MSME Financing and Credit – Trends and Issues

Background

As per the 4thCensus of MSME Sector, this sector employs an estimated 59.7 million persons spread over 26.1 million enterprises. It is estimated that in terms of value, MSME sector accounts for about 45% of the manufacturing output and around 40% of the total export of the country which is next only to the agricultural sector. It is, therefore, only appropriate that public policy has accorded high priority to this sector in order to achieve balanced, sustainable, more equitable and inclusive growth in the country.

The MSMEs primarily rely on bank finance for their operations and as such ensuring timely and adequate flow of credit to the sector has been an overriding public policy objective. Over the years there has been a significant increase in credit extended to this sector by the banks. As at the end of March 2011, the total outstanding credit provided by all Scheduled Commercial Banks (SCBs) to the MSE sector stood at Rs.4785.27 billion as against Rs. 3622.90 billion in March 2010 registering an increase of 32%.

In a highly competitive environment, finance is needed not only for running an enterprise and operational requirements but also for modernization/upgradation of technology, capacity expansion, marketing etc. Inadequate access to finances the root cause of poor technological and marketing performance of MSMEs. Credit to the sector has consistently declined over the years. It is suggested that at least 20 per cent of banks lending must be reserved for the MSME sector.

To increase the credit flow to the MSME sector, it is essential to improve the accounting practices followed by MSMEs and proper documentation is also crucial. Improvement in accounting practices and documentation can provide transparency in the business operation of enterprise and banks will be able to assess the credit – worthiness of such borrowers proficiently.

Due to high collateral requirements and complex procedure followed by banks in lending, MSMEs prefer to use own funds or borrow from informal sources. In few regions cooperative banks have been very active in lending to MSMEs, but the higher rate of interest charged by these banks pushes the cost of production.

Keeping in mind the need of the SMEs a special Equity Fund could be created with an initial corpus of around Rs 50,000 crores. Contribution to the fund could come from the PSU Banks, and the management of the same could also be with the PSU Banks.

The purpose of the Equity Fund would be to provide capital to SMEs through equity stake in companiesupto 25 percent. This would provide SMEs with long term funding as well as meet their margin money requirements.

When large capital flows both on account of portfolio flows and direct investment are sought to be sterilized to hold on to monetary targets, tight credit conditions are imposed on domestic firms. Such credit tightening operates asymmetrically between firms that have access to foreign capital inflows and foreign direct investment (FDI)and domestic firms that lack such access. Small firms, being dependent upon intermediated banks for finance much more than other firms, are particularly affected. Structural distortions in the regulation of banks and in incentive structures within banks accentuate the SMEs credit difficulties.

For most scholars, small industry policies have typically meant narrow sector-oriented policies such as reservation, duty concessions, directed credit, and government regulation, controls, and extension. The major impact of macroeconomic policies both monetary and fiscal on the sector has been almost entirely missed in both government's discussion of policies and academic debate. Similarly – Infrastructural policies and development, which specially impinge on the sector – since most firms cannot develop their own infrastructure, have got inadequate systematic attention.

Many specific macroeconomic policy-induced distortions work against the small-scale sector.

1.1 Tariff Inversion

Tariffs are not entirely free from inversion, that is, higher rates on inputs like steel, plastics, energy, and metals semi-manufactured than on finished products. This inversion which, since the reform was at its peak in the late 1990s, has declined but not disappeared. Inversion particularly hurts small firms since they have a comparative advantage in .manufacturing. in its original sense. Additionally, the very high uncompensated costs of energy, especially electricity and petroleum – based energy, which are not vetted even for export industries, impose large costs on location of manufacturing.

1.2 Exchange Rates Not Aggressive Enough

Exchange-rate policies have been particularly hurtful to small firms, especially in areas dominated by SMEs, like textiles. The effective exchange rate of the rupee has been higher than the value that prevailed at the end of the stabilization period.

If it can move back to those values the small firms of export can rise, as can manufactured goods production. It is worth remembering that export-led growth economies greatly under- valued their currencies for long periods to prime the export engine.

