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Indian Mfis And Funding Through Capital Market - Prospects And Challenges

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Abstract: As Indian MFIs inscribe their way into the capital market, the prospect of capital markets becoming a stable source of funding for the same still remains unanswered. Despite the funding options available, MFIs are not able to tap into the capital market due to various reasons. Loss of investor confidence, among other factors, following the Andhra Microfinance Crisis, 2010, has contributed a great deal to the funding difficulties faced by Indian MFIs. The factors that led to the loss of confidence are analyzed at great length in the article. MFIs and their financials before and after the Andhra crisis are to be analyzed comparatively. This helps in indicating the crisis as a critical factor for change in investor perception and prospects of MFIs forecasted until 2019. This acts as a way to improve comparability of risk and return between MFIs and other institutions. The cause and effects, when put together, may give MFIs the edge of becoming a viable investment option.

Index Terms **- Source of Funding, Investor Confidence, Comparability, Viable Investment**

Introduction

Financial sustainability and factors affecting the Microfinance sector is a pressing issue, to be addressed in order to improve the chances of MFI investment as an attractive investment option, post-Andhra Pradesh (AP) crisis. With the growth of Indian MFIs and rapid increase in the demand for funds from the target clientele, the capital requirements have risen massively. Yet the funding options have always been limited and therefore, have restricted the growth of MFIs in the Indian Market. Using the deposits received by MFIs as capital comes with strings attached. Deposits along with loan principal repayments and interest on such loans are a major source of funding. But, unfortunately, the costs associated with collections of the loan amounts as well as the defaults on the loans owed outweigh the actual loan principal amount, reducing the significance of this funding. These factors bring the financial sustainability of MFIs into question.

The Indian MFIs have resorted to newer ways raising capital and increasing presence in the capital markets help in fulfilling the capital requirements. MFIs require capital to expand geographically as well as the range of financial products and services they offer. On a year-over-year basis, GLP has risen by 16.8% compared to December 31, 2020, and by 6.3 percent compared to September 30, 2021 (Micrometer, 2021) but the credit requirements of the clients is a staggering amount of 850 crores (Swanson, 2007) after adjusting for inflation and annual credit growth. This points to the fact that funds are insufficient to meet the excess demand for microcredit. This indicates that this wide gap requires due attention and highlights the need to expand operations on a wider scale.

To address such unmet demands, MFIs requires a sustainable source of financing and capital markets provide a wider scope of options with a range of financial products available. Indian MFIs has one of the highest numbers of borrowers and therefore, MFIs need new funding avenues to meet the credit demand of such a large segment.

The integration of capital market with the microfinance sector can be beneficial to both MFIs with sufficient funds available and to investors with adequate returns and wider choices. Post-Andhra Microfinance crisis, there has been numerous restrictions created on the capital raising ability of MFIs. Investment in microfinance is still considered less reliable due to absence of historical and performance information about MFIs. MIV – Microfinance Investment Vehicles is estimated to remain active in 2019 with a growth rate of 9.5% (Symbiotics MIV Survey). Microfinance institutions are entering the capital markets with the additional goal of reduction of cost of capital due to issuance of stocks or bonds with relatively low cost of capital to those of the commercial credit line. The integration barriers between MFIs and capital markets can be categorized into 2, viz: - 1) industry-specific micro level issues and macroeconomic issues cover monetary and fiscal policies, inflation, taxation and many more 2) stereotyping of MFIs as philanthropic institutions with no corporate culture. These constraints have stopped investors from approaching the capital markets.

The Andhra Pradesh crisis as dated in 2010 and remedial government actions by the government has led to bad debts ranging up to a whopping amount of more than INR 8000 crores which has been declared irrecoverable according to credit collection agencies. Prior to the AP crisis, MFIs were seen to be yielding positive returns whereas the overall performance exhibited negative results after 2010.

I. Review of Literature

An important argument discussing the tradeoff between outreach to the poor and financial sustainability. An alternative to the above, which is financial and operational sustainability and outreach to the poor, is complementary in nature. In conclusion, the results of the findings do not support the tradeoff between financial sustainability and outreach to the poor and rather, a weak correlation between operational sustainability and average loan size. This article by author **Bereket Zerai and co-author Lalitha Rani**(Research Journal of Finance and Accounting ISSN 2222-1697 (Paper) ISSN 2222-2847 (Online) Vol 2, No 11, 2011), cleared the air on any correlation between the financial and social objectives of MFIs and the prospects of the latter interfering the former.

