COMMENTARY

Covid-19 pandemic: Challenges and ways forward for the Indian microfinance institutions

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To contain the spread of the Covid-19 pandemic, the mandated social distancing and restricted market activities have adversely affected the employment and earnings of the poor who are considered the targeted beneficiaries of the Microfinance Institutions (MFIs). The MFI operation and more specifically fresh lending are under serious threat as the mode of operations primarily involve physical interaction while distributing credits at the clients’ doorsteps, conducting periodic group meetings and carrying out regular collections. This short article attempts to analyze the various challenges that MFIs may encounter in their current and future operations due to the ongoing pandemic. It discusses how the government initiated coping mechanisms may help MFIs overcome or minimize the pandemic challenges. At the same time, MFIs’ efforts towards continued services are expected to create a win-win situation.

KEYWORDS
Covid-19, India, microfinance institutions

1 | INTRODUCTION

The Covid-19 pandemic has caused unceasing damages to the Indian economy. In an attempt to rescue or revive the Indian economy from the slump, the banking sector inter alia seems to have received special attention. Ironically, there is hardly any discussion over the role of and the challenges to the microfinance institutions (MFIs), which cater to the most vulnerable sections of the society. In India, the MFIs have significant contributions in achieving the much talked about the objective of financial inclusion. They work as the supplementary institutions to banks for the outreach to the financially excluded sections of the society. As per the Sa-dhan (2019) report, the MFIs have an outreach to 40 million clients with an outstanding loan portfolio of USD 12.76 billion. There has been a 22% increase in client outreach and a 34% increase in loan disbursements over the previous year, indicating a high growth rate. MFI lending plays a substantial role in lowering the share of informal borrowings among households. According to the Debt and Investment Survey Reports (National Sample Survey Office, 2005, 2014), the share of informal lending has decreased from 33.9% in 2002 to 29.75% in 2013, thanks to the growth of MFI lending. Besides, the MFIs employ over 138 thousand individuals (Sa-dhan, 2019).

The MFI operation and the perspectives of financial services to the poor need revamping in the wake of the pandemic related lockdown measures being in force across the country. To contain the spread of Covid-19, the administration has mandated social distancing and restricted market activities. Needless to say, the MFI mode of operation primarily involves the physical distribution of credit at the clients’ doorsteps, periodic group meetings and collections. The pandemic based restrictions, however, create challenges to the continuation of the operations. Further, a majority of the MFIs’ financial services are directed to low-income households whose earnings are irregular and to a larger extent, are daily. The restrictions on the economic activities have visibly adversely affected the earnings and the cash-flow to the households. The poor seem to be more severely affected than the upper-income households. A significant number of MFIs’ clients are employed in low income-generating jobs such as rickshaw pullers, vegetable vendors, labourers, porters, artisans and other informal sector activities.

In times of crisis, when the sources of income are restricted, the poor households are vulnerable to approach unscrupulous money-lenders for their financial needs. To tackle the crisis, these households are likely to adopt unfavorable survival mechanisms such as liquidation of assets, a decline in nutritious food consumption, and abortion
of healthcare services (Chakma et al., 2017; Dev & Sengupta, 2020). Amid the crisis, the unavailability of adequate financial services may exacerbate their economic hardships. The inaccessibility of financial services to the poor and informal sector workers may lead these households into a poverty trap. In such situations, the MFIs are a great hope to these people for the financial support to maintain, start and explore available economic opportunities.

However, the current unfavorable circumstances have put the MFIs in a dilemma about whether to continue or temporarily suspend the operations. There are some compelling factors for this dilemma. One, the administrative instructions on pandemic have hampered the operations of the MFIs. Two, as the clients are themselves struggling to make their livelihoods, making periodic repayments is difficult and consequently, the loan portfolios seem to have been deteriorating. Three, in response to their deteriorating portfolios, the MFIs may stop or restrict their financing activities. The overt behavior may create a wrong impression among the clients that MFIs seem to be running away when they are most needed and that MFIs are purely driven by the commercial objectives compromising the social objectives (Chakma et al., 2017).

As the virus is spreading and the death toll is on the rise, there is no certainty about how long the crisis will prevail and how much time the Indian economy will take to revive from the slump. With negative growth rate persisting over the last two quarters and the fear of a slow growth rate continuing in the post-pandemic period in the short- and medium-run, the MFIs arguably would have to face the most difficult time in terms of credit loss and poor liquidity. On the other side, the economic slowdown has direct adverse effects on productive economic activities, thanks to both demand- and supply-side constraints. Consequently, not only does it refrain the MFI clients from venturing into enterprises but it also creates the problems of indebtedness (Chakma et al., 2017). Hence, the dilemmas are multipronged, needing scrutiny from both MFIs’ and clients’ perspectives. This short article, thus, attempts to delve into the different dilemmas and challenges that the MFIs and clients may face during the pandemic and the post-Covid period. We analyze it from the perspectives of the two key stakeholders in MFI lending namely the MFIs and the clients. In this respect, we also examine the government initiated schemes to revive the economy and their possible impacts on the MFIs and their clients.