1.3 Erroneous Sickness Data

In reporting the data on lending to small firms banks include loans made out under many sop programs of the Planning Commission. Most of these are giveaways at best. Naturally, this magnifies the scenario of overall sickness of and loans outstanding against small firms. In reality, the nonperforming loans outstanding against small firms are much smaller than in lending to medium and large firms. Such erroneous data bases not only outsiders against lending to small firms but the bankers themselves.

1.4 Underdeveloped Venture Capital Industry

Compounding the problem of non-availability and high cost of credit is the fact that venture capital institutions in the country are shy of exploiting emerging entrepreneurial opportunities for small firms. They suffer from a banking mindset, bureaucratic norms, and target orientation, and focus on the growth phase of enterprises.

1.5 Exit System

Considering the volatile market situation in India, businessmen particularly in the MSME sector are walking a tight financial rope. Amidst uncertainties, entrepreneurs need government help in exiting a business when it is no longer financially viable or at least after he has spent his last rupee to keep it running.

About a third of small industries at the all India level are classified as “sick.” According to the third All India Census of SSIs 2001-02, 11 States of the 35 States and Union Territories share among themselves 89% of the sick and incipient units and 9 among them have 69% of the units ‘closed’. These numbers speak of the units that have entered the books of the financing institutions. There are many who did not borrow but fell sick. They have assets like the land and machinery, which are locked for decades without remedy. A rough estimate of such assets in the industrial estates alone would be 5-6% of the GDP!!

The acknowledged problems common to small enterprises as a whole persisting for over four decades include: lack of demand, lack of access to finance, non-availability of raw material, inadequate and high cost infrastructure, low capability for technological up-gradation etc.

The direct intervention in the credit market for SMEs did some good, but it has also engendered the growth due to the banks lending to some sectors that lead to avoidable portfolio risks. Banks carry now as much as 30-35% in the unacknowledged sick industries portfolio. RBI Annual Reports on sickness and rehabilitation, despite redefining sickness and reformulating guidelines for rehabilitation, indicate that the banks are averse to take on rehabilitation.

The recent slowdown in industry affecting micro industries in a big way, the absence of a clear exit policy is hurting many entrepreneurs. It is easy to start a small scale or micro unit but it is difficult to run it and almost impossible to close it.

The question arises that do we have a satisfactory exit system? As we don't have a satisfactory exit system in the country, the risk taker or the entrepreneur will lead to insolvency and bankruptcy, which drives him to commit suicide.

There are need of a proper and single point of exit in case of corporate failure, provision of second chance in case of insolvency and bankruptcy, need to reform in the judicial system of corporate exit, rivalry issue, harassment by money-lenders, and the most importantly, need to change the mindset of the borrower.

A recent study undertaken by and industrial organization in Chennai, identifies bank regulations on loans, statutory obligations such as ESI, PF and retrenchment compensation as some of the barriers to easy exit for entrepreneurs when the chips are down. It was felt that for a sick industry, many of these schemes do not benefit either the employee or the employer as it is difficult for the entrepreneur to keep his unit alive.

There should be a structured exit policy, taking into account the length of time the unit functioned before going "sick." It was suggested, for settlement of all labour disputes in tribunals or courts within six months, closure of all accounts related to taxes and duties within three months and creation of social security for entrepreneurs who had been generating employment for 20 years and more. Framing a suitable exit policy will ultimately benefit the MSME sector.

While there were number of studies in the past and limited attempts on the part of the RBI resulting in formulation of certain guidelines for reviving the sick but potentially viable enterprises, they all remained largely on paper. The banks, in the meantime, as part of the reform process, have moved to revised asset classification according to which the units that fall in arrears of payment of either principal or interest for 90 days or more will be treated as NPAs.

Assets locked up in sick SEs should be released within the quickest possible time after identifying them as sick or potentially viable so that the factor productivity does not become negative. Therefore, the future policy focus has to be not merely on certain key issues for sustained growth like raising total factor productivity and price competitiveness, ensuring quality standards and facilitating export growth, but also on providing a safe exit route for unviable enterprises.

