Policy Paper on Promoting Own Account Enterprises (OAEs)

Initiated by
Foundation for MSME Clusters (FMC)

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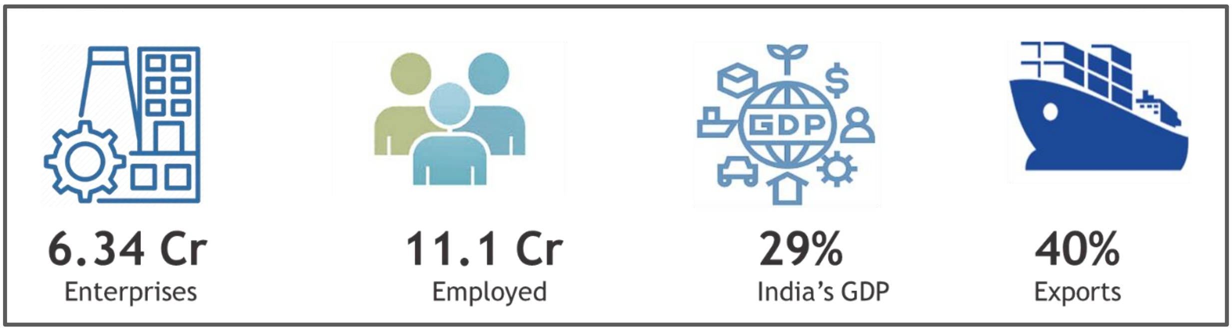
I. Backdrop

Micro, Small and Medium Enterprise (MSME) sector is a key player in generating employment and contributing to the India's GDP and industrial output. There are 6.34 Crore enterprises in various industries, employing close to 11.1 Crore people.[1] In all, the MSME sector accounts for 29 percent of India's GDP and 40 percent of exports.

MSMEs' contribution to India economy



Source: Annual Report 2019-20, Ministry of MSME

Profile of MSMEs:

- In terms of location, 51% in rural areas and 49% in urban areas
- In terms of sector, 36% are in trading, 33% in services, and 31% in manufacturing
- In terms of size, 99.47% are micro, 0.52% are small and 0.01% are medium
- In terms of ownership, 84% are owned account enterprises (OAE) and 16% are establishments (one or more hired workers). The average number of employees per OAE was 1.3 and for establishment was 4.2
- In terms of their form, 96% are proprietorship based (76.4%-male, 19.6%-female), 2% partnerships, and 1.8% SHGs and rest 0.2% are others (like trust etc.)
- In terms of status of registration, 69% are unregistered, and 31% are registered[2]. Non registration attracts multiple sources of exploitation such as paying bribe to local administration, police and politicians etc.
- In terms of financing, 78.2% are self-financed, 9.7% from formal sources (government, FIs, SHG) and remaining 12.1% from informal sources[3].
- Thus, the definition of MSMEs covers a huge population of 63.05 million enterprises in one category (micro including OAEs). OAEs do not bank and are mostly dependent on NBFCs and MFIs for loaning purposes.
- Also, OAEs only has access to term loan type arrangement with NBFCs. This is also a time consuming and costly procedure of follow up.

[1] This is as per the National Sample Survey (NSS) 73rd round for conducted between Jul'16 to Jun'15 and published in June 2017 unincorporated non-agriculture MSMEs in the country

[2] Registered under various industry specific agencies or authorities like State Directorate of Industries, KVIC, DC-Handicraft/ handlooms, various commodity Boards, DGFT, Pollution Control Board, EPF Organization, Sale Tax etc.

[3] As per the 6th Economic Census

- OAE are characterized by lack of financial documents, lack of basic education, lack of collateral and are perceived by lenders as high risk-high cost type of accounts.

To enhance the flow of credit to Micro, Small and Medium enterprises (MSMEs), in April 2015, the Government of India launched the Pradhan Mantri Mudra Yojana (PMMY) scheme for giving non-farm income-generating loans up to Rs10 lakh by existing government and private sector banks, and other financial institutions. PMMY offers unsecured loans for MSMEs requiring credit for investments in existing businesses, as well as for new start-ups. By March 2020, over 24.48 crore loans had been given, worth Rs 12.30 lakh crore[i].

