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MUDRA BANK: A PARADIGM SHIFT IN REFINANCING AND REGULATING MFIS IN INDIA

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Abstract

About 70 percent of the poor people reside in rural and interior parts of India. Most rural households are excluded from getting facilities like insurance, credit, savings and other financial instruments to help them establish and grow their micro businesses and enterprises. The micro and small enterprises have been starved of credit, either they depend on local moneylenders for credit and the loan comes at high interest rate, often with unbearable conditions. And another option with them are microfinance and non-bank financing companies (NBFCs), which currently charge interest rates of more than 20 percent, it is further higher than twice banks' base rate because of high cost of funds. It is difficult for small entrepreneurs and microenterprises owners, because they want timely and low interest rate funds for improvement of their small businesses. As per NSSO (National Sample Survey Organization) of 2013, there are close to 5.77 crore small-scale business units, mostly sole proprietorships, which undertake trading, manufacturing, retail and other small-scale activities and comparing this with the organised sector and larger companies that employ 1.25 crore individuals. The Government of India launched on 08th April 2015 the Mudra (Micro Units Development and Refinance Agency) bank under the Pradhan Mantri MUDRA Yojana scheme with a corpus of Rs 20,000 crore and a credit guarantee corpus of Rs 3,000 crore, with the aim of providing loans to

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the small businesses at any time at an affordable cost. The objective of this paper is to gives an overview of the role of MUDRA bank in refinancing and regulating the Micro finance Institutions in India and also discusses about the issues that needs to be address with the creation of MUDRA bank. This paper is also an attempt to explore how establishing a new bank will help in boosting loans, cut borrowing costs for the country's cash-starved small businesses, as similar efforts has been taken in past like nationalisation of banks in 1970's and making mandatory priority sector lending which also includes micro & small enterprises have not addressed problems.

Key words: MFIs, Refinancing, Financial system, Mudra bank

I. INTRODUCTION

Non-availability of timely and adequate credit at an affordable cost at a fixed time is one of the most important problem is faced by the rural poor households and other small business entities in the society. One of the major reasons for low availability of timely credit is lack of financial institutions, which provides loan to the underprivileged society. The problem of non-accessibility of credit at time is more serious for micro enterprises requiring small loans and the first generation entrepreneurs who want to establish their own enterprise. Pradhan Mantri Mudra Yojana have to be special step in the way of regulating microfinance institutions and provides accessibility of credit to the poor at a reasonable and affordable cost. MUDRA (Micro Units Development and Refinance Agency) was launched by Government of India (GOI) on 8th April 2015 for providing easy funding to the small business enterprises and small entrepreneurs. GOI launched the MUDRA scheme with the corpus of 20,000 core and guarantee of credit are 3,000 crore. MUDRA will be responsible for refinancing MFIs (Microfinance Institutions) in the establishment of lending to small entities who are engaged in manufacturing, trading and service activities. The main objective of MUDRA is providing necessary finance for development and establishment of micro, small business units and new entrepreneurs. MUDRA will not only help in improving the quality of life of these entrepreneurs, but also go round them into powerful instruments of increasing GDP growth, poverty alleviation and employment generation. MUDRA will turn into very essential for the small manufacturing units, fruit and vegetable sellers, truck operators, hawkers and artisans in both rural and urban areas.

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II. PROBLEMS OF MONEYLENDERS AND EXISTING MFIS:

There are many problems, which have faced by rural poor in the access of credit from the local moneylenders. The very common problem faced by rural poor people is interest rate charged by the local moneylenders because they charges very high rate of interest to the poor. After getting loans from the moneylenders, poor become vulnerable and are exploited by them in the repayment of loans. Poor farmers committed suicides (AP crisis 2010) due to high rate of borrowing cost, which they had taken from the moneylenders. Microfinance Institutions provide loan through self-help group and joint liability group model to the needy poor people but their rules and regulations regarding repayment of loan are up to mark for the poor. Interest rate is also very high for the borrowers. Seasonal calamities and lack of raw material for manufacturing of products are extreme problem for small business owners in the rural areas. Other problems faced by MFIs include: compliance of formalities; lack of access to external funds because of lack of confidence shown by borrowers; Illiteracy; no idea about what to do with the borrowed money for their development; customers prejudiced assessment about repayment of loans; Shortage of finance in short time span; deficiency of finance for expansion enhancement of borrowers; Lack of development skills among office bears.

