Policy Push for Financial Inclusion: Ladder Approach

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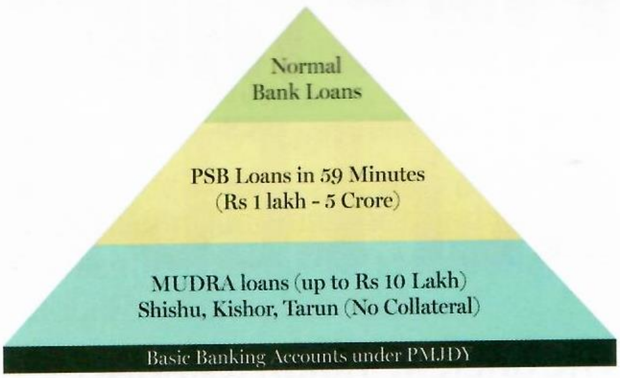
Increasing access to credit for the poor has always remained at the core of Indian planning in the fight against poverty. The assumption behind expanding outreach of financial services, mainly credit was that the welfare costs of exclusion from the banking sector, especially for rural poor are very high. Means of expanding access to credit, however, evolved over five decades broadly following the pattern in the macroeconomic policy. Broadly, three stages emerge in the role of the financial sector in expanding access to credit. The first phase from 1950 to mid-1960s relied on the existing credit structure consisting mainly of cooperative banks in rural areas and private commercial banks in semi-urban and urban areas to meet the credit requirements of the rural sector, primarily agriculture. The second phase in the financial sector starting from the nationalisation of private commercial banks in 1969 lasted up to the early 1990s and can be considered as the most important phase inasmuch as it not only resulted in a drastically new paradigm but also created specialised institutions for rural credit. Under this approach, India was home to one of the largest policy interventions to expand access to credit for rural poor through institutional agencies. However, the supply-side response led to institutional weaknesses through high loan delinquency; though there was a phenomenal jump in credit to the priority sector and expansion of bank branches in rural areas (average population per bank branch fell ten-fold from about 140 thousand to 14000). In this backdrop, third phase coincided with the financial sector reforms of 1991. Under this phase, the focus was on rationalisation of branch network, closure of many unprofitable branches, broadening the ambit of priority sector (an indirect way of phasing out), elimination of interest rate caps and revamp of banks mainly via recapitalisation and greater autonomy. This reorientation of the banking sector coincided with the growth of microfinance as an alternative credit delivery mechanism for the poor and the focus of poverty lending shifted through microfinance.

By 2014, despite so many initiatives, the objective of financial inclusion remained elusive. FINDEX 2014 of the World Bank noted that only 53 per cent of adults in the country had a bank account and only 8 per cent had borrowed money from a financial institution in the previous year. The paucity of credit to small enterprises and regional skews were other issues that plagued the financial inclusion landscape. Since then, the Government has taken up financial inclusion in a mission mode and built up a basic platform of universal bank account through Pradhan Mantri Jan Dhan Yojana and a credit ladder on top of it. Under this approach, clients get into the formal financial system through opening of bank accounts-with 32 crore accounts opened under PMJDY. Once he/she has developed savings and banking habits and needs credit to either expand business or start a business, the facility of collateral-free loans up to 10 lakh under Mudra Yojana (PMMY) is available. There are three variants of MUDRA loan – Shishu (up to Rs. 50,000), Kishore (50,000 – 5 lakh) and Tarun (5 lakh-10 lakh). In the Financial year 2018-19, loans of Rs. 3,118 billion were disbursed under MUDRA. For middle-scale business credit requirements, the client can go through the recently launched PSB loans in 59 minutes portal- a true fintech lender that integrates GST returns, bank statements and financial statements to give an algorithm based credit eligibility. Support in preparation of business plans and other capacity building interventions are available through the Udaymi Mitra portal of SIDBI. The last stage is higher loans from banks under the normal route.

In design, the pyramid looks to have solved the credit journey of an entrepreneur but there are few critical issues pertaining to the middle tier. While bank accounts have now become universal and PMMY loans are easier to get, the middle segment of Rs.10 lakh onwards in its present form is not suitable for unincorporated enterprises. PSB loans in 59 minutes are tailored for formal enterprises as it requires GST registration and this excludes the majority at present. However, there is no denying the fact that rails for credit have been laid on the lines of JAM trinity and its results will be seen in years to come with the greater formalization of the economy.



The expected increase in credit flow to Micro and Small Enterprises with this ladder approach is critical on account of its contribution to employment and inclusive growth. As per the 2017-18 annual report of the Ministry of MSME, there are 63.39 million MSMEs in India providing 110 million jobs and contribute 30 per cent to the national GDP. The fact that the MSME space is overwhelmingly dominated by micro and small enterprise provides it with the ability to foster broad-based inclusive growth by creating enterprises and jobs at the local level (51 per cent of MSMEs in India are in rural areas) and thereby be an antidote to the problem of jobless growth in the corporate sector. Despite their contribution to the national economy and inclusive growth, the share of micro and small enterprises in total industrial credit by banks remains low at 13 per cent as of March 2019 and is stagnant over the years.