

MicroSave Policy Brief #19

Pradhan Mantri MUDRA Yojana: Behind the Numbers

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Key Points:

- *Pradhan Mantri MUDRA Yojana (PMMY) aims to develop and refinance all financial institutions (FIs) in the business of lending to micro/small business entities engaged in manufacturing, trading, and service activities.*
- *This Policy Brief highlights the effectiveness, impacts and challenges of the PMMY and assesses its capacity to finance those unable to get loans under the conventional system.*

Executive Summary

Prime Minister Narendra Modi launched the [Pradhan Mantri MUDRA Yojana](#)¹ (PMMY) on 8 April 2015. The objective of the scheme is to develop and refinance all banks and micro-finance institutions (NBFC-MFIs) in the business of lending to micro/small business entities engaged in manufacturing, trading, and service activities. The scheme is based on the premise that providing institutional finance to micro/small business units will turn these entities into instruments of growth, employment generation, and development. *MicroSave* conducted an independent, point-in-time assessment of the PMMY to analyse its effectiveness.

Key Findings

- Both banks and NBFC-MFIs have built huge MUDRA loan portfolio, but only a small part of these loans appear to be “new MUDRA loans”, extended to “first-time borrowers”, i.e., financially excluded. In absence of clear reporting by both banks and NBFC-MFIs on the number and amount of MUDRA loans extended to financially excluded borrowers, it will be difficult to track the progress of MUDRA’s mission to “fund the unfunded”.
- MUDRA has made positive impact on bottom-line of micro, small and medium enterprises (MSMEs). However, the loan amount sanctioned is not always aligned to the business requirements of the MSMEs financed.
- PMMY has “delivered successfully” on key product features envisaged. However, low programme awareness and monitoring makes customers prone to fraud and malpractices.
- Banks perform better than NBFC-MFIs on customer targeting, product and process features.
- Banks perceive MUDRA loans as high risk and low value, requiring extremely high involvement from staff. Therefore, banks have been extremely conservative in extending MUDRA loans. Banks pre-select customers, avoid marketing the scheme, and seek to fund only businesses located very close to their branches to mitigate the risk of non-performing assets.
- MUDRA loans provide an excellent, but, as yet, unrealised business proposition for banks. In absence of a suitable incentive structure to extend MUDRA loans, banks refrain from opening their doors to all potential MUDRA customers.
- A series of policy changes could better motivate banks to promote MUDRA loans.

Key Recommendations

- In order to incentivise banks to lend to MSMEs, the quota for MSME loans in the priority sector guidelines² (PSL) should be increased. This will encourage banks to lend more to MSME sector and thus achieve their annual PSL targets.
- Centralised processing and initial sanctioning of MUDRA applications could increase the scheme’s reach.
- The credit bureaus used by banks need to interface/integrate with the credit bureaus used by NBFC-MFIs to prevent over lending.
- Banks can leverage transaction history of [Pradhan Mantri Jan Dhan Yojana](#) (PMJDY) accounts to assess the credit worthiness of borrowers without credit history.
- Banks and NBFC-MFIs need to improve reporting on PMMY (see Annexure-I and Annexure-II for examples of proposed reporting formats) – particularly with regard to loans provided to MSMEs without previous access to formal sector finance.

¹ [Pradhan Mantri MUDRA Yojana](#)

² Currently, RBI has prescribed a target of 7.5% (by March 2017) for micro-enterprises.

Introduction

India's MSME is a vast, vital and yet challenging, market segment. Vast, because the sector provides employment to 117 million people through 51 million³ (2014–15) organised and unorganised enterprises. Vital, because the MSME sector is 37.5%⁴ (2012–13) of total GDP and has the potential to solve the unemployment problem through the “personal sector”⁵. Finally, it is challenging because the sector is currently credit starved and depends almost entirely on informal finance or self-financing to fund its credit gap of 56%.⁶ The reasons for this credit gap are not hard to find. Formal financial institutions (FIs) struggle to assess credit worthiness of MSME customers, as they lack credit history, have no business records, and are unable to offer collateral against the loan.