High Cost of funds: outrage

Cost of funds is high for the borrower in getting loans from the informal financial institutions and local moneylenders. Borrowers are mentally tortured and exploited by the lenders. Rural poor are not aware of formal financial institutions for access of credit it is big problem for achievement of the inclusive growth of the society. According to the newspaper the Hindu (April 19, 2010) that due to the high cost of the funds field officers notice and made report about the negative impacts like harassment of borrowers, fear, mistreatment and insult the reticence of women and extreme punishment like making defaulters stand in the hot sun, tying them to trees and making them run in open grounds". Mohd Saleem (2013) The borrower faces so many problems or can say some sort of torture mainly the mental torture, depression and social fear. If borrower does not able to pay, he/she may lose his/her belongings specially the collateralized asset. This fear may induce or compel the borrower to kill the life and there are so many instances where it is find that due to insufficient earnings and lack of funds to pay the loans, the people opted to suicide so that he/she may avoid social injustice and torture of lender.

Interest rate

Problem of interest rate is very common of microfinance institutions that provide micro financial services to the borrowers. Interest rate between 22-26% charges by the customers (RBI website).

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Illiteracy

Illiteracy is biggest obstacle for microfinance institutions; if borrowers are illiterate, they have to face many problems in getting loan.

III. INTRODUCTION AND CREATION OF MUDRA

MUDRA is special set up of regulating and refinancing to the microfinance institutions, small business entities, small and new entrepreneurs at a relatively low 7% rate of interest. MUDRA aims to reduce borrowing costs of these borrowers and provide affordable credit at a reasonable price. MUDRA is probable to develop as a regulatory body for microfinance institutions, which regulates MFIs that are registered as Non-Banking Finance Companies (NBFCs) which are not accepting public deposits. MUDRA a subsidiary of Small Industries Development Bank of India and registered as an NBFC (Non Banking Finance Companies). MUDRA is expected at benefiting around 58 million small businesses in the country, who account for a mere 4% of institutional funding, in spite of employing over 120 million people, a lot of from unprivileged strata of society. The basic purpose of MUDRA is to attain development in an inclusive and sustainable manner by supporting and promoting partner institutions and creating an ecosystem of growth for micro enterprises sector. MUDRA will provide different types of products for those who are engaged in the small business ownership and want to start small businesses in future. MUDRA will become sustainable medicine for unorganized sector, which are not sustaining in the society as before announcement of this bank, which are in the business of lending to micro and small business entities engaged in manufacturing, trading and service activities. MUDRA will legally responsible for developing and refinancing all micro-finance institutions (MFIs). The Bank would also become partner of MUDRA to assisting and organizing refinance to small business owners. Covering of loans from 50,000 to 10 lakh will be financed by MUDRA to the financial institutions for lending to micro business and small and new entrepreneurs. The purpose behind this scheme is easy and low interest access of credit to the unorganized sector, which are always exploited by the formal financial institutions for their funding requirements. Shopkeepers, vendors, vegetable shoppers, truck operators and members of self help groups are also availed their credit requirement through MUDRA.MUDRA can become a sustainable vehicle for integrating financial markets for enhancement of employment generation, removing not availability of credit at an affordable cost for small scale business enterprises, unorganized sectors, Non banking financial institutions, self help groups and new and small business entrepreneurs. Creation of MUDRA will help in laying down policy guidelines, registration of microfinance institutions, regulating and refinancing financial institutions and credit rating of micro financial institutions.

Functions/ Principle objectives of MUDRA Bank

- The main function of MUDRA bank is to bring the stability in microfinance system through regulating and bringing in inclusive participation of borrower and lender of microfinance.
- It also extends credit and finances to microfinance institutions (MFIs) and various agencies that lend money to the small business & SHGs self help group. It play significant role in mapping out policy guidelines for SMEs in terms of financing.
- Incorporating ICT to assist in the process of efficient borrowing, lending monitoring of the existing distributed funds.
- To register all the MFIs and establishing performance rating & accreditation system, which will enable last mile borrowers of finance to evaluate the various MFIs that suit their requirement and have the satisfactory past record on the basis of rating. It will also bring competitive among existing MFIs, ultimately benefitting the borrower.
- To provide structure framework and guidelines for the lenders to be followed to cover up the losses in case of default from the part of borrowers.
- To develop the standard covenants that fill form the backbone of the last mile business in future.
- To provide credit guarantee scheme for ensuring guarantees for loan to the micro businesses