2 | THE MFIS’ PERSPECTIVES

The resilience of MFIs to the pandemic depends largely on the extent of cash inflows to MFIs, their operational sustainability, and the governance. The cash inflows to MFIs comprise primarily loan repayments by the clients followed by the borrowings from financial institutions and investors. However, the loan repayment capacity of the clients seems to have fallen during the pandemic. The clients are struggling to engage themselves in economic activities and make earnings for the repayments under conditions of restricted market activities. There is pressure on financial institutions and social investors to fund the operations of MFIs (Bull & Ogden, 2020).

From the perspective of operational sustainability, several factors may affect the normal operations of the MFIs. The MFIs’ financing mechanism involves group gatherings/meetings among the clients and their regular interactions with the loan officers, which seem to have been stopped, thanks to the imposition of restrictions. There are also concerns over the safety of the loan officers and the clients, as microfinance services require direct cash collections from the clients (Singh & Sharma, 2020). A large number of clients may also have relocated themselves from the infected areas to other safe locations. Consequently, MFIs may be compelled to take decisions to temporarily suspend their operations. This may lead not only to hamper new businesses but also impose a threat to existing MFI-client relationships. Besides, this may deteriorate the health of the existing loan portfolios while adversely affecting MFIs’ liquidity and solvency in the medium to long term.

The dilemma that MFIs may be facing during the current pandemic is regarding their financial viability of operations. In India, at present, the COVID 19 infected cases are nearing ten million with a daily death toll approximating 500 people (mohfw.gov.in). Looking at the upsurge in the pandemic spread, if MFIs plan to halt their operations partially or fully, it may adversely impact the MFIs’ cash generation process. This may lead to a heavy financial burden on them in terms of payment towards fixed expenses such as employees’ salaries and rent. In such a scenario, the MFIs are left with two sweeping measures either (a) to increase the interest rates on lending or (b) to reduce its current and fixed expenses, which may include reducing salaries or laying off employees. In case, the MFIs consider laying off some of their employees, it can spoil the employees’ loyalty towards the organization. Such steps can have other repercussions as well.

First, the MFIs will lose contact and information about the clients and consequently, the MFI-client relationship may break. Second, after the crisis is over, the MFIs will have to incur the costs of recruiting and training new employees. However, the problems of tracing back and building a relationship with the clients may turn out to be a tough task (Chakma et al., 2017). All these may result in poor repayments from the clients and rising non-performing assets. Third, in the case of retaining the employees on payroll without paying them salaries, the feeling of demotivation and detachment is bound to crop up leading to rising inefficiencies in delivering microfinance services (Holtmann & Grammling, 2005).

The MFIs are expected to face the problems of low repayments for some other pressing reasons as well. Amidst minimal market activities and the restrictions on movement, the clients keep struggling to make earnings and repay their debts. In such situations, they may search for credible sources to borrow bigger loan amounts and clear their older debts. These borrowings can have cascading effects and can drag the clients into indebtedness (Sangwan et al., 2020).

One way-out for the MFIs in such a situation could be to consider restructuring the existing loan contracts instead of closing off the operations. They may provide an interest rate subsidy or extend the loan moratorium. These measures may provide flexibility in repayments and improve loan portfolios (Bull & Ogden, 2020). One may, however, argue that such measures on the part of the MFIs may send
a wrong signal to the clients about the possibilities of future loan waiver, disturbing their credit discipline (Chakma et al., 2017). To make the condition worse, loan non-repayment can have a contagion effect leading to mass loan default (Chehade & Negre, 2013).

The problem of poor repayment behavior may invite the phenomenon of moral hazard (Chakma et al., 2017). On the one side, mass loan delinquency may pose a serious threat to MFIs' financial solvency (Chakma et al., 2017). On the other side, the loan officers may exert coercive measures towards ensuring better repayments (Chakma et al., 2017). Consequently, many genuinely vulnerable clients would be into dual problems of poverty and debt trap. Besides, the possibilities of a mission drift on the part of the MFIs cannot be ruled out whereby the MFIs shift their client base from the low-income households to the relatively wealthier ones. Hence, the social objective of serving the unprivileged is expected to take a back seat.

Given the complex challenges, the sustainability of operations and continuity of microfinance services largely depend upon the skillset of its management and the experiences of its employees. The MFIs having a good governance structure and employees with technical skills in banking and finance may perform better compared to their counterparts lacking the same. These organizations may overcome the crisis by adopting vigilant and robust lending and risk management practices.

