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Financial Inclusion or Financial Destruction: A Case Study of Microfinance Institutions

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Abstract

Microfinance sector, in India has played an significant role in the progress of the Indian rural as well as urban economy. A large number of Micro Finance Institutions (MFIs) in India are serving to the financing needs of rural and semi-urban Indian population. For achieving the target of financial inclusion in India this sector cannot be ignored. Generally daily wage earners, marginal farmers, women working from homes are the clients of MFIs. Such clients work only cash basis. Collection of loan is generally done by MFIs on weekly or fortnightly basis. The objective of the paper is to analyze the short and medium term positive and negative effects of many government decisions including demonetization on MFIs in India. This study will give more insights about the impact of the demonetization and other government policy framework on MFIs in India.

Key words: CE, Demonetization, MFIs, PAR30, PAR90, PAR180

1. Introduction

Microfinance sector has been serving India since a long time for achieving the object of financial inclusion. Financial inclusion is the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low-income groups at an affordable cost (Dr. C. Rangarajan Committee (2008). Presently, There are 73 NBFC-MFIs registered with RBI which 51 are MFIN members. The study examines the performance of MFIs impacted due to different microfinance variables and government policy during the period 2011-2016. This period is very important for a many reasons mainly because Indian government and RBI took initiatives for making microfinance sector an organized one. Microfinance bill was passed in this period. During this period more emphasis was given on financial inclusion by introducing microfinance regulations and setting up regulatory authority. This period noticed new highs in microfinance sector after AP Crisis and also faced downward trends due to unhealthy government decisions. Many variables such as disbursements, amount of loan, no. of loans, collection efficiency, portfolio at risk, demonetization, loan waiver policy which affect microfinance sector are taken into account as illustrative variables so as to have a complete understanding of positive and negative impact on MFIs during 2011-2016 (study period)

This paper has been divided in V sections. In section I, a brief introduction of MFIs, their working process and demonetization in India has been given. Section II of this paper states the objective of this paper. In section III, research methodology used in paper has been explained. In section IV, analysis and interpretations of results have been presented. Section V, presents Summary and conclusions. In section VI, references have been given.

2. Objectives of the Study

The objective of the present study is to evaluate the positive as well as negative impact of demonetization and other government policy frame work on the working of MFIs in India. To achieve the objective of the paper, study for the period 2013 to Oct.2016 as pre demonetization period and Nov. 2016 to March 2017 as post demonetization period has been conducted.

3. Research Methodology

3.1 Data Collection

To achieve the objectives of the study secondary data is used which is collected from various sources i.e. publications of MFIL, reports of CARE RATING, RBI guidelines for MFIs and from websites of MFIL, CARE, RBI, etc. Quarterly. The relevant data have been collected for the period 2011 TO March 2017.

4. Analysis and Interpretations of results

4.1 Growth of MFIs in post AP Crisis Period

The real growth of MFIs in India can be analysed only after 2010 when RBI and Indian government initiated steps to revive

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this industry. The period after 2010 can be considered as post ANDHRA PRADESH CRISIS (herein after AP Crisis) period in India. Up to 2010 Portfolio at risk (PAR 30) for the industry increased significantly. It was a direct result of AP Crisis. Before AP Crisis PAR 30 of this sector was less than 1%. This variable increased up to 22% after AP Crisis. According to micrometer of MFIN, During FY 12-13, MFIs disbursed 18.10 mn loans. It was an increase of 5% over FY 11-12. In the same period an increase of 10% in disbursement of loans was noticed for Non AP MFIs. During the year 12-13 loan disbursements by large MFIs accounted for 82%[1]. There were many reasons behind this growth. As mentioned in MICROMETER of MFIN JUNE 2012[3], in April 2011, ministry of finance (MOF) constituted committee for drafting new Microfinance Bill. In May 2011 RBI issued detailed guidelines covering loans to MFIs by Banks. In July 2011 Draft Micro finance Bill 2011 was put in the public domain. In Oct 2011 MoF constituted committee for framing Vision Document for Financial inclusion 2020. According to MICROMETER of MFIN Nov. 2013[6] During Q1 FY 13-14, MFIs disbursed 4.78 mn loans, an increase of 42% over Q1 FY 12-13. However, loans disbursed decreased by 23% compared to Q4 FY 12-13 as disbursement activity typically peaks during the last quarter of the financial year. During Q2 FY 13-14, MFIs disbursed Rs 76.61 bn, an increase of 50% over Q2 FY 12-13 and 22% over last quarter Q1 FY 13-14. Similar growth was noticed in further period. RBI regulations and govt. efforts were responsible for this growth. Financial inclusion was one of the most important agenda of Indian govt. Since 2013 growth in micro finance sector can be analyzed. A clear rising pattern can be viewed (Figure 1). During Q1 fy 14-15, MFIs disbursed over 6.3 mn loans worth Rs 94.2 bn. Compared with Q1 fy 13-14, number of loans disbursed grew by 34% and loan amount disbursed by 48%.During Q3 fy14-15,MFIs disbursed over 8.2mn loans worth Rs132.6bn Compared with Q3 fy13-14,number of loans disbursed grew by 33% and loan amount disbursed by 46%. In April 2015, RBI took a great step by increasing the lending limit by MFI from Rs. 50000 to Rs.1. by this step of RBI, the client of MFI could borrow double amount as compare to earlier. This allowed lenders to give out more loans to the same customers. It can be seen that on quarter to quarter basic this sector enjoyed growth. However increment in loan amount with less increment in clientage was a matter of concern.