However, as these micro enterprises evolve and grow it needs to meet its continuous working capital requirements depending on the business cashflow patterns. Hence a onetime credit transfer is deemed as inadequate for enterprise growth, though it can provide a very short-term liquidity support. A continuous line of credit will be more suitable to match cashflow requirements of micro enterprises.

PMMY loans needs to be more business oriented product. If the loan is repaid, the unit will not have working capital. These loans should have been offered as cash credit overdraft limits. That would also have reduced the interest burden on the borrowers. The average loan size of only Rs 27,143 till March 2019 under Shishu. Of this Rs 27,000 loan, the micro- entrepreneur will normally invest a large part, at least Rs 20,000 in working capital and remaining Investment in fixed assets, if any.

Now, with a PMMY loan, this micro enterprise has to make a periodic (monthly or quarterly) payment of a principal instalment and interest. For a loan of Rs 27,000 repayable monthly over 36 months, that could be as much as Rs 1000 per month. Vast majority of PMMY loans go into trading activities, wherein the gross income is estimated to be at Rs 16,200 in the year. The net income from the microenterprise is less than Rs 1400 per month, which means the monthly instalment is nearly 75 per cent of the incremental income, leaving behind less than Rs 400 per month, to meet household needs. If in some months due to contingencies such as illness in the family, the micro-entrepreneur draws out more money, she will end up skipping an instalment.

As happens, there is an adverse event like illness in the family, or a theft in the shop, or a client does not repay goods/services rendered on credit, there is no cushion to maintain the instalment repayment and this leads to the loan becoming a non-performing asset. Thus, micro-analysis shows why PMMY loans can give temporary relief to a business enterprise for the first one or two years in its current form.

1. **Reduce the moral hazard of providing upfront cash disbursements** - Cash disbursements as well as cash-outs must be discouraged and the entire ecosystem can be brought under the digital banking and digital payments fold to improve transparency and data visibility on the transactions undertaken by the borrowers. Credit must be utilized to support only business activities to increase the income and hence borrowers must be encouraged to use the facility to directly and digitally make business payments through an underlying line of credit account. Incentives in the form of interest waivers and higher limit amount can be employed to reward the disciplined borrowers who make repayments on time.

2. **Digitising for efficiency**– In order to improve the efficiency, the entire process of credit delivery for OAEs, needs to move away from physical paper-based origination to a complete digital model. The disbursements and repayments should be digitally emphasized. Also, apart from payments, complete on-boarding till disbursement need to be digitised to discourage any biases and misrepresentations. Underwriting decision must be arrived on the basis of digital KYC, SMS

analysis, Bank statement Analysis, mobile bill payments, water bill payments, GST analysis and bureau analysis for the applicants.

3. **Improve transparency and data visibility -** Increase transparency and create new dynamic data for the end use of funds and counterparties which can be used for policy formulation as well as continuous improvement of scheme – A separate supplier data aggregator platform can be created for micro enterprises wherein the entrepreneurs availing credit can be brought under one digital ecosystem and trade between buyer and supplier can be facilitated as well as monitored. This will help to monitor the transaction as well as bring NPA under control.

II. NAMAN Bharat - Neo Atamnirbhar Scheme for Micro and New Enterprises in Bharat

NAMAN Bharat (Neo Atamnirbhar Scheme for Micro and New Enterprises) is proposed as a comprehensive app based digital product through which member lending institutions can offer a digital line of credit to existing and new micro enterprises. Borrowers will be able to do digital repayment through the app. The lending can be done by MFIs/NBFCs. NAMAN Bharat can remediate the current set of issues and also improve the performance of MUDRA 1.0 for all the stakeholders. Some of the salient features of this proposed new scheme is described below:

1. **What is NAMAN and how will it work?**

NAMAN Bharat is (a Scheme Proposed by us) to support member lending institutions to extend an App based line of credit to existing and new micro enterprises in a completely digital manner. Beneficiaries will be onboarded through NAMAN App and basis their application and credit assessment a suitable credit limit will be sanctioned. To start with this will be given to app savvy borrowers and the same will be popularised along with training given by the proposed Apex organization for OAEs for providing Entrepreneurship / skill development support, as detailed below in the section of “Other Recommendations”.

