



Analysing Microenterprises Financed by Public Sector Banks (with SHG Linkages), SFBs and MFIs



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Director's Message



Micro, Small, and Medium Enterprises (MSMEs) have been monumental in accelerating the growth of the Indian economy. As many as 63.4 million units of MSMEs contribute 33% of the country's GDP and generate over 120 million jobs across regions in the country. The sector enables inclusion of generally neglected entrepreneurs e.g. women and marginal entrepreneurs in addition to empowerment and wealth creation at the grass root level. However, despite being an instrumental component in the wheels of economic growth and nation-building, MSMEs have been restrained by too many challenges that hinder their true potential. Also, the sector has been one of the worst affected sectors by the COVID-19 pandemic. Access to credit has been one of the key concerns, especially for the micro segment.

The Government of India has been proactive in encouraging MSMEs and ensuring that large number of them benefit from various enablers. It has come up with measures that address structural issues like changes in the definition of MSMEs apart from schemes targeted at providing credit and financial assistances, skill development training, infrastructure development, marketing assistance, etc. There is no ambiguity that the government has stepped up the efforts towards greater credit flow to MSMEs in general and microenterprises in particular. Despite these efforts, the shortage of capital, particularly working capital, still remains a challenge for the micro enterprises.

The current study "Analysing Microenterprises Financed by Public Sector Banks (with SHG Linkages), SFBs and MFIs" provides an assessment of the microenterprise sector financing in India. It analyses the demand for and the flow of credit into the sector and the consequent credit gap. It further examines the impact of COVID-19 pandemic crisis on microenterprises and support received from the financing institutions to recover from the crisis. It also explores the experiences of micro entrepreneurs in terms of marketing and on-boarding digital platforms.

The study has been conducted in 8 districts in 4 states of India. They are Varanasi and Gorakhpur in Uttar Pradesh, Chandrapur and Kolhapur in Maharashtra, Belagavi and Dakshin Kannada in Karnataka and Tiruvallur and Tiruvannamalai in Tamil Nadu. PSBs, MFIs and SFBs with well-diversified portfolio and having an exposure in the microenterprise segment have been included in the study. The study has covered a sample of 144 microenterprises clients of 48 branches of PSBs, MFIs and SFBs.

The study has been conducted by Centre for Research on Financial Inclusion and Microfinance (CRFIM) at BIRD, Lucknow. I congratulate them as also thank all the stakeholders and agencies for their responses and essential inputs for the study.

I sincerely hope that the findings and recommendations of this study will be useful for the policy makers, development practitioners and other stakeholders of the sector.

S N Mallick
Director



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Anukampa Jha
CRFIM In-charge

Executive Summary



The Micro, Small and Medium Enterprise (MSME) sector is crucial to India's economy. There are 633.88 lakh enterprises in various industries, employing close to 11.10 crore people. Of these, nearly 20.37% are women-led enterprises, and close to 51.25 % are based in rural areas. In all, the MSME sector accounts for 30 percent of India's GDP and 49.8% of exports. Micro sector with 630.52 lakh estimated enterprises accounts for more than 99% of total estimated number of MSMEs and employs 1076.19 lakh persons which is about 97% of total employment in the sector.

Lack of adequate and timely access to finance continues to remain the biggest challenge for the sector and has constrained its growth. The problem is more persistent for microenterprises. The financing needs of the sector depend on the size of operation, industry, customer segment, and the stage of development. Financial institutions have limited their exposure to the sector because of small ticket size of loans, higher cost of servicing the segment, and limited ability of MSMEs to provide immovable collateral.

The present study seeks to elucidate the role played by the sample Public Sector Banks (PSBs), Microfinance institutions (MFIs) and Small Finance Banks (SFBs) in serving the credit needs of the sample microenterprises. It includes survey of 144 microenterprises which have received credit from a total of 48 branches of PSBs, MFIs and SFBs, located in eight districts in four states in India viz. - Uttar Pradesh, Tamil Nadu, Karnataka and Maharashtra. It highlights the key characteristics of the microenterprise sector and assesses the demand for, and the flow of credit into the sector. The study also evaluates the consequent gap in the financing needs of microenterprises. It further examines the impact of COVID-19 pandemic crisis on microenterprises and support received from the financing institutions to recover from the crisis. It also explores the experiences of micro-entrepreneur clients in terms of marketing and on-boarding in digital platforms. Some of the key findings of the study are given below.

