International Journal of Trend in Scientific Research and Development (IJTSRD)
Volume 4 Issue 6, September-October 2020 Available Online: www.ijtsrd.com e-ISSN: 2456 – 6470

Microfinance Industry: Picking up the Pieces after the Financial Year: 2019 Liquidity Jolt

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ABSTRACT

Not many believed that the microfinance industry (MFI) would bounce back quickly after the FY: 2019 liquidity jolt. It has sort of bounced back, but it will take another year or two for the bounce-back to be complete. Fortunately for the MFI players, rather the larger players among them, the response of the capital market to their capital-raising efforts has been encouraging. The smaller players however have not been that lucky. They need to look for alternatives like settling for the co-lending model by partnering with large lenders. Or they could seriously explore the business correspondent channel to shape up to stay relevant. It is time they shaped up or shipped out. However, when things come to a head, the inevitable will happen, namely a shake-out would materialise with the smaller MFIs being acquired by the larger NBFCs and even scheduled commercial banks. However, in the backdrop of the FY 2019 liquidity squeeze that shook the industry, measures to calibrate the risks involved in the operations of the MFIs are due and this led the researcher to take up this study.

It concludes that since the smaller players cannot shape up financially given the market's reluctance to support them, they had better become partners of large MF lenders and co-lend. Overall, it makes sense for the microfinance industry to welcome a shake-out in the industry, since unviable players will be taken over by stable and viable players like large NBFCs and scheduled commercial banks to the benefit of all stakeholders associated with the industry. Such a development should not be viewed sceptically.

KEYWORDS: *Business correspondent; Calibrate; Capital-raising; Co-lending; Jolt; Shake-out*

How to cite this paper: Dr. Nandisha H D "Microfinance Industry: Picking up the Pieces after the Financial Year: 2019 Liquidity Jolt" Published in International Journal of Trend in Scientific Research and Development (ijtsrd), ISSN: 2456-6470, Volume-4 | Issue-6, October 2020, pp.370-375, URL: www.ijtsrd.com/papers/ijtsrd33368.pdf

IJTSRD33368

1.1. INTRODUCTION

Micro financing came into being in the first place to financially assist those who could not be assisted by banks or formal financial institutions for various reasons. They obviously remained financially excluded. However, newer strategies were put into place to help these disadvantaged and hence vulnerable sections of society. These people were organised into groups of ten or twenty at the village level and financed one by one to pursue an income-generating activity that involved indigenous technology; they were financed individually too. Alongside, they were forced to save for a rainy day. The savings stood them in good stead when they sought loan from the banks either directly or through the MFIs indirectly, either singly or as members of joint liability groups, as the groups are called. This ensured an interrupted flow of working capital to them if they serviced the debt promptly.

1.2. Statement of the problem

In view of the liquidity crunch that hit them in FY 2019 and the problems the crunch gave rise to, it is important that the stakeholders got down to the task of addressing the problems promptly and effectively. It is a different thing that things are looking up for the industry in FY 2020, the FY 2019 setback notwithstanding. But complacency is the last thing the industry can afford now.

1.3. Review of literature

- NBFC-MFIs raised INR 26,000 crore through securitisation in FY 2019, up 2.6 times from the INR 9,700 crore it raised in FY 2018. Liquidity crunch led to securitisation according to rating agency ICRA (The Hindu Business Line, 2019). In FY 2019, NBFC-MFIs significantly raised their reliance on the securitisation route to meet growth targets: Securitisation had always been an important funding tool for NBFC-MFIs, but the dependence had risen during the second half of fiscal 2019 according to an industry source. In FY 2018 and H1 FY 2019, securitisation accounted for only 18-20 per cent of the overall disbursements. The figure leapfrogged to 37 per cent and 50 per cent in Q 3 FY 2019 and Q 4 FY 2019, respectively. In other words, almost half of the incremental disbursements in Q 4 FY 2019 was allegedly generated from the securitisation mechanism. Investors were also comfortable buying retail loan portfolios originated by these entities as opposed to taking direct on-balance sheet credit exposure, especially the loan portfolios of small-and medium-sized entities. The securitisation market in India covered two types of transactions, namely rated Pass through Certificate (PTC) transactions, and unrated Direct Assignment (DA) transactions (bilateral assignment of pool of retail loans from one entity to another). The PTC route had historically been the preferred route for microfinance asset class owing to the absence of credit enhancement in DA transactions. However, recent trends indicated a sharp rise in DA transactions. According to ICRA, DA transaction volume undertaken by NBFC-MFIs were around INR 13,500 crore for FY 2019 against INR 4,000 crore and INR 3,000 crore in FY 2018 and FY 2017, respectively.