Approved borrowers can digitally avail the credit limit and make real time digital payments directly into the bank account of intended suppliers and workers through IMPS, UPI or any other digital payment mode. This new way of providing credit to MSMEs will be controlled through instruction-based disbursement feature directly in the account of intended beneficiary (supplier, workers etc.) to meet the working capital requirements.

It is desirable that instead of pushing Public Sector Banks to lend to micro enterprises and being perceived as Government Money by the borrowers, it is delivered through private sector (MFIs/NBFCs/Pvt Sector Banks etc), as public sector lending is many a times considered as not repayable. However, PSBs may be encouraged to offer this scheme without having a target-oriented approach and providing loans in an objective manner with complete prudence.

i) <u>NIJI-DIGI vyapar (non collateral Credit Limit)</u>

(Niji meaning own, represents the targeted user segment - OAEs and Digi represents the digital nature of the product and the process)

A revolving line of credit to which cash or credit can be withdrawn and re-deposited as needed, with maximum limit sanctioned per MSME as per the four tiers as follows

Shishu - Rs. 10,000 to 50,000
Kishore - Rs. 25,000 to 1,00,000
Tarun - Rs. 1,00,000 to 2,00,000
Yuva - Rs. 2,00,000 to 5,00,000

This has to be from a Micro Finance Institutions (MFIs) / Non Banking Financial Companies (NBFCs) / Pvt sector Bank , direct or Banking Correspondents (BC).

The credit assessment variables and data requirements across these tiers may vary as per the defined credit policies of the Member Lending Institutions (MLIs).

ii) <u>NIJI-DIGI pariyojna (non collateral Term Loan)</u>

A long duration term loan per MSME, repayable in 24/36/48 Equated Monthly Instalments (EMIs), with a moratorium of principal for three/six/twelve months. During the moratorium period interest would be payable monthly on the full amount drawn. Can be from a private Bank direct, Banking Correspondents (BC) or an Non Banking Financial Companies - Micro Finance Institutions (NFBC-MFI). Co-lending with Non Banking Financial Companies (NBFC) / Self HelpGroup Federation (SHG federations) may also be explored, to bring in more resources from private sector.

Shishu - Rs. 50,000 to 1,25,000
Kishore - Rs.1,25,000 to 5,00,000
Tarun - Rs. 5,00,000 to 10,00,000
Yuva - Rs. 10,00,000 to 25,00,000

iii) **<u>NIJI- DIGI Nishchint</u> (Insurance - means risks have been covered)**

There is a third component which is not financing but insurance for Shishu and Kishore borrowers only. NIJI- DIGI will come with a separate but co-offered comprehensive insurance policy called NIJI- DIGI **Nishchint**. This will be from an Insurance Co under the IRDA Micro Insurance guidelines. **Nishchint** will cover:

- Lives of the MSME owner (for Shishu and Kishore borrowers) and her/his spouse, with a cover of Rs 100,000 to Rs 500,000 per person. This will be a term life insurance renewable annually. The premium cost could be loaded in credit limit and term loan component.
- Health cover for MSME owner and his/her household (for Shishu and Kishore per person in the household per annum on a family floater basis. The premium cost could be loaded in credit limit and term loan component.
- Assets of the MSME and his/her owner household (for Shishu and Kishore borrowers) worth from Rs 10,000 to Rs 300,000, covered against multiple perils such as fire, flood, earthquake, theft, riots, etc. The premium cost could be loaded in credit limit and term loan component.

2. **Process**

<u>Customer Education and Buy-In</u> – will be done digitally using videos and podcasts/jingles by Banks, MFIs, NGOs, SHGs linked to government development agencies like the SRLM. MUDRA may consider developing a Mobile based APP to provide information to prospective and existing borrowers on various

govt schemes, process for availing the same, advantages of digital use, credit uses and other financial literacy related aspects.

On-boarding – digital KYC, linking with existing bank account or opening a new bank a/c. onboarded through NAMAN App/

Underwriting/Appraisal– where the financing amounts will be determined involving a structured telephone conversation and data filling by a bank/MFI/BC agent. Services of research organisation using Artificial intelligence and various data bases such as Credit Vidya could be used. Government may support such institutions in building their capacities by way of grant / soft loan or both.