PMMY is a bold step by the Indian government to “fund the unfunded”, to develop the micro-enterprise sector. Under the scheme, Micro Units Development & Refinance Agency Ltd (MUDRA) was launched on 8th April, 2015, to refinance banks and NBFC-MFIs to, in turn, extend credit support to non-farm income generating activities. According to the [MUDRA website](#), the non-corporate small business sector (NCSBS), the market segment to which PMMY caters, adds INR 6.28 trillion annually to the Indian economy. If PMMY covers all NCSBS borrowers and completely meets their financing requirements, the sector may add another INR 1.25–1.89 trillion annually to the GDP.⁷

The differentiating factor of PMMY is its simplified documentation and quick turnaround, coupled with collateral-free loans up to INR 1 million, at reasonably low interest rates. The scheme has over-achieved its loan disbursement target (109%) in the inception year⁸ itself. The following table highlights the outreach of MUDRA.

Financial Year	Number of PMMY Loans Sanctioned	Amount Sanctioned	Amount Disbursed
2015–16 (As on 31 March 2016)	34.9 million	INR 1,374.5 billion	INR 1,329.5 billion
2016–17 (As on 17 August 2016)	10.3 million	INR 375.3 billion	INR 360.4 billion

Source: MUDRA website

While these numbers are impressive, the Ministry of Finance (MoF) has informed Parliament that MUDRA Ltd has refinanced NBFC-MFIs and banks with only INR 32.87 billion (FY 2015-16).⁹ This refinancing is only 2.5% of the total MUDRA loans disbursed (INR 1,329.5 billion) during the same period. One of the plausible explanations for this huge difference is that [Department of Financial Services \(DFS\) classified all advances granted to MSMEs on or after April 08, 2015 as MUDRA loans under the PMMY](#). This may indicate that the reported disbursement under PMMY scheme also includes advances that were already granted as part of FIs' regular business operations (without PMMY support).

MicroSave conducted an independent point-in-time assessment of the PMMY during the month of July 2016. The study's objective was to assess the effectiveness of the PMMY, gauge capacity of MUDRA to deliver its mandate to finance those unable to get loans under the conventional system, and highlight the impacts and challenges of PMMY. The study comprised a quantitative survey of 1,496 MUDRA customers¹⁰ in 12 states¹¹ and qualitative interviews with 70 MUDRA customers in 6 states. The study does not offer a nationally representative picture and only provides insights on the status of PMMY implementation in 12 states covered under the study.

³ MSME Annual Report: 2015-16

⁴ MSME Annual Report: 2015-16

⁵ The government focus is to create a “personal sector” wherein a person turns into a job provider through entrepreneurship rather than a job-seeker

⁶ BusinessLine: There is credit gap of 56% in MSME sector

⁷ It is assumed that NCSBS accounts achieve an additional growth of 20% to 30%PMMY

⁸ PMMY Performance: 2015-16: A target of INR 1,22,188 crore was set for F.Y. 2015-16

⁹ Please see answer given by the Minister of state (MoF) in parliament

¹⁰ 879 customers of NBFC-MFIs and 617 customers of banks

¹¹ AP, Assam, Bihar, Delhi, Gujarat, Haryana, Karnataka, MP, Rajasthan, UP, Uttarakhand, and West Bengal

MUDRA loans have made a positive impact on the bottom-line of MSMEs, but the value of loans sanctioned are not aligned with MSMEs' business requirements

84% of the MUDRA customers accept that the loan has helped to improve top-line (revenue) by 20% to 30%. Small business owners, with monthly turnover less than INR 50,000, claim to have earned an additional profit of INR 2,000–3,000 in a month. MUDRA's *Shishu Loan*¹², in particular, has helped unlock the business potential of small shop-owners and vendors by meeting some of their working capital requirements. *Shishu Loans* have helped businesses to add products to their existing offerings and also to increase inventory to cater to a wider set of customers. The eateries have bought chairs to serve more customers daily; vendors (of fruits and vegetables) have bought additional "*Petis*" (fruit and vegetable packets); Paan (betel shops) have added dairy products; carpenters do not need to take advances from customers any more, and so on.

