



## MUDRA : Financial Inclusion of the Missing Middle

### KEYWORDS

MUDRA, MUDRA Bank, Non-Corporate Small Business Sector (NCSBS), Microfinance, Financial Inclusion, SIDBI, MSME

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### ABSTRACT

*The biggest bottleneck to the growth of entrepreneurs in the Non-Corporate Small Business Sector (NCSBS) is the lack of financial support to this sector. Majority of this sector does not have access to formal source of finance. Government of India has set up Micro Units Development & Refinance Agency Ltd. (MUDRA) for catering to the needs of the NCSBS segment (or the informal sector) for bringing them in the financial mainstream. Till such time as the enactment creating MUDRA Bank is complete, it is being set up as a subsidiary of SIDBI which has been supporting India's small scale industry since last 25 years. It is set up for development and refinancing activities relating to micro units. It is envisaged that it will benefit small entrepreneurs and will also act as a regulator for 'Micro-Finance Institutions (MFIs). The MUDRA bank will cater to 5.75 crore small business units that are spread all across India who currently find it difficult to access credit from the regular banking system. Mudra Bank will partner with local coordinators and provide finance to "Last Mile Financiers" of small/micro businesses. It is envisaged that the measures to be taken up by MUDRA are targeted towards mainstreaming educated youth, skilled workers and entrepreneurs, apart from NCSBS, who lie between the large industrial credit seekers at one end and very poor small borrowers like low income households, farmers and migrant work force at the other end of financing spectrum. Thus, MUDRA bank hopes to facilitate financial inclusion of the missing middle, through refinance and development support.*

### INTRODUCTION

MUDRA stands for Micro Units Development & Refinance Agency Ltd. Setting up of the MUDRA Bank was announced as part of the Union Budget proposals for FY 2015-16, while its conceptual vision was announced earlier by the Indian Prime Minister as part of PM MUDRA Yojana – a scheme for funding the unfunded. The Micro Units Development & Refinance Agency (MUDRA) Bank shall be set up through a statutory enactment but since the enactment is likely to take some time, it was decided to initiate MUDRA as a unit of SIDBI for the time being, to benefit from SIDBI's initiatives and expertise. Mudra, in Hindi, means currency/capital. It is hoped that the currency/capital would become the key to the success of small enterprises. The purpose of MUDRA is to provide funding to the non-corporate small business sector (NCSBS). The MUDRA bank will cater to 5.75 crore small business units that are spread all across India who currently find it difficult to access credit from the regular banking system. Mudra Bank will partner with local coordinators and **provide finance to "Last Mile Financiers" of small/micro businesses.** It is envisaged that the measures to be taken up by MUDRA shall be targeted towards mainstreaming educated youth, skilled workers and entrepreneurs, apart from NCSBS, who lie between the large industrial credit seekers at one end and very poor small borrowers like low income households, farmers and migrant work force at the other end of financing spectrum. Thus, MUDRA bank hopes to facilitate financial inclusion of the missing middle, through refinance and development support for the benefit of micro, small and medium enterprises (MSME) or the NCSBS. It is not a direct lending institution but provides loans at low rates to banks, microfinance institutions and non-banking financial institutions, which then provide credit to MSMEs or informal enterprise sector.

Supporting the small entrepreneurs of India is the biggest way to help the Indian economy grow and prosper. In our country, only 1 crore 25 lakh people find employment in large industries, whereas small enterprises employ

12 crore people. Yet, the harsh reality is that whereas there are a number of facilities provided for the large industries in India, small entrepreneurs and informal business entities are often cut off from banking system because of limited branch presence and other constraints. There is a need to focus on these 5 crore 75 lakh self-employed people who use total funds of just Rs 11 lakh crore, with an average per unit debt of merely Rs 17,000 to employ 12 crore Indians. These facts, when brought to light, led to the vision for MUDRA Bank. The small businesses, with a little help, have the potential to grow manifold.

The MUDRA scheme is aimed at "funding the unfunded". The small entrepreneurs of India are used to exploitation at the hands of money lenders so far, but MUDRA will instill a new confidence in them that the country is ready to support them in their efforts that are contributing so heavily to the task of nation building. The biggest bottleneck to the growth of entrepreneurs in the Non-Corporate Small Business Sector (NCSBS) is the lack of financial support to this sector. Majority of this sector does not have access to formal source of finance. Government of India has set up the MUDRA Bank for catering to the needs of the NCSBS segment (or the informal sector) for bringing them in the financial mainstream. It is being set up as a subsidiary of SIDBI, which has been supporting India's small scale industry since last 25 years.

### The modalities of functioning and offerings of MUDRA

MUDRA will be operating as a refinancing institution through State and Regional level intermediaries. MUDRA's delivery channel is conceived to be through the route of refinance primarily to NBFCs/MFIs, besides other intermediaries including Commercial Banks, Regional Rural Banks (RRBs), Primary Lending Institutions etc. At the same time, there is a need to develop and expand the delivery channel at the ground level. In this context, there is already in existence, a large number of 'Last Mile Financiers' in the form of companies, trusts, societies, associations and oth-

er networks which are providing informal finance to small businesses. The role envisaged for MUDRA in this respect includes laying down policy guidelines for micro enterprise financing business and registration of MFI entities as well as their accreditation and rating.