4.2 Growth Of MFIs in post Demonetisation Period

Growth of microfinance sector had to face a check when the Indian Government ceased to recognise Rs.500 and Rs.1000

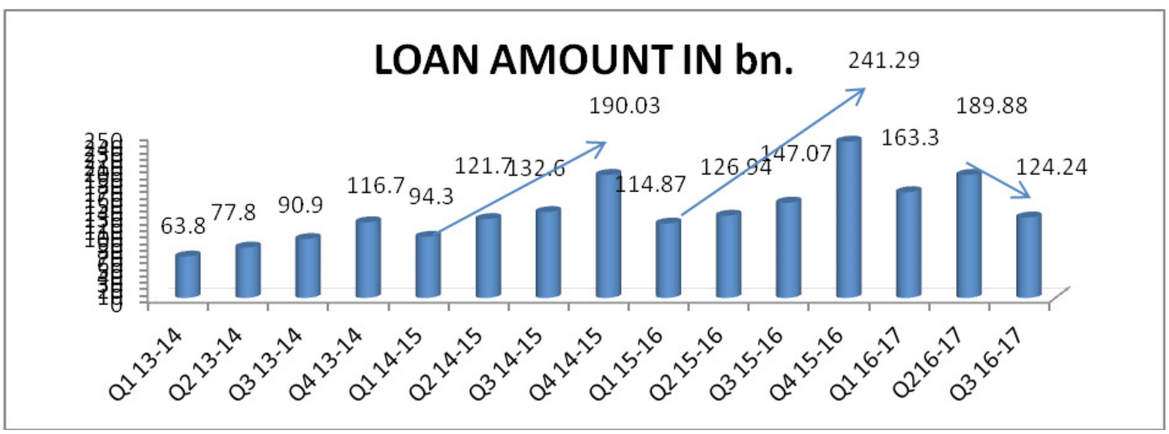

Figure 1. Source: MFIN Publications.

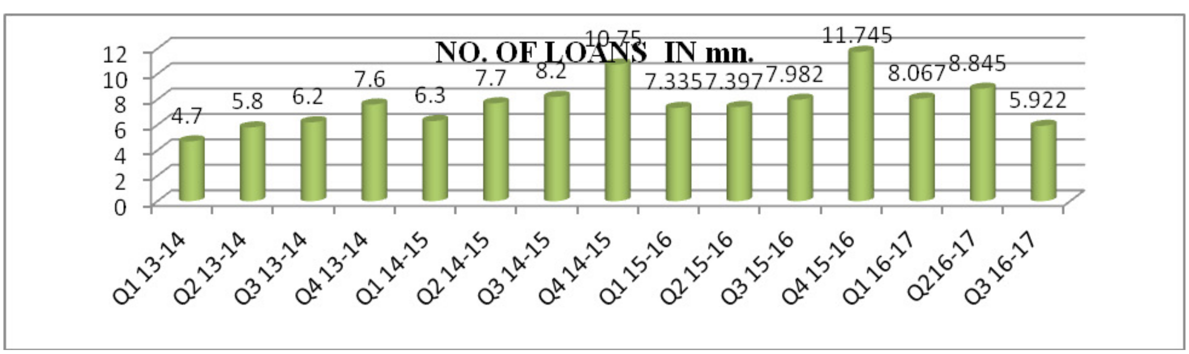

Figure 2. Source: MFIN Publication.