However, the MSMEs voiced a concern that the loans disbursed are insufficient to meet their business needs. The study found that, on average, a MUDRA customer receives a loan of INR 33,675 against demand of INR 40,133. The study also highlights that 66% of MUDRA customers are ready to repay the existing loan outstanding, and take a larger loan under the Kishore Loan category, if that option is available to them.

No customer has "visited more than twice" to avail a MUDRA loan. However, low scheme awareness and restricted communication from banks have left customers vulnerable to "frauds"

Almost all the MUDRA customers interviewed are highly satisfied with the overall process of MUDRA loan application and praised the documentation process, which was unexpectedly straight-forward. Borrowers particularly value three attributes of PMMY:

1. the lack of requirements for a guarantor or collateral;
2. the simple documentation; and
3. the quick processing.

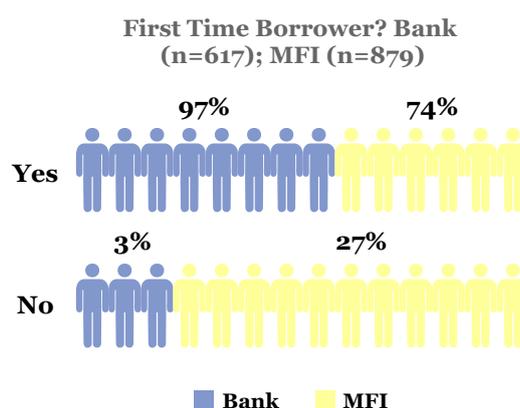
Most existing customers recommended MUDRA loans to other prospective customers from their business circles, but experienced their referrals being turned away by the bank branches.



FIs have not made much effort to promote PMMY. Only 22% of MUDRA customers interviewed said that FIs had organised a camp to communicate MUDRA. Most (64%) MUDRA customers came to know about the scheme through word of mouth. Evidence from our assessment strongly suggests that, in the absence of official communications, fraudsters can cheat gullible villagers in the name of PMMY. We came across an incident¹³ where a group of four, claiming to be from MUDRA, collected a huge sum of money from Panchayats near Patna in Bihar. So it is no surprise that nearly 70% of customers suggested that MUDRA advertise more to increase awareness of PMMY.

Banks are "pro-active" in identifying and disbursing loans to the "first-timers" and weaning them off the moneylenders

Banks' customer selection is more aligned to the PMMY's objectives than that of NBFC-MFIs. 97% of banks' customers interviewed had borrowed from a formal FI for the first time under PMMY; as compared to 74% of NBFC-MFI customers. Customers who had taken a MUDRA loan from a bank are "in awe" of the changed bank behaviour, and noted that, had the bank not approached them, they would have never ever imagined of taking a loan from a bank.



¹² There are three types of loans under PMMY: Shishu (up to INR 50,000), Kishor (from INR 50,001 to INR 5 lakh) and Tarun (from INR 500,001 to INR 1,000,000).

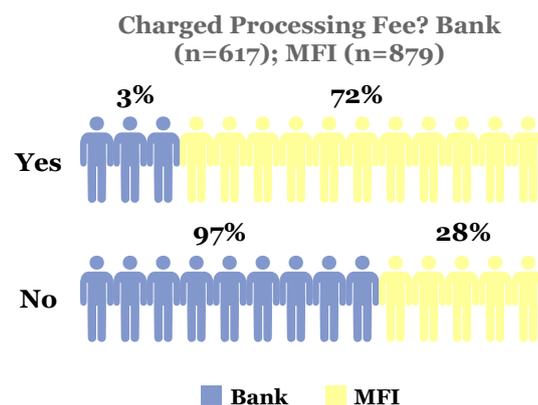
¹³ The group claimed that they belonged to the MUDRA refinance agency and that the Government of India had authorised them to collect applications from prospective MUDRA customers. After collecting application forms from the villagers, the group conducted a "verification of the applicants" phone call (where they enquired about their daily business transactions) and informed them that their MUDRA application has been accepted and the loan sanctioned, but that they would have to pay INR 200 for the acknowledgment receipt. The group then collected INR 200 for each fake acknowledgment receipt and told the villagers to visit the nearest bank branch to receive their MUDRA loans. However, it was only after visiting the nearest bank branch that the villagers realised that they had been cheated, as (inevitably) the bank refused to accept the acknowledgment receipt or disburse the loans.