The Bank will be set up with a corpus of Rs 20,000 crore and a credit guarantee fund of Rs 3,000 crore. Non Corporate Small Business Segment (NCSBS) comprising of millions of proprietorship/partnership firms running as small manufacturing units, service sector units, shopkeepers, fruit /vegetable vendors, truck operators, food-service units, repair shops, machine operators, small industries, artisans, food processors and others, in rural and urban areas will be granted financial assistance by MUDRA. The financial products have been designed to cater to customers operating at the lower end of the enterprise spectrum. MUDRA will be a refinancing agency which will extend its funds to Last Mile Financiers like MFIs, NBFCs, Banks, RRBs etc to enable them to reach out to the MSME sector with greater liquidity/capacity. Access to finance in conjunction with rational price is going to be the unique customer value proposition of MUDRA. It will use a variety of innovative financing means to bring down the cost of funding for the ultimate borrower. Mudra Bank will ensure clients are properly protected and will lay down principles and methods of loan recovery in case of a default. The Bank will also rigidly follow "responsible financing practices" so deter borrowers from indebtedness.

Pradhan Mantri Mudra Yojana (PMMY), of granting micro finance to end users, will be extended by all Public Sector Banks such as PSU Banks, Regional Rural Banks and Cooperative Banks, Private Sector Banks, Foreign Banks, Micro Finance Institutions and Non Banking Finance Companies, who will be provided re-finance from MUDRA. Depending on the nature of business project a MSME/informal sector entrepreneur can access finance from one of the intermediaries of MUDRA as per the norms. All loans upto a loan size of 10 lakh provided for non farm sector income generating activities since April 08, 2015 is treated as PMMY. The Bank will nurture small businesses through different stages of growth and development of businesses - termed as *Shishu*, *Kishor* and *Tarun*. Under the aegis of PMMY, MUDRA has already created its initial products/schemes. The interventions have been named '*Shishu*', '*Kishor*' and '*Tarun*' to signify the stage of growth/development and funding needs of the beneficiary micro unit or entrepreneur and also provide a reference point for the next phase of graduation/growth to look forward to. At *Shishu* stage, the first step when the business is just starting up, the loan cover will be upto Rs 50,000. In *Kishor* stage, the entrepreneur will be eligible for a loan ranging from Rs 50,000 to Rs 5 lakh. The last and final category i.e. *Tarun* stage category will provide loans for upto Rs 10 lakh. It would be ensured that at least 60% of the credit flows to *Shishu* Category Units and the balance to *Kishor* and *Tarun* Categories.

Within the framework and overall objective of development and growth of *Shishu*, *Kishor* and *Tarun* Units, the products being offered by MUDRA at the rollout stage have been designed to meet requirements of different sectors / business activities as well as business and entrepreneur segments.

#### Rationale, Role and Responsibility of MUDRA

**a) Supporting /developing Non Corporate Small Business Sector (NCSBS):** The Non Corporate Small Business

Sector (NCSBS) accounts for a large share of industrial units. They feed large local and international value chains as well as domestic consumer markets as suppliers, manufacturers, contractors, distributors, retailers and service providers. The gross value addition of this sector is 6.28 lakh crore annually. Mainstreaming these enterprises will not only help in improving the quality of life of these entrepreneurs but will also contribute substantially to job creation in the economy thereby achieving higher GDP growth. The major constraints faced by the myriad of the micro enterprises along the length and breadth of the country are:

- Access to Finance
- Skill Development Gaps
- Knowledge Gaps
- Infrastructure Gaps
- Policy Advocacy Needs
- Information Asymmetry
- Lack of growth orientation
- Lack of Market Development / Market Making
- Need for Entry Level Technologies

The biggest bottleneck to the growth of entrepreneurship in the NCSBS is lack of financial support to this sector. The support from the Banks to this sector is meagre, with less than 15% of bank credit going to Micro, Small and Medium Enterprises (MSMEs). A vast part of the non-corporate sector operates as unregistered enterprises, or the informal sector. They do not maintain proper Books of Accounts and are not formally covered under taxation areas. Therefore, the banks find it difficult to lend to them. Majority of this sector does not access outside sources of finance.

**b) Financial Inclusion by enabling/supporting the Micro finance activities:** Micro Finance is an economic development tool whose objective is to provide income generating opportunities to the people at the bottom of the pyramid. It covers a range of services which include, in addition to the provision of credit, many other credit plus services such as savings, pensions, insurance, money transfers, counseling, financial literacy and other social support services. The players in the Micro Finance sector can be qualified as falling into 3 main groups:

- The SHG-Bank linkage model through Commercial Banks & RRBs channels
- The Non Banking Finance Company and
- Others including Section 8 (formerly Section 25) Companies, Trusts, Societies, etc.