rupee denominated bank notes ("Specified Bank Notes" or "SBNs") as legal tender with effect from November 9, 2016. As clear from figure 1 and figure 2, this industry faced a sharp decline in total amount of loan disbursed and no. of loans during Q3 2016. Amount of loan by MFIs was declined from 189.88 bn in Q2 2016 to 124.24 bn.Q3 2016(34.57%). It was followed by decline in no. of loans which were 8.84 mn in Q2 2016 and declined up to 5.92 mn. in Q3 2016((33.03%).On analysis it can be seen that there had been good growth in amount of loan from Q2 to Q3 since 2013 i.e. 13.55% growth in 13-14, 9% growth in 14-15 and 15.86% growth in 15-16 which was sharply declined i.e.34.57% in post demonetization period

4.3 Portfolio at Risk (PAR)

Portfolio performance of MFIs can be measured with the help of PAR to a certain extent. PAR 30, PAR 90 and PAR 180 are relevant tools for this purpose. PAR 30 indicates the total principal value outstanding of loans that have at least one payment more than 30 days overdue. PAR 90 indicates the total principal value outstanding of loans that have at least one payment more than 90 days overdue. PAR 180 indicates the total principal value outstanding of loans that have at least one payment more than 180 days overdue. Growth of MFIs during pre demonetization period can be noted with Figure 3. After analyzing this figure it is clear that during the period Q1 2013 to Q2 2016 PAR30, PAR90 and PAR180 were under 1% which can be considered as desirable risk. However there was noticed tremendous increment in PAR30 in post demonetization period which was 7.52%. similarly PAR90 was increased from an average of 0.23% to 0.41% and PAR180 was increased from 0.20% to 0.91%. Demonetization created shortage of cash in economy which played major role in this increment.

4.4 Collection efficiency of MFIs during post demonetization period

Since 2013 Indian Microfinance industry was growing at a very fast pace due to low penetration of formal banking system to majority of population. The industry has been considerably impacted from demonetization announcement on November 8, 2016 due to high dependency on cash transactions. The average collection efficiency of the Microfinance Industry has gone down from 99% in October 2016 to 70% during Nov 7 – Nov 25, 2016. Average Collection efficiency in the states Karnataka, Tamil Nadu, Maharashrta and UP which consist of 48% share (figure 5) of microfinance industry was declined up to 77.75% (figure 4). This was due to less supply of new currency, disruption in borrower's cash flow, lengthening of working capital cycle and government intervention in deposit and withdrawing of cash. In 3rd week of Nov., RBI extended the time limit for repayment of loan which was treated as waiver of loan on account of borrower. This misconception held responsible for less collection efficiency. In Post third-week of November 2016, the collection efficiency improved to more than 80% but remained stable at this point till March 2017. During this period the states, Uttarakhand, Uttar Pradesh, Delhi, Haryana, Rajasthan, Maharashtra, Punjab and Madhya Pradesh were the worst impacted states (figure 4). The states in Southern and Eastern part of India have been the least affected. Collective collection efficiency (CE) of MFIs decreased up to 82% and disbursement as % of CE was decreased up to 34 % in Dec.2016 (figure 6)