1. Key findings on Microenterprises

General Profile of Borrowers

The average age of sample clients is 39.3 years and a noteworthy number of 82 (57%) clients have studied up to 10th standard, suggesting that the clients comprise of adult population and have sound financial literacy, necessary to make important financial decisions regarding borrowing, investing and saving. Lending to the sample microenterprises is done mostly in the group based model (JLG/SHG) to women by their lending institutions - MFIs, SFBs and PSBs. A total of 95 (66%) clients belong to OBC social category, followed by 24 (17%) General category clients, 21 (15%) SC clients and 4 (3%) ST clients. This suggest that the needs of the vulnerable segments of the society like women, OBC, SC and ST are well addressed by the sample lending agencies. Microcredit received by the sample microenterprises has been majorly used by the enterprises for fulfilling working capital requirement as 112 (78%) microenterprises have utilized the loan for buying raw material and 63 (44%) microenterprises have used for buying tools/equipment.

Flow of Finance to the Microenterprises

The total supply of finance from all 3 sample formal funding agencies was ₹66.12 lakh. The sample microenterprises received a total amount of ₹24.85 lakh from MFIs, which is 37.5% of the overall debt supply. SFBs provided ₹24.12 lakh as credit, which is 36.5% of the total debt amount. PSBs with SHG linkages supplied ₹17.14 lakh as loan to microenterprises, which is 25.9% of the total credit supply. Among the three sample lending institutions, MFIs constituted the largest micro-lenders in the microfinance



segment followed by SFBs and bank-linked SHGs. The data supports some of the inherent strengths of MFIs such as - operational flexibility, limited geographical area of operation, greater acceptability amongst the poor and better understanding of the issues specific to the poor.

Quick loan, lesser documentation work, collateral free loan and flexible repayment schedules are some of the key factors due to which 74 (51.4%) respondents preferred taking loan from MFIs while 68 (47.2%) respondents preferred SFBs over other formal and informal sources. 57 (39.6%) respondents preferred PSBs for SHG loan over other financing sources due to lower interest rate and collateral free loan.

Credit Gap for Microenterprises

Most of the sample microenterprises are underserved by the formal funding institutions. The total credit demand of 144 microenterprises at the time of availing loan was ₹103.02 lakh while the overall supply of finance from formal sources was ₹66.12 lakh. Therefore, the overall addressable credit gap in the sample microenterprises is assessed to be ₹36.90 lakh. The entire demand of funds required by a microenterprises is not usually fulfilled by one lending agency and the enterprise has to depend on multiple sources of funding i.e., MFIs, SFBs, PSBs, personal savings, friends or family members and private moneylenders.

A number of reasons can be attributed to the aforementioned credit gap, such as unreasonably high demand for loan which may not fit into the loan product range of sample MFIs, SFBs and PSBs and not meeting the eligibility criteria. In case of credit demand of SHGs, loan can only be sanctioned by PSBs in phase wise manner varying from a saving to loan ratio of 1:1 to 1:10, thus limiting the amount that can be sanctioned to a group and ultimately to SHG member.

Challenges Faced in Accessing Credit

Some of the key challenges faced in accessing credit by the microenterprises from institutional sources are - high rates of lending, lengthy processing time, lack of knowledge about available schemes, high service fees, lengthy documentation work, and procedural complications. Among the aforementioned issues, high interest rate and high service charge are more pronounced among the clients of MFIs and SFBs. While issues of inadequate loan, lengthy processing time, lack of knowledge about available schemes and lengthy documentation work are more pronounced among SHG clients of PSBs.

Observations on Microenterprises

Multiple Lending: Many of the members of MFIs, SFBs and SHGs held multiple membership with other lending agencies owing to inadequate loan from one single source of funding agency and availability of alternative credit delivery mechanism available at their doorstep.

Access to Credit: Greater and more frequent access to credit enjoyed by the MFI and SFB clients than that of SHG members which can be attributed to inadequacies in the delivery process in SHG case. While MFIs and SFBs has been able to maintain the sanctity of the delivery process, PSBs, for various reasons have not been able to maintain so leading to poor performance in terms of access and outreach.

Cost of Credit: Current study shows that the poor women continue to borrow from MFIs and SFBs at a higher rate of interest when cheaper loans are available from PSBs and the reason cited in response was that the PSBs were not as accessible as MFIs and SFBs. One had to go to the bank branch for everything while field officials of MFIs and SFBs visited their group weekly/biweekly. However they also said that if PSBs became more accessible as these institutions than they would prefer PSBs over them.