Amount in INR	Bank	MFI
Average loan applied	64,580	25,152
Average loan sanctioned	49,315	22,895

In contrast, 23% of NBFC-MFI MUDRA customers interviewed had previously taken a loan with the same NBFC-MFI. The loyalty of these customers was typically rewarded by the NBFC-MFI with a MUDRA loan at a lower (19%) than the usual (22–26%) interest rate.

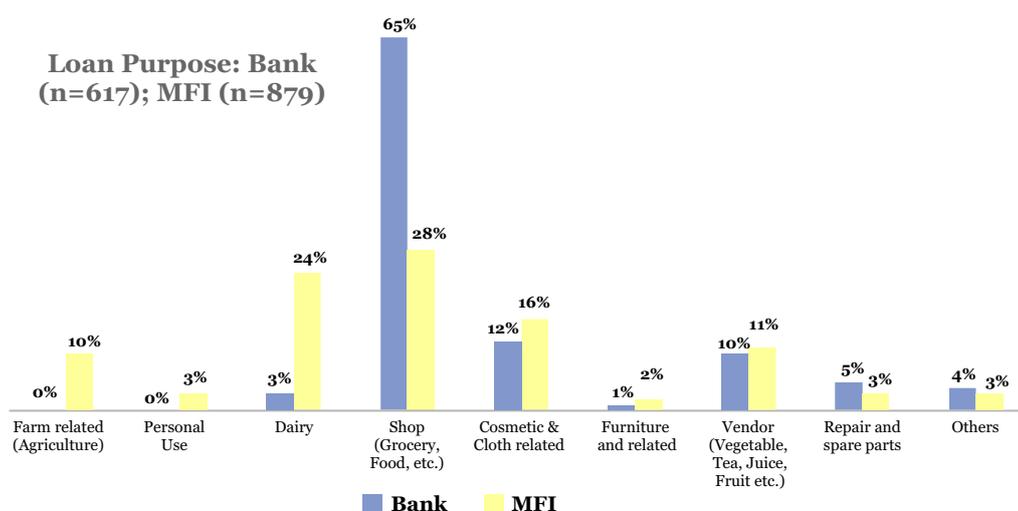
On average, banks have disbursed loans two times the value of those disbursed by NBFC-MFIs. Banks offer these larger loans at lower interest rate (in the range of 9.5% to 12.5%); whereas NBFC-MFIs have much higher interest rate in the range of 19% to 26% (the 19% being for MUDRA refinanced loans).

While MUDRA clearly instructs FIs not to charge processing fees, three out of four NBFC-MFI customers have been charged an average processing fee of INR 383 or 1% of the loan amount. Banks complied with this instruction and did not charge any processing fee from customers. The level of awareness about PMMY among bank customers is much higher (87%) than NBFC-MFIs (26%). Most of the NBFC-MFI MUDRA customers were not even aware that they have availed a MUDRA loan.



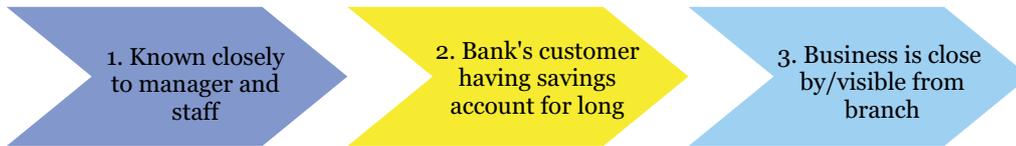
Banks' MUDRA portfolio is diversified and aligned to sectors that PMMY promises to serve. Banks' MUDRA portfolio largely (93%) comprises of small shop-owners, eateries, vendors, carpenters, furniture sellers, and mechanics. In contrast, NBFC-MFIs' end-use of MUDRA loans is hard to track and monitor. The study indicates that 3% of MUDRA loans disbursed by NBFC-MFIs have been used for non-business, personal needs, such as house repairs or construction and weddings. Similarly, 10% of MUDRA loans disbursed by NBFC-MFIs have found to be used for agriculture.¹⁴

The MUDRA loan application process is “not a customer initiated process”. Banks are pursuing “50 metre rule” and “personal relations” as selection criteria to “hand-pick” customers, to hedge risk of unsecured lending.