- The number of microfinance accounts stood at 8.91 crore as of December 2018, reflecting a growth of 24.3 per cent (The Economic Times, 2019). The aggregate loan portfolio of the microfinance industry grew at a healthy 43.1 per cent to INR 1, 66,284 crore as of December 2018, according to a report. The loan amount included a portfolio of INR 458 crore in Andhra and Telangana and stressed (days past due or DPD 180+) portfolio of INR 8,787 crore. In the period to December 2017, the total loan outstanding of the MFI industry stood at INR 1, 16,198 crore. The number of microfinance accounts stood at 8.91 crore as of December 2018, reflecting a growth of 24.3 per cent over the third quarter of FY 18, according to a report released by the Microfinance Institutions Network. In the December quarter, 50 MFIN members collectively disbursed INR 19,919 crore loans to 77 lakh accounts. According to MFIN, the industry overall continued to clock a strong growth rate with a healthy portfolio quality. The MFIs NBFC-MFIs that held the largest share in the microcredit space, had shed the impact of the previous year's liquidity crunch and are focusing on steady growth in the loan portfolio and client numbers in the upcoming quarters. As of December 2018, 74 NBFC-MFIs held the largest share of portfolio in micro-credit with total loan outstanding of INR 60,631 crore, accounting for 36.5 per cent of total micro- credit universe. Banks' microfinance portfolio stood at INR 53,605 crore, reflecting a growth of 50 per cent over the last year. Small finance banks had a total loan amount outstanding of INR 30,187 crore or 18.2 per cent to the total. NBFCs accounted for another 10.7 per cent and non-profit MFIs accounted for 2.4 per cent of the universe. During the reporting quarter, NBFC-MFIs members received a total of INR 8,235 crore in debt funding, representing an increase of 11 per cent
- The micro-finance industry registered a 38 per cent growth in its gross loan portfolio at INR 1.87 lakh crore in the 2018-19 fiscal (The Times of India, 2019). Gross loan portfolio of the sector stood INR 1.35 lakh crore in FY 2017-18. The number of micro-finance accounts stood at 9.33 crore as on March. 31, 2019 registering a growth of 21.9 per cent over FY 2018, according to a report released by Microfinance Institutions Networks (MFIN). MFIN, an RBI recognised self-regulatory organisation and industry association, boasts of 53 NBFC-MFIs as members. The members collectively disbursed 3.25 crore loans worth INR 82,928 crore in FY 2019. In 2018-19, the microfinance industry demonstrated its resilience by growing steadily despite liquidity squeeze that all NBFCs faced in the third quarter, natural disasters like cyclones and drought. NBFC-MFIs held the largest chunk of portfolio in micro-credit with a loan outstanding of INR 68,868 crore, accounting for 36.8 per cent of all micro-credit universe. As on March 31, 2019 the aggregated total loan portfolio of NBFC-MFIs stood at INR 68,207 crore, flaunting a growth of 47 per cent year-on-year. The NBFC-MFIs received a total of INR 35,759 crore in debt funding from banks and other financial institutions, representing a growth of 63 per cent compared to FY 2018. Total equity in FY 2019 grew by 42 per cent at INR 14,206 crore. In terms of regional distribution of portfolio, East and North East accounted for 38 per cent of the total NBFC MFI portfolio, South 24 per cent, North 14 per cent, West 15. Per cent and Central contributed 9 per cent. As of March 31, 2019, the banks had a micro-finance portfolio of INR 61,046 crore, reflecting a growth of 36 per cent over the last year while small finance banks (SFBs) clocked a growth of around 25 per cent. The report said the asset liability management (ALM) of all categories of NBFC-MFIs are well placed in terms of ALM across various buckets. The borrowings of MFIs were of longer term while assets were of shorter-term and as a result, they had a comfortable gap as on March 31, 2019 to manage their obligations for the upcoming quarter and up to the next 12 months.
- Cashless disbursements by NBFC-MFIs now account for 87 percent of the total disbursements (Namrata, 2018). Defying muted credit growth in the banking sector, the microfinance sector registered a growth of around 39 per cent on a year-on-year basis, with the total outstanding loan amount standing at INR 1,480 billion at the end of June 2018. According to Reserve Bank of India, gross bank credit rose by 11.07 per cent in June on a year-on-year-basis, while microcredit grew by 48.3 per cent. Over the past few months, most MFIs (microfinance institutions) have been recovering from the after-effects of demonetisation and government-mandated debt waivers. However, with most non-performing loans written off, MFIs are again looking at growing their portfolios. Several of the MFIs have been exploring the option of initial public offerings (IPOs) to raise funds. Banks hold the largest share of microloans at 39 per cent, followed by non-banking finance companies (NBFC)-MFIs, accounting for 32 per cent of the total loan outstanding. Small Finance Banks had a share of 21 per cent, while NBFCs had seven per cent and non-profit entities accounting for the remaining one per cent of the microfinance pie. About 64 per cent of bank lending to the MFI sector was in the form of direct lending, while the rest was through banking correspondents. The portfolio at risk (loans that have at least one payment for more than 30 days overdue), which were 10.7 per cent in June 2017, stood at 3.2 per cent at the end of June 2018, signifying an improvement in the asset quality of microloans Cashless disbursements by NBFC-MFIs now account for 87 per cent of the total disbursements. In Q1 FY 2018-19, a sum of INR 114 billion was disbursed in cashless mode in about 4.2 million loan accounts. According to MFIN, the microfinance industry has gained pace, manifesting growth in the past quarters. More of new players are entering the space and the current ones are growing larger, realising their IPO plans. Additionally, improved investor confidence, driven by superior regulations being in place and improved transparency in the sector, will also support the growth. In Q1 of FY 19, NBFC-MFIs received a total debt funding of about INR 102 billion, representing a whopping 160 per cent growth over Q1