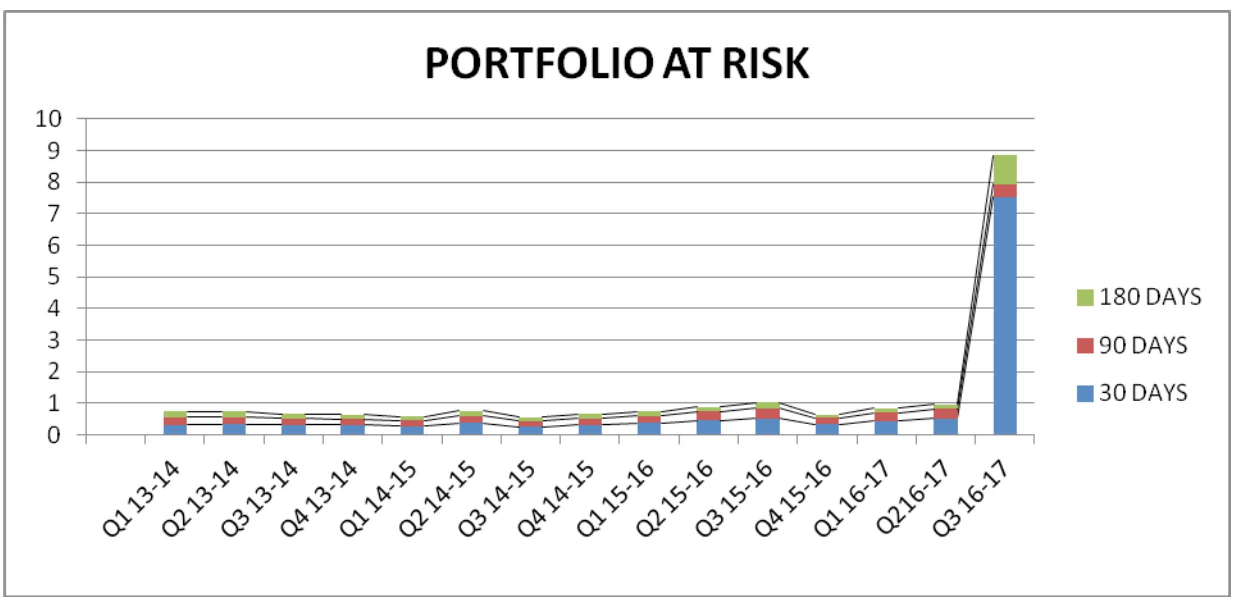

Figure 3. Source: MFIN Publications.

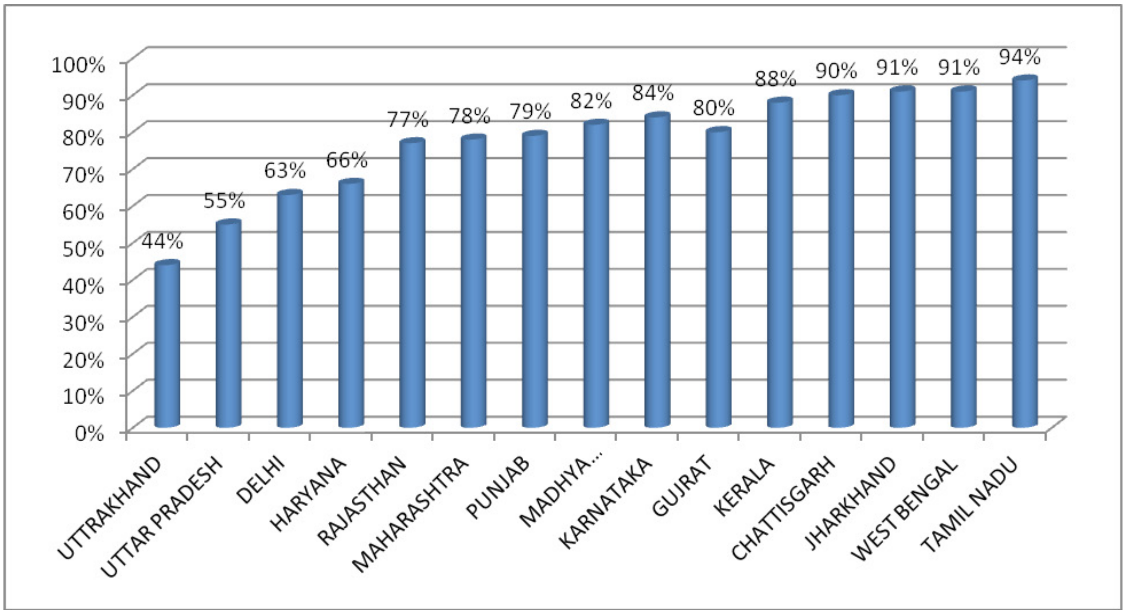

Figure 4. State wise collection efficiency in post demonetization period Source: CARE RATING State wise Portfolio share as on 31st Dec 2016.

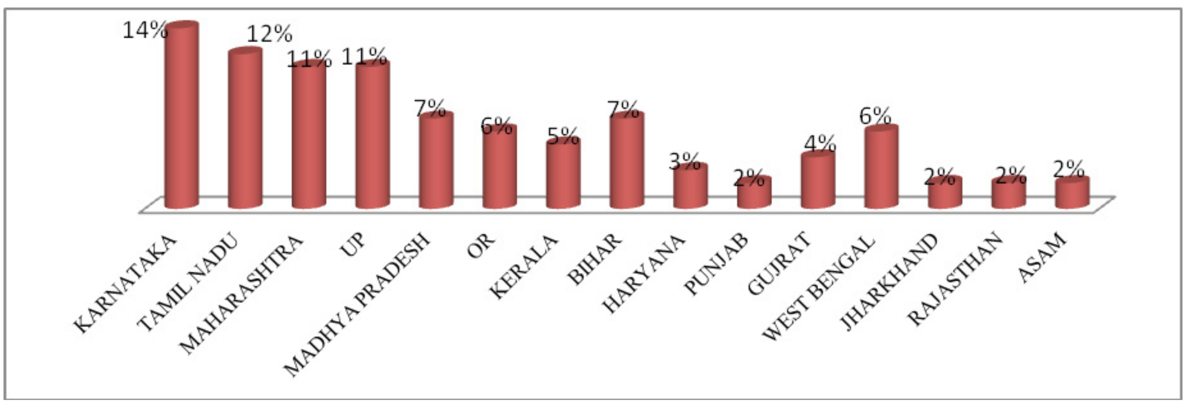

Figure 5. Source: MFIN Publications.