Disbursement/Drawdown of the term loan and the line of credit component - Approved borrowers can digitally avail the credit limit and make real time digital payments directly into the bank account of intended suppliers and workers through IMPS, UPI or any other digital payment mode. This new way of providing credit to MSMEs will be controlled through instruction-based disbursement feature directly in the account of intended beneficiary (supplier, workers etc.)

Repayment of term loan EMI and the line of credit to the extent of cash inflows – online

Enrolment for insurance – determining coverage, collecting premium, online enrolment

Claim settlement in case of any adverse events happen – digital (may involve site visit)

Monitoring of the MSME account for usage, repayment, rare delinquency/default, on-line. In most cases, monitoring will lead to additional financing and insurance business.

3. **Proposed Beneficiaries**

All registered and unregistered MSMEs including micro and small manufacturers, retailers, wholesalers, service providers as well as buyers and suppliers of MSMEs, because the intended purpose is to support the complete value chain involved in a particular transaction.

4. **How technology will further improve the efficiency and credit quality**

NAMAN will be a app based credit platform which will fetch data from various data sources including credit bureaus, mobile devices, electricity and water bill payments, KYC data, banking channels, GST, etc. depending on the data availability for a particular borrower and help to assess the credit worthiness of the borrower as well as determine the credit limit eligibility amount without any paper or human intervention.

Once a borrower is awarded a credit limit, through the NAMAN platform, lenders will be able to control the usage of funds by permitting only certain type of eligible payments and also offer incentives including providing interest discounts to maintain repayment discipline.

5. **Potential Savings due to reduction in admin costs and credit costs** –

Lenders will be able to reduce substantial cost of credit and its administration by controlling the gross NPA as well as reducing the manual and paper-based interventions.

To begin with a pilot could be tried, tested and rolled out and the based on the feedback from the pilot, it could be rolled out on the national level.

6. Benefits to various stakeholders:

i) Micro and new Enterprises

Promote entrepreneurship and contribute towards economic development of MSMEs. Availability of credit will help the micro business to become self- sustainable, generate more employment and contribute in the growth of the India economy. It will also strengthen **Make in India initiative** and improve the competitiveness of Indian MSME segment.

ii) Government

Further the goal of Financial Inclusion for micro and unregistered enterprises. This segment was hit the hardest during the Covid induced lockdowns and providing support to this large and vulnerable population will improve their confidence and also help boost the real growth in economy. Along with providing new avenues of employment this will also reduce the cash transactions and improve overall direct and indirect tax collections, thereby reducing the borrowing burden on the government.

iii) Lenders

Improve the effectiveness of credit interventions undertaken by lenders and also make the scheme self-sustainable by controlling the NPAs. It will restore the market confidence for the large public sector banks and improve their overall financial health.

III. Other Recommendations

i. National Micro Equity Fund

To encourage and promote prospective micro entrepreneurs, generate employment, first generation entrepreneurs setting up start up OAEs, must be provided with micro equity support. This could be on the lines of National Equity Fund (NEF) which was earlier being provided to MSEs by SIDBI under the NEF set up by GOI. Under NEF MSEs were provided equity support on the basis of Debt Equity Ratio of 3:1. This means that for a project cost of Rs.10 lakh, loan was Rs.7.5 lakh and Equity was Rs.2.5 lakhs. Difference between equity required for the project less amount of equity being brough in by the promoter, was provided as Equity.

It is now proposed that an interest free soft loan (with some nominal service charge) to the extent of 1/3rd of loan requirement of MSEs may be provided. On complete repayment of term loan, the same may be converted into equity/preference shares, to be held by MUDRA/SIDBI on behalf of GOI. This would be a much better way than providing capital subsidies, as conversion would depend on full repayment of term loan. This would reduce NPAs also. This will promote profit sharing also as a nominal dividend (say 6-8%) could be stipulated.

ii. Many individuals may wish to invest in micro-Equity financing as it is based on the principle that the financier must share the risk if he wants to share the profits. Unlike in a debt instrument, there is no promise of a fixed return. The product can be offered by entities registered with SEBI as Alternative Investment Funds, AIF Category I, with some changes in the extant provisions, using some of the instruments suggested in the ***Social Stock Exchange***[ii], announced by the FM in 2019. A technical committee can examine this.