Improved access to capital markets help MFIs in terms of their capital adequacy. This is seen after MFIs was caught in a financial slump and it resorted to newer ways raising capital through innovative equity and debt instruments. This paper called 'Financing of Indian Microfinance: Evidence and Implications' by **Tara S Nair** (2012) elucidates on the reliance of the poor on the commercial banking system and the steady shift in patronage towards MFIs in the mid-2000s. This has raised concerns regarding capital availability of MFIs and the need to find new sources of funding.

The state of MFIs after the microfinance crisis of 2010 changed MFIs risk levels and investor preferences as well. But the firms are oscillating in taking capital structure decisions about financing through debt or equity. The research on the article titled 'Thriving the Transformation Process of MFI through IPOs - Case Study of Indian MFIs' (2020) by **Professor P. Baba Gnanakumar** gives us perspective on the hesitation of MFIs in entering into IPOs and the result indicates that retail investors consider the performance level and the social values created by the MFI.

This paper written by **Vijeta Singh** (2014) explains the limited borrowing opportunities available to MFIs and the perks for MFIs in tapping capital markets as a source of funding. Ways to align the accounting methodologies of MFIs with that of other financial entities are suggested as well. The author suggests was to strengthen accounting methodologies which would boost investor confidence to invest in MFIs.

II. Research Methodologies

The dataset used in the article has been taken from Symbiotic MIV Survey, NSE India articles, MFIN Synopsis Issue 40 Micrometer as on 31 December 2021, M-CRIL Microfinance Review 2012, Dominicé et al. (2014), http://reports.mixmarket.org/crossmarket. The financials of MFIs before and after the Andhra crisis have been analyzed through a comprehensive comparative analysis, the results of which have been analyzed and interpreted. The profitability indicators have been forecasted up to 2019-20 from 2012 based on 4 factors such as Number of MFIs, Yield on gross portfolio (median), Return on equity (median) and Return on assets (median) and the results have been compared before and after Andhra Crisis. We identify all 4 factors in Table 1 shows microfinance institutions before and after Andhra crisis.

Barriers to capital market integration have been pressed out after careful analysis of sources of funding, investor psychology towards risk investing, after effects of Andhra crisis, change in bad debts and irrecoverable assets and so on. Supply data relating GLPs and loan disbursed have been aggregated and compared to demand data relating credit requirements of the target clientele. The result was excess demand and factors leading to the same have been brought into light and capital market integration is found to be the solution. The closing price of Bharat Financial Inclusion Pvt. Ltd. has been snipped after 2010 to analyze the performance of the prices post Andhra Crisis. A trend line has also been generated for a visual confirmation, indicating a U-shaped curve.

III. Research Findings

1. The profitability indicators chosen for analysis include number of MFIs, yield on gross portfolio (median) and return on assets (median). The data contained which was available until 2012 has been forecasted till 2019 and the returns have been compared with actual data available on the same. The forecasted yield and return on assets are available on Table 1 below along with number of MFIs.

Fiscal Year	Number of MFIs	Yield on gross portfolio (median)	Returns on assets (median)
2006	105	21.05%	0.27%
2007	79	22.30%	0.75%
2008	98	24.11%	1.98%
2009	121	23.93%	1.18%
2010	125	26.61%	-0.72%
2011	118	23.92%	-2.08%
2012	77	22.42%	-2.50%
2013	106	24.88%	-2.54%
2014	107	25.24%	-3.14%
2015	108	25.59%	-3.73%
2016	109	25.94%	-4.33%
2017	109	26.29%	-4.92%
2018	110	26.64%	-5.52%
2019	111	27.00%	-6.11%

Table 1: Profitability indicators of MFIs between 2006-2019

But when the data above was compared with actual returns, the forecasted number of MFIs and yield on gross portfolio was close to the actuals whereas the return on assets (median) seemed to have a positive growth after 2014 as opposed to a negative growth as per forecasts.

2. The supply of loans at disposal as loans disbursed (Gross Loan Portfolio) was found to have a growth rate of 6.3% as on December 2021 as compared to 16.8% as on December, 2020. This was compared to credit demand in India among the target clients. This number was derived by converting the demand as given in Swanson, 2007 into INR. This number was adjusted for inflation and credit growth rate by averaging a common rate to around 8%.