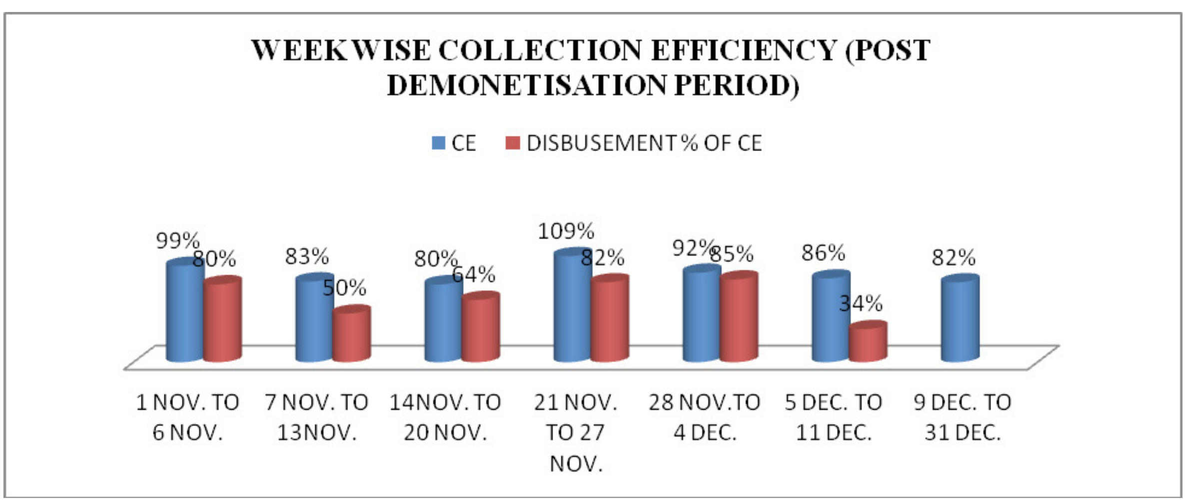

Figure 6. Source : CARE RATING (Data for disbursement % of CE during 9 Dec. to 31 Dec. not available).

5. Summary and Conclusion

Since 1992 till March 2017 microfinance industry has faced many ups and down. Till 2010(AP Crisis) govt. had never thought for any regulations and setting up of any regulatory authority for this sector. Being unorganized, this sector developed itself. However NABARD had been playing a great role for providing finance in this sector. In the absence of any regulatory guidelines, this sector faced big disaster in 2010 in the form of AP Crisis when PAR30 increased up to 23%. In 2012 the microfinance institutions (development and regulations) bill 2012 was passed in which regulatory guidelines for MFIs were proposed. This was a positive up move for this sector. Power was given to RBI to decide upper limit of providing loan to a customer by MFIs. MFIN and SA DHAN were appointed as regulatory authority for MFIs. Upper limit of interest rate was also fixed up to 25%. All these initiatives proved as golden keys for financial inclusion. Growth in MFIs can be seen with the facts that during Q1 2013 to Q4 2015, total amount of loan was increased from 63.8bn to 241.29bn and no. of loans for the same period were increased from 4.7mn to 11.745mn. PAR 30 during this period was also under 1%. This growth was noticed in pre demonetization period. In Q3 2016 demonetization decision once again badly hit this sector when a sharp decline in amount of disbursements, no. of loans and collection efficiency was seen. Par30 during this period (up to 31 Dec.) was also increased up to 7.52%.Not only this but govt. promises to waive off loan amount of farmers during Q4 2016, badly deteriorated financial backbone of MFIs especially working in UP. Each coin has two faces. On the basis of this fact, some positive effects can also be noticed of different govt. decisions during this period. Passing of microfinance bill converted this sector from unorganized to organized one. Portfolio risk of MFIs came to desirable bottom line i.e 1%. Fixation of upper limit of interest rate helped in more financial inclusion. Digital india campaign of govt. helped this sector to be more digitalized. It can be concluded that Microfinance sector can grow in India to a great extent to achieve the target of financial inclusion with govt. positive support but unhealthy policies can dump it in financial destruction.

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