iii. Data Bank

The OAEs are characterized, inter-alia, by lack of credit history, lack of data on their creditworthiness or performance. It is proposed that a National Data Bank for OAEs may be set up, where a standardized page could be maintained to keep a record of their growth and credit behavior etc. along with a unique ID for each OAE. This could be on the lines of E-Shram portal for migrant labors. This data should be available to prospective lenders. The proposed data bank may also contain details on their mobile/electricity/water bill payments etc. The data may also help in policy making for the Govt.

iv. Access to Knowledge

Technology based non-financial support are being provided to OAE entrepreneurs through udyamimitra, standupmitra and also digitalsmemitra. We propose that a mobile app may be developed by SIDBI / MUDRA. This app may contain information on various government support, financial literacy, advisory services, how to avail loan/equity, how to set up enterprise, calculating interest on loan, costing etc.

v. Apex organization for OAEs for providing Entrepreneurship / skill development support

Presently, number of organizations are providing entrepreneurship/ skill development support to prospective / existing entrepreneurs. These include EDIs, RSETIs, NISIET, NISBUD, etc. These are working under different ministries/ banks. With a view to organize their activities in a coordinated manner, all such organizations may be brough under one umbrella at MUDRA/SIDBI/NABARD.

Besides credit, promotional and developmental (P&D) support is the crying need of the unorganized sector.

There is need for a national level institution or MUDRA may be upgraded to meet all the requirements of OAEs in unorganized sector in a comprehensive manner including credit, to provide developmental support and above all to advocate policy formulation for the unorganized sector. Hence, there is a felt need for an exclusive and national level DFI which would ensure not only adequate finance by way of supplementing inadequate efforts of the existing financial institutions but also provide financial and other assistance for developmental services to the unorganized sector including hand holding/escort services to the new enterprise for at least one year.

The main objective of the apex body will be to bring about increased employment and higher incomes for people engaged in the unorganized sector by promoting and catalyzing the growth of the sector. The objective will be social as compared to profit.

MUDRA as apex institution for OAEs shall provide:

Credit assistance - (i) Refinance to banks and other financial intermediaries (ii) Micro finance support through NGOs / SHGs / MFIs as well as formal banking system (iii) Seed capital and such other start-up capital for the new entrepreneurs in the unorganized sector.

Development support - (i) Creation of unorganized sector enterprises through entrepreneurship development, vocational training and capacity building & hand holding (ii) Strengthening of unorganized sector enterprises through cluster development program, marketing support, support for raw material procurement and technology upgradation (iii) Information dissemination (iv) Policy advocacy.

Vertical upgradation of existing successful OAEs –

They need to be given exposure on leaping NEXT through short capsule MDPs or exposure trips to corporates with good practices.

Mentoring has always lacked and there is a need to have that easily accessible.

Capacity building of Fintechs – The apex organization should build capacities of fintech companies engaged in providingsupportto OAEs, by way of grant / soft loan. This will enhance / ease access to them by any OAEs.

vi. Ankur Udyam Yojna

A model scheme named as "Ankur Udyam Yojna" has been formulated to provide support setting up of start-up OAEs, trained by entrepreneurship / skill development institutes with guarantee support from NCGTC. The draft scheme is attached at **Annexure II.**

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IV. Annexure I

Policy Group for Promoting Own Account Enterprises (OAEs)

1. Prof. Santosh Mehrotra, Chairman, Policy Group for Promoting OAEs
2. Mr Ajay Shankar, Chairman, Foundation for MSME Clusters (Invitee)
3. Mr Vijay Mahajan, Secretary and CEO, Rajiv Gandhi Foundation
4. Mr Manoj Sharma, CEO, Microsave
5. Dr Tamal Sarkar, Executive Director, Foundation for MSME Clusters (Invitee)
6. Mr Surendra Srivastava, Former GM, SIDBI and CFO, MUDRA
7. Vaibhav Anand, Managing Director, Credochain
8. Mr Vikram Joshi, CERO, Rangotri