There should be basic recognition that enterprises have their inevitable failures (even the top 500 companies in the world were never the same every year). There is a need to understand that the failed entrepreneurs have an urge to restart their enterprises with a new agenda or in a new shape after drawing lessons from their failure. Legally, bankruptcies among the SEs would need recognition to facilitate exit route. All developed nations have bankruptcy laws that define exit rules giving honor and dignity to failed entrepreneurs to make an honorable living.

MSME Finance and Credit Policies

2.1 Adequate and timely finance

The MSMEs should have access to adequate and timely credit. An effective regulator of banks should check and ensure compliance to the instructions and guidelines given by RBI.

The future credit policy for this sector should aim at providing a level playing field with others in the domestic and global market. Reduction in the cost of credit to the extent possible within the overall condition of the economy. The government should make an endeavour to bring it at par with other countries particularly those with whomv we have to compete. To begin with, the cost of credit could be made identical for both small as well as large units.

Availability of higher amounts of loan without insistence on collaterals and third party guarantees. This will, however, depend to a great extent on the experience under the Credit Guarantee Fund Scheme.

2.2 Working Capital

A large segment of MSMEs particularly those who are part of supply chains face working capital shortages due to unpaid or delayed bills. In majority of the cases the delay is greater than 180 days. The NPA norms classify a bank a/c as NPA after 90 days (extended to 120 days now), whereas the payment cycle is 180 days and beyond.

The impediments in the use of factoring should be addressed and should be promoted among the MSMEs. The Working capital loan enhancement is time consuming and additional collateral is being insisted upon during enhancement.

2.3 Commodity Crash

Many MSMEs that contracted for import of raw material during 2008 suffered heavy losses. There being no precedence of such situations, most bankers fail to come to their rescue. One time waiver needs to be considered with Government help.

2.4 Term Loans

Many progressive companies that went for expansion or started a new unit during boom period (last 4-5 years) are finding extremely difficult to service periodic re-payments as market conditions have suddenly reversed. In current situation neither top line nor bottom line targets could be met by borrowers. Therefore repayment plans have gone awry and defaults become imminent. A Moratorium for one year is needed for the affected MSMEs. There is also need for more sensitive restructuring guidelines having strict time frames.

The Banks should clearly spell out their restructuring norms as branch managers remain clueless and MSMEs are unaware what they could expect.

2.5 Access to funds for new projects/ start ups

New projects/startups find it difficult without access to funds as either loan proposals are not acknowledged or not disposed. Venture funds and private Equity funds have also disappeared. The Banks continue to discourage Credit Guarantee Cover in lieu of collateral and have deposited more money under SLR/CRR than what is required instead of lending.

There is a need to reverse incentives for not lending. Reduction of Repo/reverse Repo may be considered further. The loan margin requirement may be reduced by 5 -10% and allowing longer gestation by 12 months. Collateral free lending up to Rs. 25 lakhs under Credit Guarantee may be made mandatory for a year. The Government also may consider putting in place alternative market for raisin equity.

2.6 Interest rate and service charges

MSMEs get the raw deal in interest rate, made to pay higher charges for all types of chargeable services particularly non-fund based limits such as bank guarantees.

The RBI should benchmark maximum services as is done by TRAI and make continuous efforts for their reduction.

The interest is supposed to be charged based on performance of the borrower. The process of judging is internal, non transparent and subjective. The findings are never shared with the borrower. Over the years, if there is improvement on some parameters, values are changed to keep the borrower under higher slab of interest. There is a need to improve transparency, internal credit rating/ scoring report must be shared with the borrower.

2.7 Collateral

RBI should constitute a Committee for issuing guidelines on extent of collateral. Collateral greater than 100% (besides mortgage of plant and machinery should be refunded.

2.8 Third Party Credit rating

The third party credit rating requirement under BASAL II for loans portfolio above Rs. 10 Cr. has unnecessarily burdened SMEs. There is need to review their efficacies of credit rating models and fee structure and service quality. Moreover, these conditions be withdrawn for unlisted SMEs.