of FY 18. The total equity in the NBFC-MFI sector was about INR 103 billion, of which about 48 per cent belonged to the category of foreign equity.

1.4. Research gap

The reviewed research, though valuable and insightful, has not dealt with the measures needed to calibrate the risks involved in the backdrop of the FY 2019 liquidity squeeze that shook the microfinance industry. Nor has it examined the problems the MFIs are grappling with now. It is this gap the present research seeks to bridge.

1.5. Scope of the present study

The study covers 50 MFI officers and 30 MFI experts, based in Bangalore.

1.6. Objective of the study

The objectives of the study are to:

1. Identify the measures needed to calibrate the risks involved in the backdrop of the FY 2019 liquidity squeeze that shook the microfinance industry
2. Ascertain the problems the MFIs are grappling with now

1.7. Hypothesis proposed to be tested

The study proposes to test the following hypotheses:
"A shake-out in the industry should be encouraged, with the smaller MFIs being acquired by larger NBFCs and banks"

1.8. Research design

1.8.1. Research methodology

The study is descriptive in nature and has used the 'fact-finding' survey method

1.8.2. Sources of data

Data required for the research has been collected from both primary and secondary sources.

Primary data has been collected by administering Interview Schedules to the respondents, namely, the MFI officers and microfinance (MF) experts

In addition, the researcher interacted extensively with other stakeholders, namely, trade / industry bodies associated with the microfinance industry and perused literature on the subject carried out by MFIN INDIA

Secondary data has also been collected from books relating to the topic, articles, reputed journals, the financial press, government publications, websites and company annual reports.