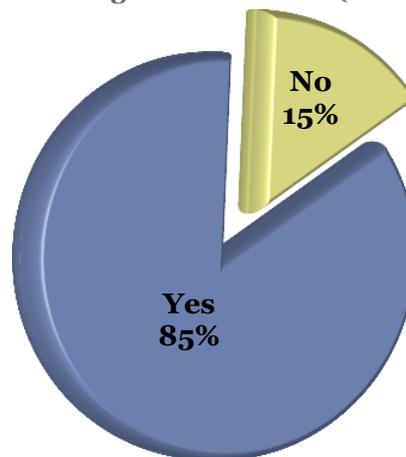
¹⁴ Note: Dairy is categorised by RBI as “Agriculture and Allied Activities” and belongs to non-farm sector. Lending to non-farm sector is allowed under MUDRA.

To respond to the design of PMMY and mitigate the risks associated with unsecured lending, banks have devised interesting customer selection strategies. The primary strategy of banks is to select their potential MUDRA customers on the basis of branch staff's knowledge of customers and potential borrowers' transaction history. Customers who are well known to branch staff and have healthy transaction record are preferred over others.



In the second and final stage of customer selection, banks follow a “50 metre rule”, under which customers are screened on the basis of their proximity to the bank's branches. Customers whose business is within “50 metres”, or is visible

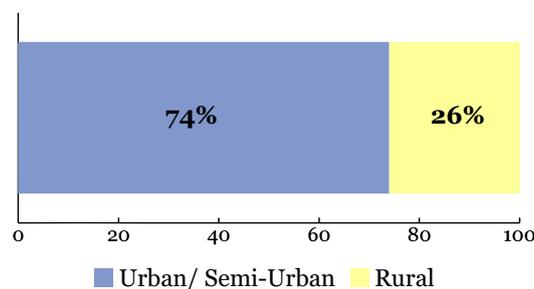
Had Bank Account before taking MUDRA? Bank (n=617)



from the bank branch, are finally offered MUDRA loans irrespective of whether the customer wants a loan or not. The *MicroSave* study corroborates this – most of the banks' MUDRA customers interviewed were within 50 metres from branches. Such customers are easy and adequate for bank branches to achieve their modest quarterly targets. These customers are approached with pre-determined loan offer in the range of INR 10,000 to INR 50,000 irrespective of customer's financial need.

This bank-driven selection process makes it hard for other customers to apply and get MUDRA loans. Other strategies followed by banks include preferring customers who already have successful running businesses; funding customers

Beneficiary Location; Bank (n=671)



who do not need loans but are capable to repay; avoiding risky businesses such as jewellery shops and vendors who do not have permanent establishment; making it tough for other potential customers by asking for shop licence, TIN¹⁵ and property documents; and miscommunicating that the MUDRA scheme has lapsed. Limited and miscommunication from banks has led false customer perceptions that the PMMY scheme is on “a first come, first serve” basis; is available from “government-sponsored banks only”; and that the “scheme is no longer available”.

Common Bank Practices	
Target based approach – 4 to 10 MUDRA loans per quarter	“Ab loan nahi ho raha hai kyunki bank ka bees ka target pura ho gaya hai” (The bank's target of 20 is over) - Customer, Karnataka
Pre-selection of loan amount irrespective of business requirement	“Humko bole ki 50,000 ka scheme khatam ho gaya hai ab 10,000 hi milega. Itna to hum Gaanv walo se le lenge wo bhi bina byaj ke” (Manager told us that the scheme of INR 50,000 is over but the scheme for INR 10,000 is available. I can get that amount from relatives without any interest) - Customer, Haryana
Miscommunicating that scheme/quota under MUDRA is over	“Bank me bola ki niyam khatam ho gaya”. (The Bank Manager told us that the scheme is over) - Customer, Bihar
Providing irrelevant reasons to turn away customers	“SBI group merger ke bad loan milega” (MUDRA loans will be distributed only post SBI group merger) - Customer, Uttarakhand

Reporting by banks and NBFC-MFIs on incremental loans to new customers under PMMY is “vague and confusing”. A more precise MIS is needed to assess new loans.