2.9 Losses due to Exotic Forex Derivatives and Forward Contractors

Exotic Forex derivative instruments were sold by some banks to unsuspecting SMEs to manage their Forex risks. Losses worth more than Rs. 2000 cr. are reported to be absorbed by SME exporters alone. RBI circular has given temporary respite but status quo remains. Similar is the fate of SME exporters that signed Forward contracts. There may be one-time settlement of MSME cases with 'no-profit no-loss.

2.10 Subsidies/Credit

The SME sector is not given any subsidies, incentives or tax exemption as given in case of large scale sector.

Creation of a widespread institutional network for credit rating for SME projects at affordable cost to them.

Introduction of newer and more innovative finance schemes such as factoring services and venture capital supported by incubation centers for new entrepreneurs. The policy measures required for popularizing venture capital concept may be initiated by Ministry of SME & ARI.

In order to mitigate the post sale problems of SME, there is a need to encourage bills culture, without recourse, to SME. In this context, Government of India be requested to help creating conducive climate for development of factoring services through appropriate policy prescriptions/legislative changes to ease the problems relating to stamp duty, registration fee, assignment of debt, etc. A task force should be appointed to look into these problems.

Strengthening of the financial/capital base of the SFCs, the institution that has played important role in the development of the SME sector by providing fixed capital. The respective state governments, SIDBI and IDBI would have to play a major role in revamping the SFCs.

There is a need for continuous and rigorous monitoring of the guidelines/directions issued by the RBI to the banks and other financial institutions for improving the flow of credit to SME sector.

Commercial banks may be instructed by RBI not to take all future fixed assets of assisted units for securing its existing advances. This will help units going in for technology upgradation, modernization, etc to avail assistance from financial institutions for such programmes without difficulties.

The Credit Guarantee Trust Fund Scheme may be extended from Rs. 50 Lakhs to Rs. 1 crore but most of the banks are not considering the proposal under the scheme and the SME entrepreneurs are not benefiting from the scheme.

There is a need for a change in the attitude and orientation of commercial bank staff in their lending to the SME sector.

RBI may take up the matter with the banks for sub-allocating the overall limits sanctioned by banks to such large borrowers specifically for meeting the payment obligations in respect of purchases from SMEs either on cash basis or bill basis.

SIDBI should promote financial intermediaries as venture capital funds, equity funds, marketing consortia, co-operative industrial banks, incubators, consultancy services at national, state and district level to be operated by different agencies including industrial associations.

Commercial banks should fulfill priority sector lending targets by lending directly to SME sector instead of adopting soft approaches like subscription to bonds of SFCs/NABARD etc.

Within the amount earmarked for SMEs, sub targets may continue to be fixed for lending on incremental basis to micro, tiny and other SME units.

The various committees appointed from time to time like the Nayak Committee, Kapur Committee, Ganguly Committee have given their recommendations to Reserve Bank of India (RBI) and many of these have not been implemented till date which should be looked into and necessary follow-up action for implementation should be taken by the Government to meet the adequate and timely financial need of the SME Sector.
Moreover SIDBI should be made full fledged bank for the SMEs to meet the group needs of the sector.

Systematic Reforms for MSME Growth
Business Laws:

The current legal system does not recognize failure of business as a possibility. There is a need to evolve Insolvency and Bankruptcy Codes.

(ii) SEBI Norms on Delisting

The Securities Laws (Amendment) Act 2005 allowed delisting of securities, necessitating the creation of a delisting framework. Even after repeated announcements, simplified delisted names have not been announced as yet. The de-listing norms for SMEs should be announced without delay as it is causing enormous burden on such SMEs that have applied for de-listing.

Taxation
Implementation of nationwide GST to reduce transaction costs and also to remove distortions

Location based Tax breaks should be immediately revoked

High stamp duties on transfer of property and on commercial transactions such as on financial instruments (Bank guarantees; Factoring etc.) create huge cascading effect. There is a need to harmonise the Stamp Duties across states and to reduce them drastically.

Income Tax rates on labour intensive MSMEs may be fixed at 50% of normal rate. This will help in capital formation and growth of this sector as has happened in IT sector. FBT is a retrograde step in direction of tax reforms and has proved to be the biggest nuisance tax

FBT has increased the tax compliance cost for MSMEs hugely; needs to be done away with.