1.8.3. Sampling plan

MFI officers: Given the limited availability of MFI officers in the area covered by the study, the researcher selected 50 MFI officers. The researcher used the purposive or judgement sampling under the non-probability method for the purpose. What is important is the typicality and the relevance of the sampling units to the study and not the overall representativeness to the population. Thus, it guarantees inclusion of the relevant elements in the sample. Probability sampling plans cannot give such a guarantee.

MF experts: Given the limited availability of MF experts in the area covered by the study, the researcher selected 30 MF experts. The researcher used the purposive or judgement sampling under the non-probability method for the purpose. What is important is the typicality and the relevance of the sampling units to the study and not the overall representativeness to the population. Thus, it guarantees inclusion of the relevant elements in the sample. Probability sampling plans cannot give such a guarantee.

1.8.4. Data collection instruments

Interview schedules, specially designed for the purpose, were administered to the respondents for collection of primary data.

1.8.5. Data processing and analysis plan

Non-parametric statistical units were used to test the association between some qualitative characters and conclusions will be drawn based on formation of H_0 and H_1. To be specific, chi-square test will be applied to test the hypotheses.

1.8.6. Limitations of the study

Primary data was at times deduced through constant topic-oriented discussions with the respondents. A certain degree of subjectivity, even if negligible, could have clouded their views. However, the researcher is confident that the subjectivity will be too insignificant to affect the accuracy of the findings of the study.

1.9. MFI officers

In the following paragraphs, the primary data collected from the 50 MFI officers is analysed.

1.9.1. Measures to calibrate the risks involved in the backdrop of the FY 2019 liquidity squeeze that shook the microfinance industry

The microfinance industry suffered a setback in FY 2019 owing to the liquidity squeeze that cropped up. Hence the researcher requested the respondents to disclose the measures needed to calibrate the risks involved in the said backdrop. Their replies to the query appear in the following Table.

Table-1 Measures to calibrate the risks involved in the backdrop of the FY 2019 liquidity squeeze that shook the microfinance industry

Measures	Number of respondents
Smaller and capital-starved MFIs should seriously explore the co-lending model by becoming partners of large lenders	45
A thorough credit analysis / assessment of the actual debt repayment capacity of the borrower should be mandated.	43
Group selection / elimination norms should be enforced strictly so credit discipline can be ensured at the borrower level.	41
A shake-out in the industry should be encouraged, with the smaller MFIs being acquired by larger NBFCs and banks.	40

Smaller and capital-starved MFIs should seriously explore the co-lending model by becoming partners of large lenders assert 45 respondents. A thorough credit analysis / assessment of the actual debt repayment capacity of the borrower should be mandated, aver 43 respondents. Group selection / elimination norms should be enforced strictly so credit discipline can be ensured at the borrower level, suggest 41 respondents. A shake-out in the industry should be encouraged, with the smaller MFIs being acquired by larger NBFCs and banks, according to 40 respondents.

1.9.2. Problems the MFIs are grappling with now

Post the liquidity squeeze they faced in FY 2019, a host of collateral problems have cropped up in the microfinance industry and some of them persist till date. Hence the researcher requested the respondents to disclose the problems the MFIs are grappling with now. Their replies to the query appear in the following Table.

Table-2 Problems the MFIs are grappling with now

Problems	Number of respondents
Smaller players unable to raise capital	45
High single-state exposure, especially in the eastern and north eastern markets, could raise the cost of equity	42
While larger players have been able to raise capital, the smaller, less-diversified players continue to be capital-starved	40

45 respondents state that smaller players are unable to raise capital. High single-state exposure, especially in the eastern and north eastern markets, could raise the cost of equity, cite 42 respondents. While larger players have been able to raise capital, the smaller, less-diversified players continue to be capital-starved, rue 40 respondents.