Converting USD to INR

USD 350 million * INR 76.59 (s on April, 2022) = INR 2680492500

Forecasted Credit Demand

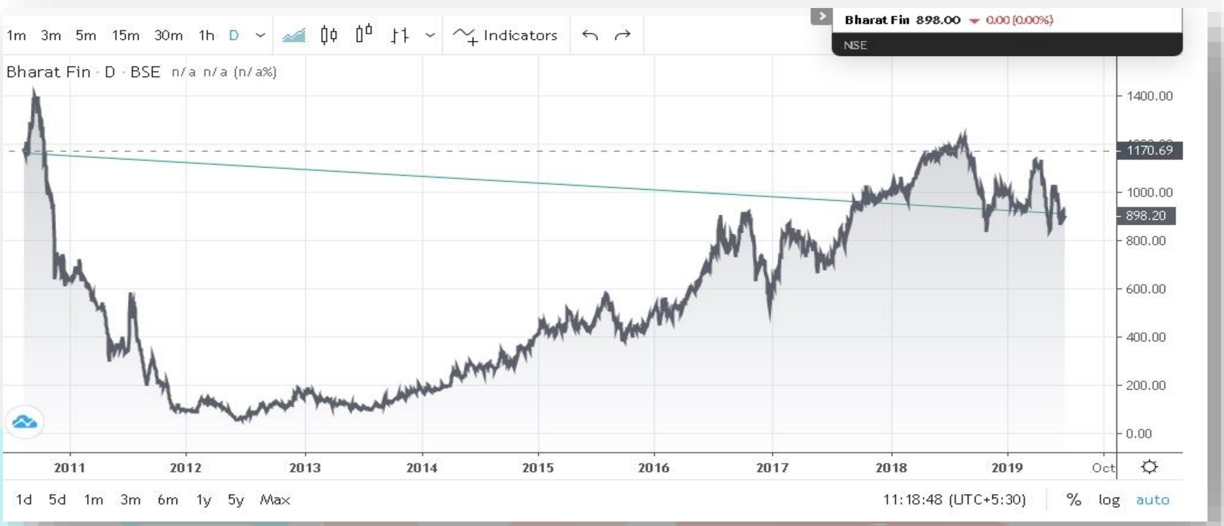
INR 2680492500 * (1+0.08) ^15 = INR 8497161225

= INR 850 crores

The demand and supply, when compared, indicated an excess demand for credit and this wide gap requires due attention and sufficient funding for the same.

2. The closing prices of Bharat Financial Inclusion Pvt. Ltd. which was previously known as SKS Microfinance, is chosen as a sample for MFIs. The objective was to see the performance of share prices post Andhra crisis. A trend line is drawn for a visual representation of the performance. The data represents share prices from 2011 to 2019 and indicates a U-shaped curve with prices hitting a slump from 2011 and then gradually increasing till 2019. The results show that, post Andhra crisis, prices have seen a positive gradual change from the lowest point at around INR 60 in 2012 to INR 898.2 in 2019.
Source: moneycontrol

IV. CONCLUSION



While it is apparent that the microfinance sector suffers deficiency in funding, some pressing concerns require the attention of microfinance stakeholders. The first issue is the lack of a concrete assessment of credibility of borrowers/ customers and due diligence by investors for managing risk of the investment. Therefore, there should be multiple parameters for assessing the credit score of customers before extending loans to reduce the possibility of defaults as well as credit risk assessment conducted by or on behalf of investors directly lead to sustainability of microfinance institutions in the capital market. Risk management of MFIs is another pressing issue that requires attention. This can be mitigated by expanding geographies of MFIs and this leads to diversification of risk. This reduces the level of loan losses making MFIs, an attractive investment option to prospective investors. Regulatory provisions must concentrate on two main objectives: Transparent fundamentals and Disclosure norms. The result of these provisions help MFIs accommodate changes in the capital markets and face macro-economic challenges with greater vigor.

All of the above factors/ barriers identified and prospects of MFIs forecasted contributes to the image of MFIs in the minds of investors as a profitable asset class. The study also helps the microfinance institutions transform themselves making them dynamic, adaptable and profit oriented. The bottom-line intended as part of the study is to help MFIs pursue their social objectives along with financial sustainability through capital market integration.

The microfinance disaster in Andhra Pradesh is a lesson for all microfinance stakeholders, and it emphasizes the importance of ethical business operations in accordance with the code of conduct. If MFIs in India want to profit from the capital markets, they must embrace transparent governance and adhere to disclosure standards so that investors may analyses their financial qualifications and activities.

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