes are providing some leniency on repayment under the form of reduction of installments by extension of loan tenure, provision of moratorium period, etc[10].

6.2) Reduced lendings- As a large number of potential and existing customers are under stress, scaled lending is not prudent as there is a risk of a large number of over dues since the majority of new loans will be transferred towards consumption requirements. As a result, several microfinance organizations have scaled down their operations and have reduced lending. As per the report published by C-GAP, more than 75% of the MFIS globally have reduced the loan amount which they offer to the customers[11].

6.3) Channel management- As physical monitoring has become unfeasible because of the lockdown and subsequent covid-19 protocols. Micro-finance institutions are attempting to expand their virtual and digital channels by enabling digital payment, an extension of call centers and customer support networks[12]

6.4) Flexible personnel management- To prevent becoming a community spreader of the pandemic, the microfinance institutes have designated a flexible working mechanism. While several microfinance institutions have allowed work from home, many have also reduced the working hours and have increased the number of leaves which can be taken by the employees. Some MFIS, unfortunately, have also performed massive lay-offs to compensate for the losses.

7. Government Intervention

Since microfinance has proven to be one of the pivotal tools of poverty eradication and it is facing an existential crisis, the government of India has come forward to assist this sector in coming out of stress. The government of India has launched a special package of around 4 billion USD to Non-banking financial companies and micro-finance institutes. This will fulfill the dual objective of financing the microfinance enterprises as well as increasing the loan availability for the customers which will have a circular impact on the revival of the sector[13]. The government has also launched several other packages under" *Atmanirbhar Bharat"* which will attempt to revive the economy by specifically focusing on small and micro enterprises and facilitating credit availability for these enterprises. Microfinance institutes will play an important role in ensuring credit access to these enterprises, thereby enhancing their viability in the process. The government is also ensuring the availability of food grains and other essential items at the bottom of the pyramid, this will help in satisfaction of the consumption requirements and as a result, they can utilize microfinance loans for production purposes rather than consumption purposes[14].

8. Conclusion

In conclusion, we can state that although the microfinance sector is facing an existential shock because of the pandemic, it is quintessential to assist the people and micro-enterprises to come out from the financial stress caused by the pandemic. However, since the pandemic is here to stay, and we can expect to face several bouts and waves of the pandemic for the next few years, a more sustainable method is required by the microfinance institutions operating in India. For many years, these institutions have been blamed for their high interest rates, it is high time that they rethink their towering interest rates and make them more sustainable. Also, since physical distancing has become a norm, they need to update their repayment and supervising requirements which is currently heavily tilted towards physical interaction and must make it slightly more virtual. Another thing of immense importance is that they must not bother about distributing consumption loans as the fulfillment of consumption requirements will enhance the probability of utilization of future loans for business and production purposes.

Microfinance institution must continue their services and must not shrink the loan size when their customers are in dire need. They must continue to operate, lend and engage with its customers as they did it back when the massive Andhra Pradesh crisis took place. The microfinance organizations must not generalize the requirement of its customers and must keep on assessing the risk profile of its customers, and keep on providing its services to those who qualify its criterion.

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