### 3 | THE CLIENTS’ PERSPECTIVES

Needless to say, due to the slowdown of the economic activities, earnings and cash-flows across the country have been adversely impacted. In adverse economic situations, the borrowers’ resilience to the challenging pandemic depends on the types of economic activities they are engaged in, rescheduling of principal payments, subsidization of interest rates, and extension of moratorium period (Bull & Ogden, 2020; Singh & Sharma, 2020). The impact of the pandemic does not seem to be uniform across different sectors, regions and household types. The households which are engaged in business activities related to essential commodities like groceries, medicines, fruits and vegetables, milk products, etc. are reported to be least affected. However, a large pool of activities in the informal sector including eateries, tourism, saloons, Rickshaw pulling, daily wage labour and even contractual labour in the formal sector is severely hit. The MFI clients from the latter categories, in the absence of income generation, are expected to utilize loans primarily for household consumption purposes. They are prone to multiple borrowings, poor repayment behavior and concomitant over-indebtedness (Sangwan et al., 2020). The risk of migration of the clients from the urban to rural areas seems to be making the problem of default far worse.

The clients who have fewer installments left are more likely to clear their debts compared to those who have most or all of their installments left (Chakma et al., 2017). Particularly, those who have recently availed of credit are expected to be greater defaulters as their loan utilization may not provide them expected earnings. This would create a double challenge, both to the clients in terms of their ability to repay and to the MFIs to issue fresh loans.

Interestingly, the agricultural sector seems to remain less affected by pandemic (Singh & Sharma, 2020). This is perhaps good news for both the MFIs in particular as well as the economy at large. In India, about 46.1% of the households have their livelihood dependency on agricultural and allied activities (Government of India, 2016). A better harvest from this sector may help the economy recover the losses elsewhere and revive faster. From the perspective of the MFIs, apparently, the demand and repayments of microfinance credit are robust in this sector. This may help the MFIs sustain their operation at least in the rural economy in the medium and long-run, if not in the short-run.

### 4 | THE WAYS FORWARD

Considering the MFIs as instrumental in providing financial services to the poor, and that the MFIs are currently finding it difficult to raise capital from the debt market, the government of India has introduced certain useful measures to improve their liquidity needs. A special liquidity scheme of USD 4.06 billion has been launched for the non-banking financial companies, housing finance companies, and the MFIs (Government of India, 2020a). This is expected to ease the MFI operation and in turn, help the needy avail of much-needed credit to let go the business. If the clients can resume their economic activities, the demand for and repayments of the MFI loans are likely to improve.

Under the recently launched scheme of the government “Atmanirbhar Bharat” or “Self-Reliant India”, a financial package of USD 270.42 billion is announced to revive the economy (Government of India, 2020c). The economic package has the provision of financial assistance to the small-scale industries namely home industries, cottage industries, small-scale industries, and MSMEs that are sources of livelihood and earning for a majority of poor and low-income households. Under this scheme, there is a provision for collateral-free loans to these industries to meet their operational liabilities, to buy raw materials and to restart the production processes. Besides, under the scheme of “Pradhan Mantri Garib Kalyan Yojana” a special package of USD 23.66 billion is also announced for the poor, which will provide some relief from the pandemic. Further, to provide financial aid specifically to the street vendors to resume their livelihood, Pradhan Mantri Street Vendor’s AtmaNirbhar Nidhi (PM SVANidhi) scheme is launched. Under the scheme, economically weaker people engaged in vending of articles, goods, and food items of daily use on a street, footpath, or pavements, etc. are facilitated with a loan amount of USD 135.21, which is repayable in one year (Government of India, 2020c). Under the Deen Dayal National Livelihood Mission scheme, to boost the economic activities among women self-help groups, the limit of collateral-free loans is increased to USD 27,041. Besides, all women having their bank accounts opened under Pradhan Mantri Jan-Dhan Yojana (a financial inclusion scheme) are being provided one-time ex-gratia of USD 6.76 per month for three months (Government of India, 2020b). These initiatives are expected to
support the MFI clients in terms of supplementing their financial aid for income generation and for setting up micro-enterprises.

The government has made provisions for food and other household basic necessities for the poor. This should reduce the clients' financial burden in terms of their spending on consumption purposes. In effect, the clients are expected to invest the borrowings in some productive income-generating economic activities.

Needless to say, in a time of crisis of this magnitude, it does not seem ethical on the part of the MFIs to suspend the financial services to the poor when such services are most needed. The past experiences of microfinance services during different crises (e.g. Ebola, SARS, Tsunami, etc.) evince that MFIs should continue to retain their employees and maintain regular communication and relationship with the clients (Aheeyar, 2006; Chakma et al., 2017; Day et al., 2004). It will help them stay updated, understand and assess the ground situation better. A continuous operation would also help MFIs profile the clients according to their risk level, losses and physical migration. The acquired information can further be used by the loan officers to assess the credit demand and repayment capacity of the clients. Accordingly, the MFIs can make arrangements to refinance and restructuring the collections from the clients. They can also develop differential disbursement and collection strategies as per the severity of the operational locations.

DATA AVAILABILITY STATEMENT

The data that support the findings of this study are available on request from the corresponding author. The data are not publicly available due to privacy or ethical restrictions.

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