2. Key Findings on Financing Institutions

Loan Portfolio

Among the three sample funding agencies, the SFBs are assessed to have more outreach than the MFIs and PSBs as marked by its number of loan outstanding which is 12,257 in case of SFB. In comparison to this, it is 4,737 in MFIs and 1,463 in case of PSBs. Average outstanding amount of sample MFIs, SFBs and PSBs are ₹5.47 crore, ₹73.16 crore and ₹40.10 crore, respectively.

Loan Product Details

The rate of interest charged by SFBs (up to 25.24% p.a.) was higher than for MFIs (up to 24% p.a.) and PSBs (up to 12% p.a.), given the higher operation and funding costs as well as higher risk involved in lending to clients. Further, there is a wide variation in the interest rates charged from micro borrowers among all the three lending agencies which majorly depends on the type of loan product (secured/unsecured), loan amount, and mode of financing (individual/group).

Repayment period by individual members is shorter for MFIs and SFBs of up to 3 years which can be attributed to shorter loan size. In case of PSBs, the repayment period at group level is up to 7 years. Repayment frequency is weekly to monthly in MFIs and SFBs whereas it is monthly to quarterly at group level whereas monthly at individual level in case of SHG loan given by PSBs. Sample PSBs take longer loan processing time (7-30 days) as compared to MFIs (3-10 days) and SFBs (2-10 days) mainly due to long delays in application processes as compared to other two agencies.

Client and Loan Appraisal

In MFIs and SFBs, Credit Officers/Branch Manager identify the potential clients and assess their loan requirements. The loan requirement is assessed based on their sources of livelihood, household income, end use of the loan, investment and returns in the business, nature and scale of the business and cash flows to be generated from the business activity. Based on these parameters, quantum of loan for each members is decided. In case of PSBs, SHGs with satisfactory transactions in their SB account for at least a minimum period of six months are eligible for first phase of credit linkage subject to fulfilling grading norms. The quantum of credit given to the group is in proportion of savings/corpus fund to the loan which varies from 1:1 to 1:6 of the corpus fund in first dose, 1:1 to 1:8 of the fund in second dose, and 1:10 of the corpus fund in the third and subsequent dose, subjected to the assessment of SHG.

Challenges involved in Lending to Microenterprises

Key challenges involved in lending to microenterprises as reported by MFIs, SFBs and PSBs are – risk in lending, documentation, recovery, high operational cost, and multiple lending

Observations on Financing Institutions

Rate of Interest on Credit: The seemingly high interest rates charged by MFIs and SFBs on lending to poor people is seen as a major concern of all their clients. Few risk linked with higher interest rate, are - excessive financial burden on borrowers which may have negative impact on borrower's wellbeing and over-indebtedness among borrowers

Customer Outreach: MFIs and SFBs have greater outreach than PSBs as the number of customers served by MFIs and SFBs are much higher than that of the PSBs. All MFIs and SFBs are taking their business seriously while PSBs, on the other hand, view microfinance as a small part of their portfolio and the staff does not specialize in it.



Customer Relationship Management: The Credit Officers/Branch Managers of MFIs and SFBs regularly keep in touch with the groups which helps develop a bond and mutual understanding between them. However, such relationship is found to be missing in case of PSBs and its impact is visible in terms of poor outreach of PSBs.

Transparency in Banking: MFIs and SFBs maintains transparency in interest charges as well as other terms and conditions. All of their clients hold a loan passbook and through this they know - principal, rate of interest, amount and periodicity of repayment instalments and total interest a client has to pay. However, such “financial literacy” is missing in case of PSBs’ SHG clients. Bank pass books do not indicate all the loan terms clearly and it was observed that many client did not even possess loan pass book at individual level.

Policy and Regulatory Responses to COVID-19

In response to the COVID-19 pandemic, GoI introduced a wide range of emergency policy measures to help affected MSMEs, such as - credit guarantee schemes, loan restructuring measures, moratorium, etc. To help the small borrowers, sample MFIs, SFBs and PSBs offered relief measures to their clients through providing top up loan to eligible borrowers, PM SVANidhi loan, loan restructuring and loan moratorium and some credit plus services.