Suggestions

4.1 Affordable credit to MSMEs:

Banks must adhere to the recommendations of Task Force on MSME and provide 60 per cent of the MSE credit to micro enterprises. The Committee should closely track the flow of credit to micro enterprises and advise the Ministry of MSME, if shortfall in 60 per cent sub-target falls short;

Micro enterprises may also be provided with interest subvention on their loans as recommended by the Task Force. The Committee may discuss the ways and means of providing interest subvention to the micro enterprises;

The Industry Associations be provided fund for appropriate guidance and consultancy to the micro enterprises for resolving problems faced by them in preparation of balance sheet, maintain a proper accounting practices as also bringing up awareness towards importance of credit rating, benefits of CGTMSE and advantages of the same. Creating awareness on credit guarantee trust for micro and small enterprises at grass roots levels is particularly important;

As regards other segments of the MSME sector, regular monitoring is necessary to ensure strict adherence by the banks of the stipulated target of lending to MSME sector within the next banking credit;

With a view to increasing the level of lending to MSMEs, the banks may go in for simplification of procedures and delegation of adequate powers to the Branch Officials;

As present collateral is invariably insisted upon. The Banks need to be asked for not insisting upon collateral if the loan has guarantee coverage of CGTMSE. Further the quantum of collateral free loan may be mandatory upon the level of Rs.10 lakhs.

Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) has been very helpful for the MSME sector. However to make it stronger and support more and more MSMEs, the corpus of the CGTMSE may be extended so that all loans could be adequately covered. This might also help in bringing down the rate of interest. At present higher interest rate dampens and inhibit the MSMEs endeavours.

4.2 SME Exchange

In view of the fact that the cost of raising capital MSMEs is quite high and they do not have easy to funds from Angel Investors and PE players. The Task Force recommended setting up of a dedicated stock exchange for the SME sector so that the SMEs can access capital markets easily. Since such a platform would be of great help to SMEs to raise capital other than the banking channel, which, at present, is the only way for getting capital. A number of SMEs have evinced interest to raise IPO through the Exchange as soon as it is functional.

4.3 Delayed Payment

Despite Government directions to expedite payment to the sector that supplies goods and services, MSMEs face innumerable hurdles for getting payments against their supplies to Corporates and PSUs. Due to delayed payments, the units are defaulting on bank loans, which are being declared as non-performing assets. Specific steps are needed to ensure timely payment to MSMEs against supplied made by them to Corporates. It is suggested that the delayed payment provision under the MSMED Act i.e. payment should be made within 45 days should be strictly enforced;

4.4 Venture/Risk Capital

Presently Venture Capital availability to SMEs is not widespread due to various reasons like limited opportunities of third party or IPO exits, absence of corporatization, high handling and monitoring cost, act. This is considered very critical especially for the knowledge-based MSMEs, since India has large pool of budding entrepreneurs with rich professional and technical experience and innovative business ideas. This area needs attention.

4.5 NPA

Banks classify a borrower as non-performing assets when any commercial loans for which interest or repayment of principal or both remain outstanding for a period of 90 days. In view of the inordinate delay in receiving payments even from the PSUs and demand slump in the market, it is submitted that 90 days time-frame be enhanced to 365 days with immediate effect.

4.6 Securitization and Reconstruction of Assets

The Securitization Act allows lenders to take over the assets of defaulting companies and auction them to recover their dues or take over the management of companies after serving a notice for a period of 60 days. It is suggested that recovery of loan under the Securitization Act is extended to Rs.1 crore from the existing limit of Rs.1 lakh.
4.7 Debt Recovery Tribunals

Debt Recovery Tribunals be converted into SME Rehabilitation Tribunals. Rehabilitation Committee be formed at national, state and district level and they should be empowered to perform. The performance of these committees should be monitored on monthly basis.