Major product offering through MUDRA

MUDRA bank has classified into three segments; first is the segment of starters known as Sishu to cover loan up to fifty thousand rupees, second segment is the borrower of mid-stage finance known as Kishore to cover the loan above fifty thousand to five lakhs rupees. The third segment is borrower of growth expansion level business, which is known as Tarun to cover loan above five lakhs to ten lakhs. Apart from this government of India also organises MUDRA loan mela in various parts of the country. The MUDRA loan mela is organised for few days at one location to offer loans and small business owner can apply for the same, the amount of loans ranging from fifty thousand to upto ten lakhs. Some of the other product and services to be offered in future are MUDRA card, Credit enhancement and Portfolio credit guarantee.

IV. EXISTING MFI MECHANISM (OTHER FINANCING INSTITUTIONS NABARD, SIDBI)

Annual report 2012 of the Reserve Bank of India said that financing of trade by the regulated banking sector was Rs. 2 lakh crore in 2011, therefore, we can say that banking sector availed

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credit only 28 percent in the total finance requirement. So more than 70 percent of the financial and credit requirement of the non- corporate sector in business is met by non-banking sources for business ownership and development. The overall debt of Rs. 360-420 billion by March 2016 will expect to have by NBFCs-MFIs alone. Microfinance institutions cover more than 28.7 million customers in providing credit assistance through their models. Data collected through microfinance institutions network (MFIN) shows that the aggregate gross loan portfolio of MFIs has grown by 51 percent. MFIs in India have over 25 million active borrowers, 96% of whom deal with nonbanking financial companies (NBFCs). Today around 10% of the financially excluded section, served by the microfinance institutions and their outstanding credit portfolio is currently at `26,000 crore.

There are various sources of providing credit for running business like public sector banks, old private sector banks, new private sector banks, co-operative banks, Non-Banking Financial Companies (NBFCs), Foreign Banks (FBs), Un-Incorporated Bodies (UIBs), relatives and friends. Some major financial institutions provide credit facilities to the small businesses and medium enterprises are NABARD (National Bank for Agriculture and Rural Development), SIDBI (Small Industries Development Bank of India), RRBs (Regional Rural Banks), SSBFIs (State Small Business Financial Institutions), and NHBs (National Housing Banks).

After set up of the MUDRA, NABARD's role have been changed and they has became mediator to financing different institutions like microfinance institutions, SHGs, JLG, small business owners, entrepreneurs. The Hindu business line newspaper says that Satin credit care has become the first MFI in the Indian microfinance sector who have received Rs. 35 crore loans from MUDRA. Before set up of MUDRA all MFIs, are depend on the NABARD for credit assistance but now they have received loan directly to the MUDRA. NABARD has shows significant success in self-help bank linkage programme and dairy finance but failed to strengthen the co-operatives and regional rural banks, both as a refinance agency. In the same way, SIDBI jumped into microfinance sector because it has many unfulfilled expectations from the Micro, Small Enterprises, for filling these gaps now MUDRA joins as one of its arms for providing credit assistance in a systematic manner.

V. LOOPHOLES IN MFIS

MFIs are facing challenges in terms of inappropriate donor subsidies, poor regulation and supervision of deposit taking MFIs, limited management capacity, improper repayment of loans etc. Microfinance institutions are making borrowers vulnerable in terms of repayment of loans because their high rates of interest. In the management of MFIs, delinquency is a serious issue. It's a difficulty of survival and sustainability for MFIs. Microfinance institutions (MFIs) provide financial services to low-income, poor households, borrowers who seek relatively small amounts to finance their businesses, manage emergencies, acquire assets, or smooth consumption (CGAP 2002) delinquency is risk that MFIs across the world are confronted with on a daily basis. Delinquency is defined as a state when clients do not repay loans at the scheduled time. The RBI appointed the Malegam committee for review and recommendations on the different issues faced by microfinance institutions. Delinquency faced by MFIs due to many reasons like, poor loan product, delay in loan disbursement, lack of proper credit discipline and migration of customers. Business failure conditions, which make these poor suspecting people, fall in debt- trap for generations. In rural areas, most individuals depend on local moneylenders for credit and moneylenders give loans on higher interest rates to the underprivileged society residing in the rural areas. Today, this segment is unregulated and without financial support or cover from the organised financial banking system, it cannot be succeeded.

