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Just what the microfinance sector needed

Mudra Bank can provide some cohesion and impetus to this fragmented space, besides the right kind of regulation

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The Budget speech announcing the Mudra Bank took everyone by surprise. It was cryptically mentioned that the Mudra Bank would fund the MFIs through a Pradhan Mantri Mudra Yojana and accord priority to SC/ST enterprises. This seemed intriguing as MFIs in India have a well-established channel for debt funds from commercial banks.

However, one could still reason that this follows in the long tradition of establishing separate all-India banks for specific sectors on the lines of Nabard and Sidbi.

In March, a government press release expanded the scope of the Mudra Bank. The release said the bank will cover SHG-Bank Linkage Programme (SBLP) as well as MFIs organised as NBFCs and NGOs.

Significantly, it added other critical aspects to its work area — regulation, accreditation/rating, laying down responsible finance practices, technology solutions and credit guarantee scheme.

Various reports as well as the subsequent press release of March 31, have reiterated these points with the addition that it will get its refinancing corpus of ₹20,000 crore from the priority sector shortfall and credit guarantee corpus of ₹3,000 crore through budgetary support.

Recent press reports suggest that the government is considering clubbing the MFI Bill and the Mudra Bank Bill. Mudra Bank will undertake regulation and refinancing of all types of microfinance and have other related functions such as promoting responsible finance.

Unfounded concerns

The rationale of establishing the bank has been questioned by stakeholders on various grounds. These are: the relevance and need for a funding agency when banks are already doing the job; clubbing regulation with financing which leads to conflict of interest; and funding Mudra through priority sector shortfall depriving the agriculture sector, as currently the major part of shortfall goes for Rural Infrastructure Development Fund (RIDF) maintained by Nabard. Much of the critique does not stand the test of logic.

Yes, commercial banks are doing a great job of funding MFIs and constitute nearly 80 per cent of the sector's loan outstanding of about ₹32,000 crore.

However, two key aspects are ignored in this argument. First, the sourcing of funds from banks depends on their current perception of the sector. Mudra being the apex funding agency for microfinance will have its entire focus on the sector and not have the liberty to start funding other sectors at the slightest hint of any perceived risk. The combined outreach of the microfinance sector is about 75 million clients and it is well argued to have an apex bank, which provides undivided attention.

Second, banks in recent years have kept away from NGO-MFIs making them contract their operations. It is hoped that Mudra Bank will correct this anomaly and if the legal form of NGOs is not the right one for financial intermediation, provide a framework for their graduation to NBFCs.

Only good intentions

Equally weak is the argument about conflict of interest. Considering the reluctance of the RBI to regulate NGO-MFIs and limit its regulatory oversight to NBFC-MFIs, the sector is witnessing a situation where legal form — and not business activity — determines regulation.

Nabard and Sidbi are not willing to take up the regulatory role. Even in the case of NBFC-MFIs, the RBI has started relying on self-regulating organisations (SROs) to discharge part of its regulatory functions.

Shows the way Mudra Bank can offer clear direction to the microfinance sector HOMESTUDIO/SHUTTERSTOCK.COM

The possible alternatives suggested in the past for regulating the sector such as Nabard also face the same challenge and the current concept of SRO is acutely riddled with conflict of interest; its membership and funding comes from member MFIs.

Mudra Bank will be an independent institution and it can adopt clearly defined boundaries between regulatory and refinancing functions.

The charge of conflict of interest seems to stem more from protecting the turf. The bank, by bringing all forms of microfinance, will correct the long-standing demand of correlating regulation with business activity rather than legal form.

If this happens, it will also obviate the need for an MF Bill. It is heartening to note that Mudra Bank will also evolve rating norms for MFIs as also principles of responsible finance. By doing so, it will fill another critical void in the sector.

The rating of MFIs in India has been left to mainstream rating agencies with a focus on financials, and does not reflect international best practices.

Specialised microfinance rating agencies work on a globally accepted rating framework which accords due importance to field verification, client protection issues and other aspects of responsible finance, such as poverty outreach and staff welfare.

Freedom to fund

On funding, it is a positive thing that Mudra will not rely on budgetary support. The RIDF corpus has been around ₹20,000 crore annually and it forms a mere 1 per cent of the total annual target of priority sector credit.

The contribution to Mudra Bank will also be around 1 per cent of the priority sector lending and it need not come at the expense of the RIDF but can be supported through other shortfalls, or in other words, banks can now finance MFIs not individually but by routing their support through Mudra Bank. Over the years, it should be able to leverage its equity and borrow funds from market.

Overall, the setting up of Mudra Bank seems to be the right step and will unify the sector under a single body leading to stability and growth. However, to be effective it needs to avoid certain critical aspects.

First, it should not equate responsible finance with subsidised credit and should consolidate the market-based efficiencies demonstrated by the MFIs. Secondly, it should avoid channel bias and provide support based on merit/rating to either SBLP or MFIs.

Finally, the staffing of Mudra should not be exclusively from government banks; it should use private and microfinance sector expertise to instil global practices in Indian microfinance.

The writer is the CEO of M-CRIL, a microfinance rating agency. The views are personal