Microenterprises and COVID-19

COVID-19 posed unprecedented impact on microenterprises. 83 (57.6%) micro-entrepreneurs responded that their business was severely impacted by the pandemic due to several factors such as - supply chain, disruption, decrease in demand, financial shortages, reduction in sales and profit, among others. Out of 144 respondents, 100 (70%) of the micro-entrepreneurs expressed that they lost working days of about 6 to 12 months due to COVID-19 pandemic. 97 (67.4%) of the micro-entrepreneurs stated that their revenue from business had decreased between 50% to 100% due to the pandemic. However, the respondents also claimed that they got some relief from pandemic by various government actions such as - distribution of free ration, monetary help to poor women having PMJDY account, increase in wages under MGNREGA, etc. Other efforts such as - loan moratorium, COVID special loan, PM SVANidhi loan, etc. also helped micro-entrepreneurs to some extent to cope up with the crisis.

Microenterprises – Marketing Challenges and Strategies

Sample microenterprises relied on traditional method of personal selling, sales outsourcing, and wholesalers. Majority of them i.e., 122 (84.7%) microenterprises rely on traditional practices of personal selling. key challenges faced by the microenterprises that constrains them from reaching their potential and increasing their sales are - scale of business, competition, lack of knowledge of marketing, lack of standardization, lack of quality control, etc. To mitigate these challenges the sample micro-entrepreneurs seek support from government organizations, NGOs, SHPIs, etc. to increase their profitability and growth rates via various channels, including - access to credit, business training, access to market, innovative sales channels and digital on boarding.

Recommendations

Enhance Field Level Operation: Branch of MFIs/SFBs has dedicated team to reach out to their clients and meet them regularly. However such arrangement is lacking in case of PSBs. For taking SHG movement forward and to perform at par with MFIs and SFBs, the bank should increase their network on field to maximize their outreach to clients.

Exclusive Microfinance Bank Branches: Rural branches of PSBs should have dedicated 'Microfinance Branches' as sub points with bank branch as main point of lending with dedicated 'Microfinance Staff' recruited for these branches only. These should leverage services of BC/BF and use digital technologies for disbursements and collections. The dedicated Microfinance Branch network with dedicated staff will help increase the outreach as well as the depth of microfinance services.

Capacity building and Training of Bank Staff: Bank and other allied staff should be motivated to internalize and own the SHGs linkage project. Suitable awareness/sensitization programmes should be conducted for them to motivate them to increase the outreach of microfinance as well as the depth of microfinance services.

Rapid Processing of Loan Sanction: PSBs should speed up their loan sanctioning process and avoid delay in sanctioning of loan.

Bank Branches as Wholesalers: Bank branches may finance local NGO which can then on lend to SHGs. Such an arrangement is already permitted under RBI/NABARD/SIDBI guidelines but has not been adopted by many NGOs. Well performing NGOs should be encouraged to take up such activities.

Faster and Convenient Approvals under CGFMU scheme: There is a need of formation of fast track committee for faster approval of loans under CGFMU scheme so as to accelerate the process of imparting loan to SHGs.

Reduce Interest Rate in MFIs/SFBs: Measures should be taken to lessen the interest rate on loan amount and reduce burden of poor borrowers. MFIs and SFBs should try to increase their client outreach. Competition among lending agencies is also believed to promote allocative and productive efficiency, which leads to lower costs of microcredit.

Develop More Competitive Markets in Microfinance: Competition among microfinance players lowers interest rates which would reduce the financial burden on borrowers. Policymakers may consider enhancing the means for more competitive markets in microfinance, such as reducing the barriers to entry and prohibiting exploitative practices.

Government Support to Help Microenterprise to Counter COVID-19 Impact: Government may take measures such as - reduce tariffs on facilities such as electricity, water, etc., interest subvention on the working capital, offering subsidies to entrepreneurs, a different tax slab for microenterprises under special circumstances, freezing loan accounts in such extreme conditions/ crisis for a period of few months so that the accounts are not declared as NPAs, funding institution that can train entrepreneurs, improving infrastructural facilities, etc.

Enhance Marketing Strategies for Microenterprises: Government should take concrete steps to create awareness about available schemes on marketing support among entrepreneurs. They should reach out to entrepreneurs using social media, public campaigns, government organizations, NGOs, banks, MFIs, etc. Various awareness programmes, awareness camps, street plays, showing film slides, T.V interviews, seminars, workshops, etc. should also be conducted to spread awareness about government schemes among entrepreneurs.