VI. HOW MUDRA BANK WILL MAKE CHANGE IN THE ECONOMY

MUDRA bank is set as regulating and refinancing microfinance institutions for their development and growth. Before establishment of MUDRA, People, who are living in rural and interior parts of the India, have been expelled from the benefits of formal banking system. So they never had access most of the financial services like insurance, credit, loan and other financial instruments to help them to set up and grow their micro businesses. A vast majority of the non-corporate sector of India operates as unregistered enterprises they do not follow the rules and regulations as formal financial systems they do not maintain proper account of books and have not covered under taxation area so formal financial institutions find it difficult to lend them MUDRA will help every borrower and will refinance them at 7 percent rate of interest at an affordable cost. NABARD and SIDBI are very good sources of providing financial assistance to the borrowers but they have faced challenges in the disbursement of loans to the borrowers. MUDRA bank has corpus of 20,000 thousand crore rupees to refinance all kinds of borrowers who want to take credit at a reasonable interest rate. MUDRA is special step of government of India to regulate and refinance to the all categories like vendors, shopkeepers, traders and manufacture. MUDRA became apex refinancer for the financial institutions and the architecture of MUDRA indigenously conceived for Indian context for their sustainable growth in a better manner. The Mudra scheme provides three types of loans: Shishu (up to Rs 50,000), Kishore (Rs 50,000 to Rs 5 lakh) and Tarun (Rs 5 lakh to Rs 10 lakh).However, 99.6 percent of all loans disbursed by non-banking financial corporation's (NBFC) under the MUDRA scheme has been in the Shishu category, with a ticket size of less than Rs 50,000, in financial year 2015-16, according to data from agency's website.

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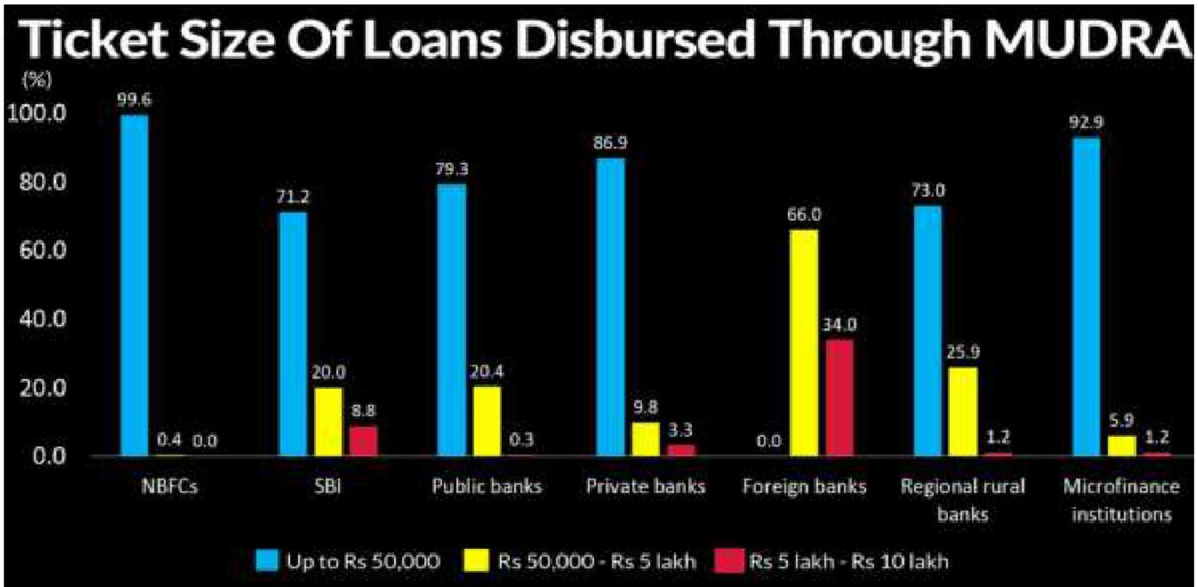