1.10. Microfinance experts

In the following paragraphs, the primary data collected from the 30 microfinance experts is analysed.

1.10.1. Measures to calibrate the risks involved in the backdrop of the FY 2019 liquidity squeeze that shook the microfinance industry

The microfinance industry suffered a setback in FY 2019 owing to the liquidity squeeze that cropped up. Hence the researcher requested the respondents to disclose the measures needed to calibrate the risks involved in the said backdrop. Their replies to the query appear in the following Table.

Table-3 Measures to calibrate the risks involved in the backdrop of the FY 2019 liquidity squeeze that shook the microfinance industry

Measures	Number of respondents
A shake-out in the industry should be encouraged, with the smaller MFIs being acquired by larger NBFCs and banks.	27
Smaller and capital-starved MFIs should seriously explore the co-lending model by becoming partners of large lenders	26
A thorough credit analysis / assessment of the actual debt repayment capacity of the borrower should be mandated.	26
Group selection / elimination norms should be enforced strictly so credit discipline can be ensured at the borrower level.	25
The difference obtaining in the average loan ticket size for the sector as a whole sector and the NBFC-MFI subsector should be investigated	24

A shake-out in the industry should be encouraged, with the smaller MFIs being acquired by larger NBFCs and banks, aver 27 respondents. Smaller and capital-starved MFIs should seriously explore the co-lending model by becoming partners of large lenders state 26 respondents. A thorough credit analysis / assessment of the actual debt repayment capacity of the borrower should be mandated assert 26 respondents. Group selection / elimination norms should be enforced strictly so credit discipline can be ensured at the borrower level, state 25 respondents. The difference obtaining in the average loan ticket size for the sector as a whole sector and the NBFC-MFI subsector should be investigated, remark 24 respondents.

1.10.2. Problems the MFIs are grappling with now

Post the liquidity squeeze they faced in FY 2019, a host of collateral problems have cropped up in the microfinance industry and some of them persist till date. Hence the researcher requested the respondents to disclose the problems the MFIs are grappling with now. Their replies to the query appear in the following Table.

Table-4 Problems the MFIs are grappling with now

Problems	Number of respondents
Smaller players unable to raise capital	27
While larger players have been able to raise capital, the smaller, less-diversified players continue to be capital-starved	27
High single-state exposure, especially in the eastern and north eastern markets, could raise the cost of equity	26
MFIs, with an AUM (assets under management) of at least INR 1,000 crore have raised more than 90 per cent of the capital in 2018-19	26
The average ticket size of loans in some states like West Bengal is way ahead of other states.	25
India's first nine districts by loan portfolio are from West Bengal	25

Smaller players unable to raise capital, cite 27 respondents. While larger players have been able to raise capital, the smaller, less-diversified players continue to be capital-starved, point out 27 respondents. High single-state exposure, especially in the eastern and north eastern markets, could raise the cost of equity warn 26 respondents. MFIs, with an AUM (assets under management) of at least INR 1,000 crore have raised more than 90 per cent of the capital in 2018-19, aver 26 respondents. The average ticket sizes of loans in some states like West Bengal is way ahead of other states cite 25 respondents. India's first nine districts by loan portfolio are from West Bengal, remind 25 respondents.

1.11. Summary of findings

In the following paragraphs, a summarised version of the findings arrived at in respect of the two categories of respondents is furnished.

1.11.1. MFI officers

- Smaller and capital-starved MFIs should seriously explore the co-lending model by becoming partners of large lenders assert 45 respondents. A thorough credit analysis / assessment of the actual debt repayment capacity of the borrower should be mandated, aver 43 respondents. Group selection / elimination norms should be enforced strictly so credit discipline can be ensured at the borrower level, suggest 41 respondents. A shake-out in the industry should be encouraged, with the smaller MFIs being acquired by larger NBFCs and banks, according to 40 respondents.
- 45 respondents state that smaller players are unable to raise capital. High single-state exposure, especially in the eastern and north eastern markets, could raise the cost of equity, cite 42 respondents. While larger players have been able to raise capital, the smaller, less-diversified players continue to be capital-starved, rue 40 respondents.

