

Limited availability of bank funding impeding the growth of Impact NBFCs, finds report

- *“State of Impact NBFCs” Report by IIC and Northern Arc Capital highlights that less than 10% of Impact NBFCs have been able to achieve credible scale in the past 5 years*

Chennai, May 9, 2022: Northern Arc Capital and India Impact Investors Council (IIC) jointly released their first research report in collaboration with TransUnion CIBIL (as knowledge partner) on the “State of Impact NBFCs”, highlighting the need for building a stronger identity for small and mid-sized NBFCs driving financial inclusion at the base-of the pyramid (BOP). The report focuses on the emerging class of non-MFI NBFCs, especially those that focus on segments such as micro, small and medium enterprise (MSME) loans, auto and vehicle finance, and other BoP credit sectors.

1. **Impact NBFCs play a catalytic role in driving social impact, combined with strong financial returns for their investors.** On average, 1 out of 3 customers supported by impact NBFCs is a first to credit customer and more than half of Impact NBFCs’ portfolios fund customers in semi urban and rural areas showing their strong impact potential to deepen financial inclusion.
2. **Impact NBFCs have shown resilience across business cycles.** Despite asset quality being impacted during the pandemic, disbursements and business performance has recovered and overall risk of sectoral defaults remains low. Data on NBFC borrowings shows non-performing asset (NPA) levels remaining moderately low on the loans borrowed by NBFCs for on-lending (4% on number basis and less than 1% on value terms).
3. **Impact NBFCs are driving innovation across the customer journey** right from targeting and identification, to acquisition and onboarding, disbursement, servicing and collection. Impact NBFCs deep understanding of the BoP segment and their ability to identify and manage different borrower risk profiles is also reflected in their asset quality being lower than other larger banks and players serving the low-income segment.

Impact NBFCs ~ NBFCs with a portfolio size of <INR 5,000 crore and BoP clients >75% of the portfolio have been included in the research as Impact NBFCs (only NBFCs registered as non-bank lending institutions with the RBI, excluding fintechs).

The report on ‘State of Impact NBFCs 2021’ reveals that:

1. **Less than 10% of Impact NBFCs have been able to achieve credible scale in the past 5 years owing to challenges in raising equity and debt capital.** Impact NBFCs will need INR 58,000 crores equity capital and INR 2,32,000 crores in debt-capital in the next 5 years (USD 7.7Bn and USD 30.9Bn respectively) to sustain their growth.
2. **Despite a benign interest rate environment, impact NBFCs have witnessed compression of margins.** Interest spreads have shrunk by more than 200 bps in FY 2021. Recent economic shocks on both the asset and liability side, along with the COVID-19 pandemic, have furthered funding challenges for Impact NBFCs. Smaller Impact NBFCs are most heavily impacted as they are reliant primarily on other non-banks for access to debt capital

3. **Transmission of benefits at small Impact NBFC level seems marginal.** Schemes and measures announced by the Government and RBI have helped reduce the negative impact of the pandemic, yet the challenges on the ground continue.

Ashish Mehrotra, MD & CEO, Northern Arc Capital, highlighted that “Impact NBFCs have played an instrumental role in India’s financial inclusion as catalysts in the spread of formalised credit to millions of unbanked and underbanked customers. Despite adverse business cycles, they have stayed resilient and have showcased deep innovation. That said, there are several challenges they face today including negative perception and access to debt. Our report highlights these challenges and suggests ways in which these can be countered, especially debt finance at the right cost, which we believe is the primary challenge for Impact NBFCs across the board.”

Small and medium sized NBFCs have been successfully operating in challenging segments such as microfinance, microenterprise, affordable housing, and vehicle finance, and contribute to the spread of formalised credit. Commenting on the role of Impact NBFCs, **Mr. Rajesh Kumar, MD & CEO, TransUnion CIBIL** said, “Impact NBFCs are playing a pivotal role by deepening financial inclusion especially across Tier-3 and Tier-4 geographies and also amongst the new-to-credit customer segment. In order to improve India’s private-debt to GDP ratio, it is vital to support Impact NBFCs with a conducive ecosystem along with insightful data framework for astute lending, while helping scale digital transformation”.

The sector needs active support to help continue to grow and support the cause of financial inclusion in the country. Speaking at the release of the report, **Ramraj Pai, Chief Executive Officer, IIC**, said, “It is important for different stakeholders whether debt capital providers, equity investors, foundations or institutional stakeholders to engage and work collaboratively towards strengthening the financial inclusion eco-system by supporting smaller Impact NBFCs and helping them flourish and scale”.

