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How can banks develop micro-finance capabilities to provide more capital to the underprivileged and small businesses?

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Executive Summary

- Roughly 40% of India’s MSME lending is in the informal sector, and an additional 25 percent is invisible(through proprietor borrowing)
- Trade sector dominates the overall MSME distribution, while most MSMEs generate <10L in annual revenue.
- States of West Bengal and Telangana optimal initial markets with high literacy and banking infrastructure.
- Digital lending models can deliver between 30 and 40 percent cost advantage over traditional models.
- Poor data availability, low financial literacy and complicated user journey major challenges to traditional Risk Management.
- Client Empowerment can offer dual benefit to clients and financial institutions.
- Psychometric Tools can reduce risk for banked clients while offering a way to extend credit to the unbanked.

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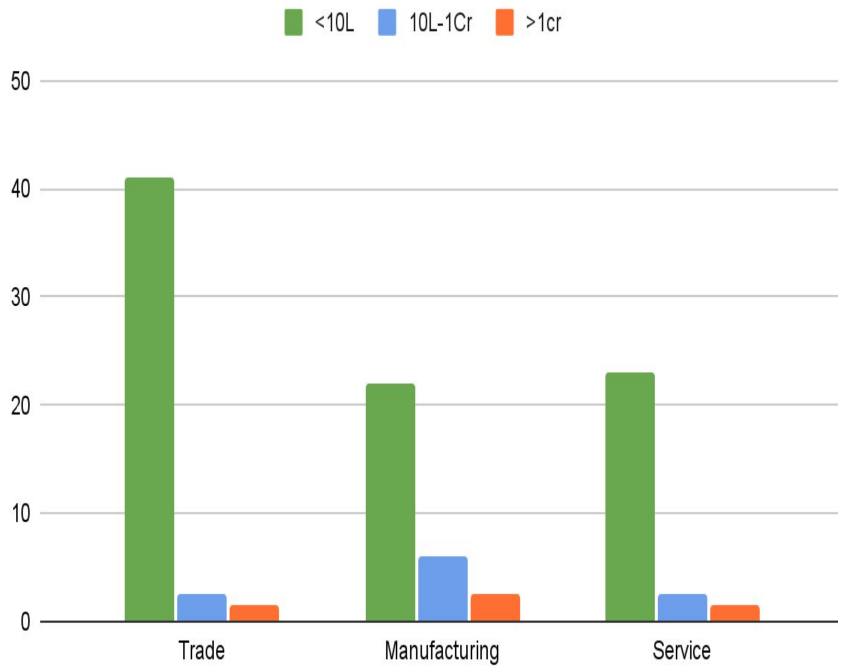
Loan Process Pain-points

Tailored loans with short transparent timelines can offer best results.

Source :Ministry Of Power, Government Of India

Trade sector comprises majority of the overall MSME distribution, while most MSMEs generate <10L in annual revenue

MSME distribution by sector and annual revenue

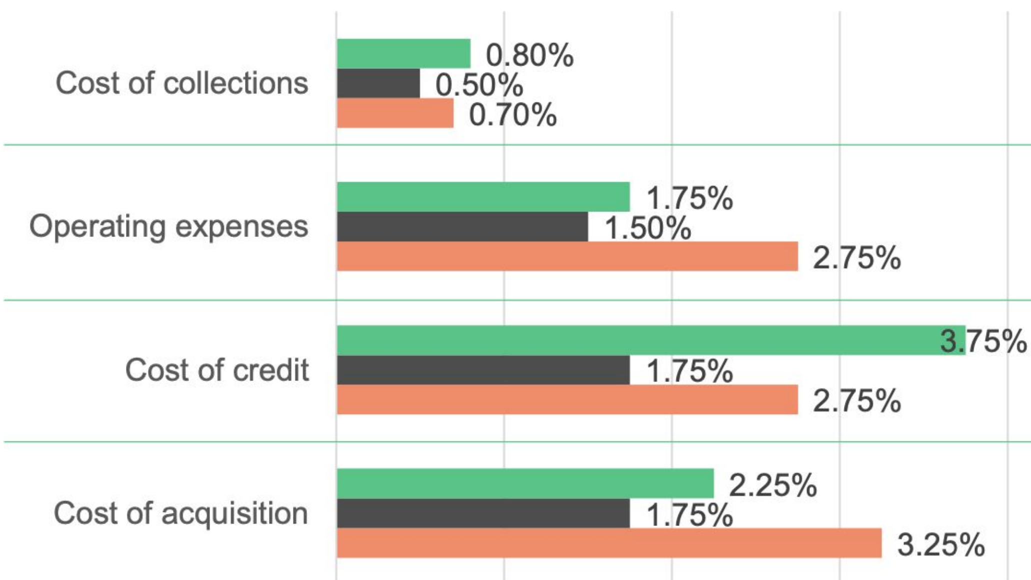


- Trade Sector makes up 40-45% of MSME distribution, while Manufacturing and services comprise 30-35% and 25-30% respectively
- 80-85% of MSMEs make <10L in revenue, while 10-15% lie in 10-1 Cr bracket.

Digital lending models can reduce costs by 30 – 40 percent.

- In Kenya, users of mobile-based money-transfer service M-PESA maintained their consumption and spending in the face of economic shocks; non-users of M-PESA had to reduce consumption by 7 percent when facing these shocks.
- **Digital financial services let people help each other.** Digital payments—for instance, by mobile phone or app—can significantly strengthen people's financial resilience by enabling an informal risk-sharing network through loans or gifts from friends and relatives

Unit Cost Estimate for INR 10L, 1 Year, Unsecured Business Loan



- Digital Models have 30-40% cost advantage over traditional model
- Digital Models have similar cost to traditional model
- Digital Models have 40-50% cost advantage over traditional model
- Digital models have -20% cost advantage over traditional model

1. Direct Digital: Sourcing through social media/ search engine platforms and fulfilling them digitally.
2. Digital Partnership: Partnership with digital platforms like e-commerce, payment providers for customer sourcing and digital loan fulfillment.

Source: BCG interviews and analysis (2018)

Poor data availability, low financial literacy and complicated user jour
major challenges to traditional Risk Management.

Challenges		Coping Methods
Poor data Availability	80% of MSMEs don't have bureau history.	Using Psychometric Models for credit assessment.
Poor Financial Literacy	With poor overall literacy rate of 70%, the financial literacy in MSMEs remains quite low.	Empowering clients through support packages and business seminars.
Poor Market exposure	The user journey is complicated. 80% of Indians prefer interfaces in vernacular languages, User journey complicated.	Outsourcing credit assessment to selected local representatives.

- A bank in Indonesia employed local Relationship Managers to serve clients in 3 Km radius.The RMs often had personal knowledge of their retail clients' character and were familiar with their business' cash flow and sources of borrowing, thereby enhancing their understanding often risks and opportunities. This approach has underpinned strong, targeted client growth and helped keep risk costs impressively low.

Source: Finbox report, McKinsey Report (MSMEs in emerging markets), World Bank Report(Psychometrics as a tool to improve credit information)

Empowering Clients can benefit both clients as well as financial institutions

Segment	Characteristics
Financially	• They may reduce financial institutions' costs • They can increase the reach of financial products, as traditional brick and mortar channels make it difficult to deliver financial products to people in remote areas.
Digitally	• Digital platforms can facilitate innovation in product and service design. For example, digital platforms can be configured to improve the customer experience by offering sub-accounts or labelling accounts,
Access to data	• They can provide bank managers with real-time information and other decision aids that can help banks provide better service to clients.

Source: Weighted BCG quantitative survey analysis