The [MUDRA performance report for the financial year \(FY\) 15-16](#) shows that banks and NBFC-MFIs have disbursed 65% and 35% of the total MUDRA loan amount portfolio, respectively, in FY 2015–16. In contrast, because NBFC-MFIs have issued smaller loans, they comprise the majority (68%) of the number of loans issued.

	MUDRA Loan Disbursed in FY 15-16 (Amount in INR)	MUDRA Loan Disbursed in FY 15-16 (No. of accounts)
NBFC-MFIs	1,329.5 billion	34,880,924
Banks	870.5 billion (65%)	11,086,497 (32%)
NBFC-MFIs	459 billion (35%)	23,794,427 (68%)

After the DFS gave permission to allow the classification of existing loans below INR 1 million as MUDRA, the total MUDRA loan portfolio (both in amount and in numbers) as reported by banks and NBFC-MFIs has three loan categories:

¹⁵ TIN stands for taxpayer identification number, which acts as a token of identification for businesses registered under value added tax.

- a) **Refinanced loans:** MUDRA loans extended by banks and NBFC-MFIs (up to INR 1 million) to new borrowers with the loans they received from MUDRA refinancing agency;
- b) **New MUDRA loans:** MUDRA loans extended by banks and NBFC-MFIs over and above their refinancing limit (with their own funds) to new “first-time borrowers” who were so far excluded from a formal financial system; and
- c) **Classification of the existing loans as MUDRA:** Classification of the already existing loan (up to INR 1 million) disbursed before 8 April 2015 (the date of MUDRA launch) or renewal of existing loan (up to INR 1 million) on and after 8 April 2015 as a MUDRA loan.

Currently, banks and NBFC-MFIs report at an aggregate level without specific details on number and amount of: a) the refinanced loans; b) the new MUDRA loans; and c) the existing loans classified as MUDRA. For example, [State Bank of India’s \(SBI\) annual report \(2015-16\)](#) highlights that SBI has distributed a total of INR 122.8 billion in MUDRA loans to approximately one million borrowers in FY 15-16. However, the SBI annual report does not explain break-up of these impressive figures in the three categories, and thus it is impossible to assess how many are new MUDRA clients, financially included for the first time. For the same reason, the report also does not show the number or amount of existing loan accounts that were just reclassified as MUDRA.

Similarly, the NBFC-MFIs reported lending to as many as 23.79 million [MUDRA customers in FY 15-16](#) (MUDRA performance report for the financial year 15-16) within just 11 months (MUDRA started from 8 April 2015). The Microfinance Institution Network (MFIN)¹⁶ report shows that the Indian NBFC-MFI industry only grew by an additional 9.9 million accounts from 22.6 million at the end of FY 14-15 (just a few days before MUDRA launch) to 32.5 million accounts in FY 15-16. This suggests that the NBFC-MFIs have simply reclassified a part of their existing loan portfolio as MUDRA loans; however, it is not possible to determine the extent of this re-classification from the current reporting formats. The *MicroSave* study shows that one in four MUDRA borrowers are already existing customers of the NBFC-MFI that lent to them under PMMY. These macro level figures suggest that this proportion may be a lot higher.

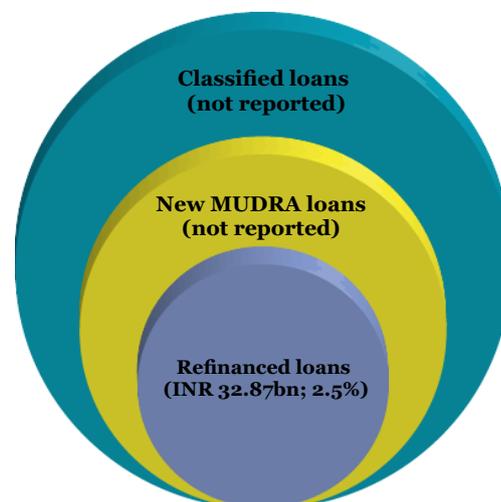
Improving clarity on the reporting on MUDRA loans disbursed to new customers by FIs is essential for understanding the pace at which FIs are pulling the financially excluded into the financial inclusion net. In the absence of this clarity, PMMY risks becoming a game of how the existing portfolio is classified, thus failing to achieve the basic purpose of MUDRA, to “fund the unfunded”.