Figure 1: Loans disbursed through MUDRA
Source: http://www.mudra.org.in/

VII. DISCUSSION

Mudra bank is established as statuary regulatory body for refinancing and regulating MFIs that are dealing with lending to micro and small businesses engaged in trading, manufacturing and services activities. MUDRA bank has corpus of twenty thousand crore rupees to refinance all the kinds of MFIs with credit guarantee corpus of tree thousand crore rupees. Bangladesh has similar entity for micro financing micro credit to small business owners; the Palli Karma-Sahayak Foundation (PKSF) which was established by the government of Bangladesh as non-profit company. The principle objective of the PKSF was to provide finance to the various organisations for their micro credit services and to the poor landless people who doesn't have anything in possession. Even though MUDRA is established with the similar objective but its scope of schemes is much larger than Bangladesh PKSF's as MUDRA bank is statutory regulatory body having broader purview. It will lay down guidelines for the borrowers of micro and small enterprises. It is responsible for registration and regulation of all the micro finance entities, along with formulating code of conduct for the industry to ensure both the lending institutions and borrower right are protected and the methods to weed out the problem of indebtedness. Credit guarantee scheme to provide the guarantee of the loan that are being extended to the micro and small enterprises is the another dimension for more transparent monitoring of the MFIs. It will ensure SMEs are not cheated and made out to pay more than what it is due to them.

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VIII. CONCLUSION

For the inclusive growth and development in India, it is imperative to provide adequate financing to the SMEs, which is the growth engine of Indian economy. They form up the bottom of the pyramid of the economy. Easier access to financing is the main issue hindering the growth of SMEs in India. Currently commercial banks are the primary source of financing for the MFIs for funds. Although banks in India are required to channelize 40% of their loans to priority sector consisting of agriculture and other and small loan. The MFIs avails such loan at the rate varying from 12-14% and extend them at around 22-25%, keeping almost 10% margins to cover up their operating cost and profits. MUDRA bank is expected to offer refinancing at much cheaper rate this will in turn help the last mile borrower in the term or reduced interest rates. Stringent guidelines and risk-averse nature of the financial institution engaged in financing MFIs forces SMEs to shift to the informal sources of financing like money lenders. This is evident from the fact that total finance requirement of SMEs sector is INR 32.5 trillion comprising INR 26 trillion of debt demand and INR 6.5 trillion as equity demand. According to the Confederation of Indian Industry (CII) data there is still a gap of INR 20 trillion financial gap which is not met by the present financial institutions. The support from formal banking system to this sector is meagre. Banks are unable to meet this gap is because of the reason that SMEs do not maintain standardised financial statement and there is lack of comprehensive monetary information disclosure on the part of SMEs to the financial institutions. Lack of possession that can be used as guarantee and their vulnerability are the other factor contributing to the cause. Exiting financing agencies like National Housing Bank, National Bank for Agriculture and Rural Development and Small Industries Development Bank of India have not been able to fully meet the financial requirement of micro and small enterprises, in their mission for establishing MUDRA bank would not have been arrived. This makes the role of MUDRA bank more significant in meeting the financial need and regulating the existing MFI to ensure that last mile borrower are not exploited by MFIs and the financial requirement is met well in time in a hassle free manner.

IX. ISSUES AND CHALLENGES AHEAD

Microfinance institutions are currently regulated and financed by Reserve Bank of India under chapters of III-B, III-C, V of the reserve bank of India act. Now on the recommendations of RBI, government of India has set up a new regulating and financing body for the microfinance institutions is MUDRA because there are several reasons for need of separate regulator in the microfinance sector. The borrowers in microfinance sector represent a particularly vulnerable section of the society. They lack individual bargaining power in access of credit facilities, have no knowledge about literacy and live in environment where they are always exploited by the internal shocks and routine problem of moneylenders. MFIs charge very high rate of interest to

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the borrowers and loans are given by the MFIs are of shorter duration but recovery modes of loans adversely affect the lives of the borrowers in case of SHGs and JLGs because loans given by SHGs being used to repay the loans given by MFIs. These complaints have reinforced the need for a separate and focused regulation for microfinance institutions. Access to finance to the microfinance sector is important plank in the scheme of financial inclusion and a fair and sufficient regulation of MFIs will push the growth of this sector and will protect the interest of the borrowers. Therefore, MUDRA takes part in overcoming these issues, which come in the path of microfinance sector.

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