# Microfin industry faces ₹2,600-cr cash shortfall on possible stress in collections from borrowers

**Our Bureau** Mumbai | Updated on April 15, 2020 Published on April 15, 2020

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The microfinance industry (MFI) is staring at a cumulative cash shortfall of around ₹2,600 crore as collections from borrowers could remain muted for some time following easing of the nationwide lockdown imposed to contain the spread of the Covid-19 pandemic, according to credit rating agency ICRA.

This shortfall is in the absence of any external funding support by way of equity/additional debt or extension of moratorium.

The agency also cautioned that credit costs for MFIs could at least double from the present levels of 1-1.5 per cent to 2.5-3 per cent for most players, which is likely to impact the profitability (Return on Equity or RoE) of the MFIs by 3-5 per cent in FY2021.

As per ICRA's analysis of a sample of 29 MFIs, which constitute around 70 per cent of the MFI industry on portfolio basis, total repayment obligations and operational expenditure of around ₹8,000 crore in Q1 (April-June) FY2021 against which the on-balance sheet liquidity buffer stood at around ₹5,400 crore.

In view of the Covid-19 pandemic, the Reserve Bank of India (RBI) has allowed a moratorium on term loans for the period March 1, 2020 to May 31, 2020.

"Following this, most of the MFIs have extended a moratorium to their borrowers till May 31, 2020. However, the MFIs are yet to formally receive moratorium from their lenders and the absence of the same could severely impact their ability to serve their debt-servicing obligations," the agency said in a note.

In ICRA's opinion, it will take time for MFI collections to get back to normal as the income levels of most borrowers have been affected. Following the resumption of economic activity, borrowers may tend to prioritise cash for their daily needs and savings over repaying MFIs, it added.

According to the agency, the strain on borrowers' cash flows will lead to a build-up of arrears, dilution of credit discipline, migration of borrowers owing to loss of livelihoods and the possibility of local/political issues.

ICRA emphasised that the ability of these lenders to recover multiple instalments from delinquent borrowers would be tested over the next few quarters as a large proportion of the borrowers do not have material income buffers. It would also be important for the MFIs to minimise the operational risks and employee frauds during this period as collections for MFIs continue to be largely in cash.

The agency said the impact on credit costs could be even higher if there is a permanent loss of livelihood/significant decline in income for a proportion of the borrowers, thereby impacting their repayment capacity.

Supreeta Nijjar, Sector Head & Vice President – Financial Sector Ratings, ICRA, said, “Based on our analysis of the sample, MFIs had unencumbered cash/liquid investments of around 10 per cent in relation to their assets under management as on March 31, 2020.

“However, if one were to segregate the MFIs based on the rating category, this ratio for entities rated in the ‘BBB’ rating category was almost half of the entities rated in the ‘A’ rating category, indicating stronger on-balance sheet liquidity available for ‘A’ rating category entities.”

Further, out of the sample of 29 entities, seven entities have a liquidity cover (for covering all repayment obligations till April 2020) less than one time, with none of these being in the ‘A’ category. Nevertheless, if MFIs get moratorium from banks and NBFCs, the liquidity cover for all the entities in the sample will be comfortable for April 2020, said Nijjar.

“Lenders and investors may adopt a wait-and-watch policy. MFIs’ ability to securitise portfolios to generate liquidity may also be limited in the interim,” the agency said.

ICRA felt that entities currently in the process of raising capital may face some delays as investors may adopt a wait-and-watch strategy and observe the collection efficiency trends post the lockdown and renegotiate valuations, which may impact their solvency and liquidity positions in the near term.

Published on April 15, 2020

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