V. Annexure II

Assistance for Start up OAEs (Ankur Udhyam)

Scheme	**Ankur Udhyam**
Brief details of the product	This scheme involves providing need based composite assistance (term loan/working capital) by Banks / NBFCs / MFIs to first generation entreprenurs, under NCGTC guarantee cover.
Eligible borrowers	Micro Enterprises, eligible under PMMY, being set up by entrepreneurs who are setting up their first enterprise.
Purpose of assistance	Need based composite loan to micro enterprises for acquiring capital assets and their working capital / marketing related requirements.
Terms of assistance	
Amount of assistance	Need based, up to Rs. 5 lakh.
Promoters Contribution	At least 10 % (No DER norm shall be applicable)
Interest rate	As per RBI norms
Upfront fee	NIL or as per RBI norms
Guarantee fee & Annual Service Fee of CGTMSE	As per NCGTC norms applicable from time to time. Presently, 1% p.a. for first 3 years on the guaranteed amount. (To be borne by MUDRA / built in interest rate)
Tenor of assistance	Need based, with a maximum cap of 5 years (including moratorium of maximum six months, if needed. Higher period could be considered on case-to-case basis, if justification exists.)
Security	**No collateral security** to be sought. Other security will be as per lending banks norms. These may include : a. First charge on all assets created out of the loan extended to the borrower and the assets which are directly associated with the business / project for which credit has been extended. (as per extant NCGTC guidelines) b. Personal guarantees of promoters c. NCGTC cover
Repayment	Monthly (Both Principal and Interest) or as per lending banks norms.

Operational aspects of scheme	
Sanction process	a) The promoter has to approach any facilitation agency (RSETI/RUDSETI/EDII/Other EDP institution). b) Facilitation agency will arrange for entrepreneurship / skill development trainings as required by the applicant. c) After the training (or if the training is not needed by the applicant), project report has to be prepared and submitted to the bank. Facilitation agency should facilitate bank linkage of the applicant. d) Loan applications may be submitted to banks online (at proposed Naman app or “udyamimitra.in” or “standupmitra.in” portals under MUDRA scheme) or at the branch of concerned bank. e) These loans shall be eligible for coverage under Refinance from MUDRA. f) These would also be eligible for coverage under guarantee cover of NCGTC.
Role of facilitation agencies / handholding / escort services	• identification and motivation of potential entrepreneurs in the rural areas. • identifying potential investment opportunities for these entrepreneurs. • facilitating skill upgradation. • assistance in project report preparation and securing finance from banks and other lending institutions. • helping the entrepreneurs in selection, sourcing, installation and commercial operation of machinery. • arranging market support wherever necessary ; and • guiding entrepreneurs till their units commence commercial production at least for one year from date of commencing production / start.
Documentation & disbursement process	a. Simplified standardized documentation. b. LOI to contain all the terms and conditions governing the assistance. Borrowers acceptance of LOI conditions on a stamped paper to serve as loan agreement.

	c. Before disbursement, the borrower to be advised to open a bank account with any of the nationalized banks with cheque book facility.
Monitoring process	a. As per norms of lending institution. b. Though annual audited statements like, Profit & Loss A/c or Balance sheet need not be insisted upon, simple income and expenditure statements have to be maintained to assess scale and profitability of operations. c. The borrower shall be encouraged to carry out maximum transactions through a bank/digitally. A copy of bank statement has to be collected from the borrower every quarter.
Accounting & System requirements	A new simplified software to capture the minimum details of the Promoters, Project, Interest rate, Repayment schedule, Guarantee fee & Service fee payment to CGTMSE etc. shall be designed to take care of the Accounting and System requirements.
Delegation of Power	a. Cases to be sanctioned at Branch level of banks/ NBFCs. b. To facilitate smooth operations and keeping in view the small amount of individual loans, the In charge of concerned Branch shall have powers to execute documents and approve disbursement.
MIS	Performance under the scheme with details of break up such as Socio- religious category of Borrowers (SC/ST/OBC/Muslim/ other minorities/ women, etc.) to be maintained.

[ii]https://www.sebi.gov.in/reports-and-statistics/reports/jun-2020/report-of-the-working-group-on-social-stock-exchange_46751.html