Revival of Micro Finance Institutions

Why in news?

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Asset quality of small finance banks and non-bank microfinance institutions hasbeen improving.

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What is the status of MFI's since DeMo?

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- Small finance banks and non-bank microfinance institutions are together referred to as Micro Finance Institutions (MFIs).
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- In Finance industry since 2016, the impact of demonetisation had cranked up delinquencies and affected borrower behaviour.
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- Since June 2017 the demonetisation impact is shrugging off, MFIs with strong credit profiles or healthy capitalisation have shown resilience despite asset quality challenges.
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- Despite the improvement, asset quality performance continues to remain weak in Vidarba and a few districts of Madhya Pradesh, Karnataka and Uttar Pradesh.
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What are the reasons behind the revival?

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- There is a significant rise in the portfolio delinquencies, which is measured in terms of principal due from borrowers who have defaulted on more than one instalment (also called 30 days-past-due or 30 dpd).

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- The improvement stems from the hard yards put in by MFIs to improve collections and engage and educate borrowers about credit discipline.
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- The presence of credit bureaus and measures undertaken by industry associations and self-regulatory organisations have also helped improve the overall environment, especially credit discipline.
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What are few challenges before MFIs?

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- Several large MFIs that transformed into small finance banks (SFBs) are looking to diversify into inclusion adjacencies such as micro, small and medium enterprise loans and affordable housing loans.
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- The demand potential in these segments also remains buoyant over the medium term given the untapped potential.
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- Few key challenges before MFI’s are
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1. Building liability franchise and garnering retail deposits to support growth.
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2. Impact on near-term profitability because of high credit costs, SLR and CRR requirements.
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3. Increase in operating expense ratios.
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What are the prospects on MFI’s?

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- In future, portfolio delinquencies for the industry will settle at a level higher than that observed in the pre-demonetisation period.
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- Credit costs are likely to stabilise at 1.5-2.5 per cent on a steady-state basis.
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- MFIs with larger rural presence, weekly collections and lower equated instalments are expected to incur lower credit costs.
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- The business prospects for MFIs remain good as total demand remains large at Rs.3-lakh crore.
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- The SFBs are currently managing their liability profiles by availing themselves of wholesale funding from SIDBI, NABARD and Mudra Bank, attracting institutional deposits by offering higher interest rates, raising funds through certificate of deposits and securitisation.
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- Profitability would improve over the medium term as credit cost stabilises, cost of funds decreases and operating efficiency increases.
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Source: Business Line

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