Potential strategies to ensure PMMY meets its end-objective

The government’s push on PMMY should be more than just asking FIs to achieve their disbursement targets. In current context, when FIs are struggling with bad loans, the additional demands of managing a PMMY portfolio may not fit into FIs’ long-term business strategies. Banks perceive MUDRA loans as high in risk, and low in value, requiring extremely high involvement from staff. Banks fear that MUDRA may be perceived in the same way as other government-supported credit programmes, such as Kisan Credit Card¹⁷ or education loans, where people anticipate that in the future loans will be waived. The absence of a suitable incentive structure and the inherently more risky business proposition of MUDRA loans, deter banks from opening their doors to all potential MUDRA customers. However, our study suggests that this perception may be ill-founded. Ninety two per cent of the so called “high risk” MUDRA customers pay their instalments on time and rest repay with a lag of 5–10 days. It is true that this segment lacks collateral and cannot present a guarantor, but they are already financially disciplined and used to borrowing and repaying on timely basis, albeit to informal moneylenders. Many of these genuine customers try their luck at multiple bank branches in their vicinity to get a MUDRA loan – usually unsuccessfully.

Therefore it is essential to create an enabling environment for banks to ensure success of PMMY. The following policy-level interventions can improve the overall efficiency and effectiveness of the PMMY.

Total MUDRA Loan
(INR 1329.5 billion; 100%)



¹⁶ MFIN Micrometer Report

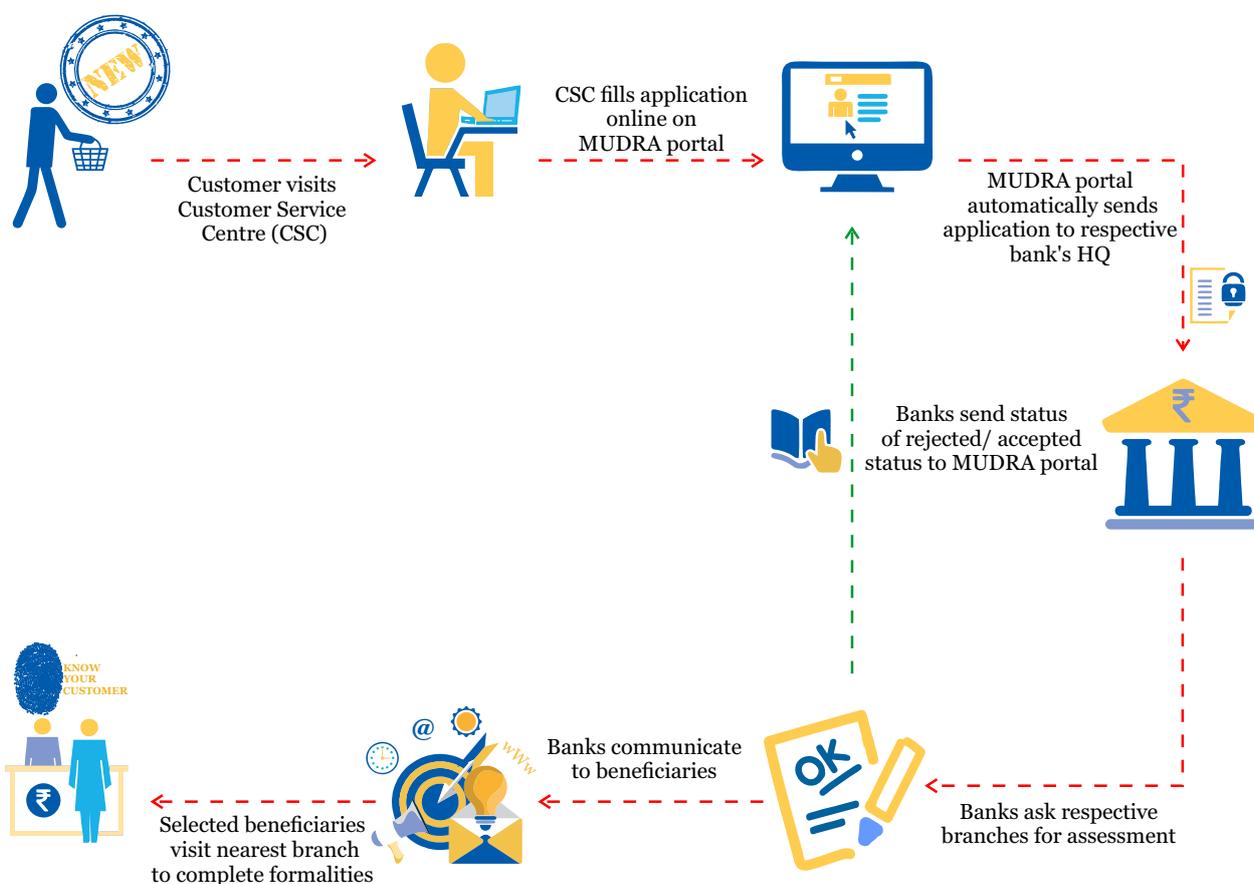
¹⁷ A Kisan Credit Card scheme was started by the Government of India, Reserve Bank of India (RBI), and National Bank for Agriculture and Rural Development (NABARD) in 1998–99 to help farmers access timely and adequate credit.