4.8 Rehabilitation of Sick Units

The Unit should be identified at pre-sick stage and timely action should be taken before they fall sick. Investment uptoRs. 10 lakh in sick units should be exempted from Income Tax for at least five years and the Income Tax Authorities should not harass investors. Identified at the incipient stage itself and appropriate measures taken to avert the sickness. Sick units viable for rehabilitation, contingency loan assistance need to be arranged at concessional rate of interest with longer moratorium for start-up, repayment to pressing creditors, working capital requirement, etc. There should be a time bound special package for easy exit policy for the non-viable sick units without cumbersome procedures together with a Social Security Scheme for all the sick units.

4.9 Timely /Adequate Availability of Credit

The adequate /timely availability of credit has been a long standing issue confronting the vibrant sector of economy. Various committees were set up in 90s by RBI/Govt. such as P.J. Nayak Committee, S.L. Kapoor Committee to address the issue. P.J. Nayak Committee had recommended that 20% of sales achieved should be provided bare minimum & banks were liberty to justify/verify, if additional working capital is required. It is an admitted fact that since Nationalization in 1969, banks were conservative in sanctioning the working capital limits. Banks were reluctant to provide 20% of sales achieved. The recommendations were not implemented in letter & spirits. The Task Force was constituted in Sept., 2009, which has recommended 60% of MSE credit to Micro Enterprises, which is to be achieved in stages. The fact that 50% was to be achieved in 2010-2011 (both manufacturing & Service sector).Needless to mention that the focus of Nationalized banks is on SMEs & not on Micro Enterprises/service enterprises. Moreover, there is no separate data with commercial banks. Even after 6 months have passed, many banks have not provided data of 50% to Micro/Service Enterprises, which is quite worrisome /undesirable. There is a lot of difference between providing Micro finance & credit to Micro /Service Enterprises. Thus, it is evident that the recommendations have not been implemented in letter & spirit.

4.10 Collateral Free Loan

The limit of collateral free lending to MSEs has been enhanced from Rs.5 lacs to Rs.10 lacs and banks are mandated not to accept collateral security. The limit of collateral free lending of Rs.10 lacs of RBI as per nationalized Banks is not mandatory. No loan is being sanctioned without collateral guarantee. The Branch Managers need to be trained/educated to implement the mandated directions of RBI to be implemented in toto. The branch level functionaries don't encourage availing the credit Guarantee Scheme Cover.

4.11 Banks Service Charges

At present, the Public sector Banks charge hefty service fee for each & every service provided by the banks such as processing/recital charges etc. No doubt, RBI has de-regulated the service charges and it was learnt that a working group was constituted by RBI, wherein, users representatives were not represented in the working group. It is also learnt that the commercial banks used to charge on the minimum balance of Rs.10, 000/- in the current account & Rs.1000/- in the saving account, if there as a shortfall in any quarter, Rs.400/- was charged.

It seems that IDBI will be the first bank to do away with the minimum balance requirement and simultaneously waiving off service charges, as no interest is being paid on the current account by any public sector banks. It is suggested that that other public sector bank should follow IDBI.

4.12 Interest Subvention

The government was providing interest subvention @2% upto 31.3.2010 to the Agriculture Sector. The Govt. has further provided 2% interest subvention in the budget 2010-11 to the Agriculture Sector. Thus, the agriculture sector is getting loan @5%. Recently 3% interest subvention has been granted to weavers. Needless to mention that erstwhile SSI Sector now Micro Sector is the largest employment generator next to Agriculture. National Commission on Enterprises in the un-organised sector had submitted its report on credit to Dr. Man Mohan Singh, Hon'ble Prime Minister of India and had demanded that the interest subvention should be provided to the Micro & the rate of interest should be charged at par with Agriculture sector. It is high time that the interest subvention of 4% should be provided to Micro Sector in view of its enormous potential / contribution.

4.13 Securitization Act, 2002

The Act was enacted to bring around defaulters/big fishes, but, unfortunately, the banks have exploited clause 13(2) as limit was Rs.1 lakh and the banks issue 60 day's notices under 13 (2). It is high time that limit should be raised to Rs.10 lacs instead of Rs. One lakh at present. No relaxation is being granted to Small borrowers by Banks, where the value of collateral security is much more and the commercial banks are quite rigid in the case of MSEs.

