

Impact of Demonetization on Microfinance Sector

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Microfinance Institutions (MFIs), irrespective of legal form, seek to promote financial inclusion by providing financial services to clients of financially un-served and under-served households. Over time, the microfinance sector has become an integral part of the financial infrastructure catering to the vulnerable sections of society in India. In the Indian microfinance industry NBFC-MFIs hold a significant share and are regulated by RBI. As on date, there are 71 NBFC-MFIs registered with the RBI.

As on September 30, 2016, the gross loan portfolio of NBFC-MFIs stood at Rs.55,254 Crores with Portfolio at Risk (PAR 30) being less than 1% (source: MFIN). The major positive for the sector was collection rates of more than 99% in the past. The high rates of collection emanate from the 'credit discipline' these groups are inculcated within and the group dynamics which serve as a disincentive for defaulters.

Challenges Faced by MFIs Post-Demonetization

Impact on collections

- Microfinance entities traditionally use cash in their lending and recovery operations. The installments on microfinance loans have weekly / fortnightly / monthly collections of small denominations. On account of non-availability of cash post demonetization, the borrowers were not in a position to service their loans which led to delay and drop in collection rates.

Table 1: Overall Week-wise Collection & Disbursements

	1 Nov to 6 Nov	7 Nov to 13 Nov	14 Nov to 20 Nov	21 Nov to 27 Nov	28 Nov to 4 Dec	5 Dec to 11 Dec
Collection Efficiency	99%	83%	80%	109%	92%	86%
Disbursement as % of collection	80%	50%	64%	82%	85%	34%

Source: CARE Ratings ; Note: Data compiled for 11 NBFC-MFIs

Table 2: State-wise collection efficiency for the period November 2016 to mid of December 2016

State	Collection Efficiency
Uttarakhand (UK)	53.53%
Uttar Pradesh (UP)	64.35%
Delhi (DL)	73.50%
Haryana (HR)	77.23%
Punjab (PB)	81.23%
Madhya Pradesh (MP)	84.49%
Rajasthan (RJ)	84.68%
Maharashtra (MH)	88.22%
West Bengal (WB)	90.01%
Himachal Pradesh (HP)	90.23%
Gujarat (GJ)	92.96%
Jharkhand (JH)	94.03%
Others *	> 95%
Average	87.43%

Source: CARE Ratings; Note: Data compiled for 14 NBFC-MFIs

* includes Kerala, Karnataka, Bihar, Assam, Chhattisgarh, Tripura, Meghalaya, Chandigarh, Tamil Nadu, Puducherry, Odisha, Goa and Jammu & Kashmir.

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Table 3: Collection efficiency-wise grouping of Districts

Collection Efficiency	Number of Districts	Major Districts
20% to 40%	11	<ul style="list-style-type: none"> • Bulandshahr (UP) • Jyotiba Phule Nagar (UP) • Hapur (Panchsheel Nagar) (UP) • Udham Singh Nagar (UP)
40% to 60%	15	<ul style="list-style-type: none"> • Amravati (MH) • Haridwar (UK)
60% to 80%	59	<ul style="list-style-type: none"> • Sagar (MP) • Bijnor (UP) • Saharanpur (UP) • Allahabad (UP) • Kushinagar (UP) • Deoria (UP) • Howrah (WB) • Jaipur (RJ) • South 24 Parganas (WB) • Jaunpur (UP)
80% to 90%	67	
> 90 %	267	

Source: CARE Ratings; Note: Data compiled for 12 NBFC-MFIs

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For the first 2 weeks following the announcement of demonetization, the collection ratio declined to 80%. Subsequent increase in supply of new currencies by RBI had led to increase in collections in the fourth week. But the collections have come down subsequently due to slowdown in business activities of the borrowers and dispensation provided by RBI (earlier by 60 days and later increased to 90 days) to financial institutions in terms of recognizing NPAs. This special consideration was misrepresented to the borrowers by local influential individuals and thus resulted in fall in collection efficiency in few areas of states like Uttar Pradesh, Maharashtra and Madhya Pradesh (*exhibited in Table -3*).

Impact on lending

- Despite the efforts to increase cashless disbursement, majority of the disbursements were still cash based. Because of the withdrawal limits imposed on current accounts, MFIs were not able to withdraw cash for further disbursement and the incremental disbursements were restricted to the collections.
- However the ratio of disbursements to collections fell to around 30% by the second week of December 2016. The main reason for this significant drop in disbursements was due to the focus of MFIs shifting from disbursements to collections and they also adopted a wait and watch approach in order to comprehend the position.

Conclusion

- Post demonetization, MFIs are increasingly looking for cashless disbursement and collection through Jan-Dhan accounts and by leveraging technology. With 8 NBFC-MFIs converting into Small Finance Banks (SFBs) by March 2017, the competitive environment is bound to undergo a major shift within the microfinance industry as a whole. As these entities are expected to remain focused on microfinance, cashless disbursement and collection of loans is bound to increase in the future.
- Even though the collections are less, many MFIs are conducting center / group meetings to make borrowers aware of the impact on their credit profile due to default on repayment and the role credit bureaus. These meetings are also used to educate the borrowers to overcome any kind of slowdown in their business activities and to encourage banking habits in order to move towards non-cash based model.
- MFIs with high financial leverage and low collections efficiencies are expected to face deterioration in their credit profile.

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