While larger non-banks with access to better ratings and a diversified lender base are able to mitigate the liquidity and funding gaps, smaller Impact NBFCs get left behind. Surveys conducted with leading Impact NBFCs also underlined the need to strengthen the capital financing eco-system and regulatory environment for smaller NBFCs. The report provides recommendations and potential interventions which can help Impact NBFCs flourish and grow:

1. **Greater availability of bank funding and an active market for debt funding/refinance for Impact NBFCs.** An active platform to support debt funding for Impact NBFCs through a variety of forms including refinancing, sponsoring risk capital or guarantees in addition to funding and support for non-bank intermediaries can improve the availability of low-cost funds for Impact NBFCs
2. **Enabling regulatory guidelines** as well as reviewing the scope of guarantee programs to include broader sectors served by Impact NBFCs.
3. **Systemic support via dedicated fund-of-funds to help capitalize smaller Impact NBFCs.** This provides an excellent opportunity to tap into a high potential asset class and also generate significant social impact
4. **Increase engagement of Foundations with Impact NBFCs** where the capital could take the form of convertible grants or performance-linked debt and help facilitate market linkage and incubation/mentorship in local ecosystems.

About Northern Arc

Northern Arc is a diversified financial services platform that provides credit to MSMEs, households, financial institutions and emerging businesses. Through technology and data, it provides a diverse set of solutions to cater to the credit requirements of emerging segments and small businesses. Its business model is diversified across offerings, sectors, products, geographies, and borrower segments.

By leveraging its deep data insights & scorecards, Northern Arc has cumulatively raised over INR One Trillion in funds for its clients since inception of its platform in 2009. It is backed by marquee equity investors like Sumitomo Mitsui Banking Corporation (the world's fourteenth largest bank), LeapFrog, IIFL, Accion, Augusta Investments (known as Affirma Capital), Dvara Trust and Eight Roads (proprietary arm of Fidelity).

Along with its asset management subsidiary that manages seven AIFs, the company manages a total AUM of over INR 9,000 crore. It has disbursed a total of over 6 million loans to retail customers across individuals, households, and small businesses. Through the AltiFi platform, it offers fixed income investments for affluent and retail investors. It's exposure is spread across 657 districts in 28 states and 7 Union Territories in India.

Disclaimer:

Northern Arc Capital Limited is proposing, subject to receipt of requisite approvals, market conditions and other considerations, to make an initial public offering of its equity shares ("Offer") and has filed a Draft Red Herring Prospectus ("DRHP") with the Securities and Exchange Board of India ("SEBI"). The DRHP is available on the website of the SEBI at www.sebi.gov.in, the website of the National Stock Exchange of India Limited at www.nseindia.com and the website of the BSE Limited at www.bseindia.com and the respective websites of the book running lead managers to the Offer at www.axiscapital.co.in, www.credit-suisse.com, www.iiflcap.com and www.sbicaps.com. Investors should note that investment in equity shares involves a high degree of risk. For details, potential investors should refer to the RHP which may be filed with the Registrar of Companies in the future, including the section titled "Risk Factors". Potential investors should not rely on the DRHP filed with the SEBI in making any investment decision." The Equity Shares have not been and will not be registered under the U.S. Securities Act of 1933, as amended (the "U.S. Securities Act"), and may not be offered or sold within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the U.S. Securities Act and applicable U.S. state securities laws. Accordingly, the Equity Shares are being offered and sold (i) in the United States only to U.S. persons that are U.S. QIBs that are also QPs acting for its own account or for the account of another U.S. QIB that is a QP (and meets the other requirements set forth herein), in reliance on the exemption from registration under the Securities Act provided by Rule 144A or other available exemption and in reliance upon section 3(c)(7) of the U.S.

Investment Company Act, and (ii) outside the United States, to non-U.S. persons in reliance on Regulation S. There will be no public offering of the Equity Shares in the United States.

About Impact Investors Council

The India Impact Investors Council (IIC) is India's preeminent member-based not for profit industry body set up to strengthen Impact Investing in the country. IIC's key areas of activity and effort include advocacy and policy support, research, and publications in addition to a strong focus on impact measurement and management. We are supported by 40+ investors and ecosystem partners including Aavishkaar Group, Omidyar Network, Michael and Susan Dell Foundation, Elevar Equity, and Caspian Investment Advisors, amongst others. www.iiic.in

For more details please contact:

Ramraj Pai, Chief Executive Officer: ramraj.pai@iiic.in +919920 22471