A. Permitting Higher Priority Sector Weightage

RBI should attach higher weight to MUDRA loans within priority sector guidelines (PSL) to incentivise banks. This will help to increase banks' interest in looking at this segment from a business perspective rather than just through risk prism.

B. Formulating Centralised Processing and Decentralised Service

Currently, the decision to accept a MUDRA loan application and sanction/reject it, lies solely with the bank Branch Manager. Furthermore, bank branches do not maintain a database of customers who have applied for MUDRA loans. Thus, the Branch Manager may not accept a MUDRA loan application simply to avoid the work involved and can under-report the number of customers who applied for MUDRA loan and were rejected. A centralised, digital MUDRA application process will ensure that it is accessible to all potential customers and is free from the individual biases of bank branch staff. This will also save applicants from having to put in multiple loan applications to different bank branches in his/her location. The centralised processing centre could then filter applications based on merit and then send them across to the relevant bank branch for physical verification. The figure below gives a possible flow of activities under proposed approach.



C. Integration Between CIBIL and Microfinance Specific Credit Bureaus

Credit Information Bureau (India) Limited ([CIBIL](#)) is a credit information company that holds data on those who avail credit from the Indian banking system. Similarly, [Highmark](#) and [Equifax](#) are microfinance specific credit bureaus that maintain credit-related information on microfinance borrowers. However, these credit bureaus (banks and MFI) do not interact with each other. This leads to a possible scenario where different members of a family could avail credit from different institutions, i.e. from banks and MFIs. This may lead to over-indebtedness of the enterprise, finally leading to loan defaults. Integration of these credit bureaus could help ensure that this situation does not arise.

D. Pilot Data Analytics-based Credit-Scoring Models

A credit-scoring model involving [Pradhan Mantri Jan Dhan Yojana \(PMJDY\)](#) usage statistics may be used to assess credit worthiness of potential borrowers. The segment to which PMMY caters has greatly benefited from PMJDY. While assessing potential MUDRA customers, preference should be given to customers who use their PMJDY accounts regularly. This will also help to reduce dormancy in PMJDY accounts.

E. Improved MUDRA Reporting

Banks and NBFC-MFIs should be advised to improve reporting on their MUDRA portfolio. This includes reporting (see Annexure-I and Annexure-II for examples) on number of loan applications received and rejected, number of new loans disbursed etc.

Annexure I

Category	Number of new MUDRA loans disbursed	Amount of new MUDRA loans disbursed	Number of repeat MUDRA loans disbursed	Amount of repeat MUDRA loan disbursed	Total amount of MUDRA loan disbursed
<i>Shishu</i>					
<i>Kishore</i>					
<i>Tarun</i>					
<i>Total</i>					

Annexure II

Category	Number of new applications received	Number of applications rejected
<i>Shishu</i>		
<i>Kishore</i>		
<i>Tarun</i>		
<i>Total</i>		