MUDRA would be responsible for refinancing all last mile financiers such as Non Banking Finance Companies of various types engaged in financing of small businesses, Societies, Trusts, Section 8 Companies [formerly Section 25], Co-operative Societies, Small Banks, Scheduled Commercial Banks and Regional Rural Banks which are in the business of lending to Micro / Small business entities engaged in manufacturing, trading and services activities. The Bank would partner with State / Regional level financial intermediaries to provide finance to Last Mile Financier of Small / Micro business enterprises.

#### More specifically, MUDRA would be responsible for:

- Laying down policy guidelines for micro enterprise financing business
- Registration of MFI entities
- Supervision of MFI entities
- Accreditation /rating of MFI entities
- Laying down responsible financing practices to ward

off over indebtedness

- Ensuring proper client protection principles and methods of recovery
- Development of standardised set of covenants governing last mile lending to MFIs
- Promoting right technology solutions for the last mile
- Formulating and running a Credit Guarantee scheme for providing guarantees (to the loans/portfolios which are being extended to micro enterprises)
- Supporting development & promotional activities in the sector
- Creating an architecture of Last Mile Credit to micro businesses under PMMY

#### Activities of MUDRA

The salient features of the schemes and innovative products, being worked upon, which will be offered by MUDRA going forward, are as below:

**1 Sector / Activity Focussed Schemes:** To maximize coverage of beneficiaries and tailor products to meet requirements of specific business activities, sector / activity focused schemes would be rolled out. To begin with, based on higher concentration of businesses in certain activities / sectors, schemes are being proposed for selected activities like food processing sector, textiles product sector including handlooms/embroidery, small transport sector etc. Going forward, schemes would similarly be added for other sectors / activities as well.

**2 Micro Credit Scheme:** Financial support to MFIs for on lending to individuals/ groups of individuals, joint liability groups (JLGs) or self help groups (SHGs) for creation of qualifying assets as per RBI guidelines towards setting up or running micro enterprises as per MSMED Act and non-farm income generating activities.

**3 Missing Middle Credit Scheme:** Financial support to financial intermediaries for on lending to individuals for setting up or running micro enterprises as per MSMED Act and non-farm income generating activities with beneficiary loan size of 50,000 to 10 lakh per enterprise / borrower.

**4 Refinance Scheme for RRBs / Co-operative Banks:** Enhancing liquidity of RRBs / Scheduled Co-operative Banks by refinancing loan extended to micro enterprises as per MSMED Act with beneficiary loan size upto Rs 10 lakh per enterprise / borrower for manufacturing and service sector enterprises.

**5 Mahila Uddyami Scheme:** Timely and adequate financial support to the MFIs, for on lending to women, group of women, JLGs or SHGs for creation of qualifying assets as per RBI guidelines towards setting up and running micro enterprises as per MSMED Act and non-farm income generating activities.

**6 Business loans for Traders and Shopkeepers:** Timely

and adequate financial support for on lending to individuals for running their shops / trading & business activities / service enterprises and non-farm income generating activities with beneficiary loan size of upto Rs. 10 lakh per enterprise / borrower.

**7 Equipment Finance Scheme for Micro Units:** Timely and adequate financial support for on lending to individuals for setting up micro enterprises by purchasing necessary machinery or equipment with per beneficiary loan size of upto Rs. 10 lakh.

#### 8 Innovative Offerings

In addition to its core activity of refinancing the micro credit to MSME and informal sector entrepreneurs, MUDRA will come out with innovative financial services like:

- MUDRA Card with innovative ideas like a pre-approved credit line
- Portfolio Credit Guarantee product to mitigate the issue of collaterals
- Underwriting for Intermediaries
- Creation of Resources for Credit Enhancement / Guarantee Facility
- Business/Banking Correspondent Model

#### 9 Addressing the Non-Credit Gaps:

Besides the credit constraints, the NCSBs face many non-credit challenges, like,

- Skill Development Gaps
- Knowledge Gaps
- Information Asymmetry
- Financial Literacy
- Lack of growth orientation

To address these constraints, MUDRA will have to adopt a 'credit - plus approach' and offer developmental and support services to the target audience, in addition to meeting their credit needs. It will have to act as a market maker and build up an ecosystem with capacities to deliver value in an efficient and sustainable manner.

#### CONCLUSION

MUDRA creates a vision of formalizing the informal and thereby funding the unfunded. Its role as an apex refiner, providing low-cost finance is likely to be its USP, thereby hoping to fill a yawning gap in India's microfinance space. It is being touted as a game changing idea, with an indigenously conceived architecture, especially designed for Indian context, which is likely to facilitate Inclusion of last mile financiers and thereby help expand access to finance for micro enterprises. It is still early days but it is hoped that MUDRA will be a catalyst towards mass entrepreneurship development, employment generation and higher GDP Growth.

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