1.11.2. MFI experts

- A shake-out in the industry should be encouraged, with the smaller MFIs being acquired by larger NBFCs and banks, aver 27 respondents. Smaller and capital-starved MFIs should seriously explore the co-lending model by becoming partners of large lenders state 26 respondents. A thorough credit analysis / assessment of the actual debt repayment capacity of the borrower should be mandated assert 26 respondents. Group selection / elimination norms should be enforced strictly so credit discipline can be ensured at the borrower level, state 25 respondents. The difference obtaining in the average loan ticket size for the sector as a whole sector and the NBFC-MFI subsector should be investigated, remark 24 respondents.
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1.12. Conclusion

Conclusions relate to the hypotheses. They are answers to the research questions.

1.12.1. Hypothesis testing

Hypothesis

As explained, the following is the hypothesis proposed to be tested:

"A shake-out in the industry should be encouraged, with the smaller MFIs being acquired by larger NBFCs and banks"

Hence H_0 and H_1 are as follows:

H_0: A shake-out in the industry should not be encouraged, with the smaller MFIs being acquired by larger NBFCs and banks.

H_1: A shake-out in the industry should be encouraged, with the smaller MFIs being acquired by larger NBFCs and banks.

Based on the primary data collected from the respondents, vide Tables: 1 and 3, a chi-square test was applied to ascertain the association, if any, between the two variables. The following Table reveals the computation made using MS-Excel:

Category		Observed Values		
		Yes	No	Total
	MFI Officers	40	10	50
	MF experts	27	3	30
	Total	67	13	80
		Expected Values		
	Category	Yes	No	Total
	MFI Officers	41.875	8.125	50
	MF experts	25.125	4.875	30
	Total	67	13	80
		Yes	No	
2	o-e	-1.8750	1.8750	
		1.8750	-1.8750	
	(o-e)^2	3.5156	3.5156	
		3.5156	3.5156	
	((o-e)^2)/e	0.0840	0.4327	
		0.1399	0.7212	
	CV	0.2239	1.1538	1.3777
	TV			3.8415
	P			0.8481

The calculated value of χ^2 is *1.3777*, lower than the table value of *3.8415* for an alpha of 0.05 at one degree of freedom. Hence the null hypothesis is not rejected, and the alternate hypothesis is rejected. p=*0.8481*is the inverse of the one-tailed probability of the chi-squared distribution.

1.13. Researcher's recommendations

1. Market is the best judge. When the market does not patronise small, undiversified and capital-starved MFIs, the writing is on the wall: they should either shape up or ship out. Since they cannot shape up financially given the market's reluctance to support them, they had better become partners of large MF lenders and co-lend.
2. Instances of over-debtedness on the part of MF beneficiaries are becoming uncomfortably rife now. They have been multi-financed and hence over-financed for whatever reason and it is thus beyond their capacity to service the loan. This gives rise unpleasant consequences for the financier and the financed as well. Since prevention is better than cure the MFIs will do well to conduct a thorough credit analysis / assessment of the actual debt repayment capacity of the borrower before sanctioning the loan
3. Group selection / elimination norms should be revisited fine-tuned and enforced strictly so credit discipline can be ensured at the borrower level as another preventive measure.
4. Overall, it makes sense to welcome a shake-out in the industry since unviable players will be taken over by stable and viable players like large NBFCs and scheduled commercial banks to the benefit of all stakeholders associated with the industry.
5. MF players should be careful while exposing themselves excessively to a select group of states like those in the east and north-eastern parts of India since it does not make financial sense or business sense to put all one's eggs in one basket.
6. Such singular and excessive exposure could raise the cost of equity to the MFIs since the risk premium the investors demand will go up
7. It is also necessary to ascertain why there obtains a huge difference in the average loan ticket size between the sector as a whole and the NBFC-MFI sub-sector. If the difference is justifiable, it should cause no worry.

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