4.14 Role of SIDBI

The Small Industries Development Bank of India (SIDBI), which was set up on 02.4.1990, as Principal Financial Institution exclusively for SSI to cater to its need, has shifted its focus since 2005 on SME's only, which is contrary to its interest of the erstwhile SSI Sector now Micro Sector. It is suggested that the Government direct SIDBI to meet the credit needs of the Micro Sector.

4.15 Credit Guarantee Fund Trust for MSEs

The Public Sector Banks don't encourage sanction loans under Credit Guarantee Fund Trust Scheme. The borrower had to bear guarantee fee & annual service charges, which added to the cost of the borrowers. However, SBI has come out to waive guarantee fee and annual service charges for loans to SMEs under Credit Guarantee Fund Trust Scheme. It is suggested that the guarantee fee & annual service fees should be borne by Public Sector Banks.

4.16 Uniform Rate of Interest

It was noticed that no uniform rate of interest is being charged by the banks for SMEs. It was noticed that differential rate of interests are being charged even by State Bank of India, which was the only bank, which provided loans to SSI, under a pilot scheme in 1956. The higher rate of interest is being charged by other Public sector banks from the Micro/Small Enterprises.

4.17 NPA Account

PSBs have surpassed the target of 20 per cent year-on-year growth in outstanding credit to micro and small enterprises, as on March 2009, 2010 and 2011.

The share of outstanding credit to Micro Enterprises vis-à-vis total outstanding credit to MSE sector by PSBs stood at 46.80% as on March 2010 which declined marginally to 46.24% in March 2011 as against the target of 50% for the year 2010-11. However, it may be noticed that of the total MSE units financed, majority i.e. 88.35%, are the micro units as on March 2011.

Similarly as against the annual target of 10% growth in number of accounts of micro units, PSBs registered a growth of 8.73% during the year ended March 2011.

Private sector banks could not achieve the target of 20 per cent year-on-year growth in outstanding credit to micro and small enterprises, as on March 2009, but they surpassed the said target as on March 2010 and 2011 by registering a growth of 38.94% and 35.9% respectively.

The share of outstanding credit to Micro Enterprises vis-à-vis total outstanding credit to MSE sector by private sector banks stood at 24.37 % as on March 2010 which increased to 28.08% in March 2011 as against the target of 50% for the year 2010-11. However, it may be noticed that of the total MSE units financed, majority i.e. 64.45%, are the micro units as on March 2011.

Similarly, as against the annual target of 10% growth in number of accounts of micro units, private sector banks registered a growth of 116.63% during the year ended March 2011.

Foreign banks could not achieve the target of 20 per cent year-on-year growth in outstanding credit to micro and small enterprises, as on March 2009, 2010 and 2011.

The share of outstanding credit to Micro Enterprises vis-à-vis total outstanding credit to MSE sector by foreign banks stood at 20.96% as on March 2010 which increased to 23.67% in March 2011 as against the target of 50% for the year 2010-11.

Similarly as against the annual target for 10 % growth in number of accounts of micro units, foreign banks registered a growth of 21.67% during the year ended March 2011.

5.2 Sick Micro and Small Units

The increasing trend of sick MSME units was discussed in detail in the 8th meeting of the Standing Advisory Committee on Flow of Institutional Credit to MSE Sector held on 16.1.2007 at RBI, Mumbai. The Committee observed that there was considerable delay in rehabilitation /nursing of the potentially viable units.

The Working Group in its Report observed that the identification of a unit is so late that the possibilities of its revival recede. To hasten the process of identification of a unit as sick, the WG had recommended a definition of sickness in order to remove the delay factor.

A micro/small enterprise would be classified as sick if it has been classified as NPA for a period of three months or more, whereas earlier it was classified as substandard for more than six months. However, as the period of delinquency for classification as NPA had been reduced to 3 months from 6 months as prevailing on the date of last definition of sickness, a unit could be classified as sick only after 3 months after its classification as NPA.

Prior to 2002, the norms stipulated for identification of sick units were very tough. A unit had to wait for minimum two and half years before it is declared sick. The Kohli Committee submitted its report when 180 days norms were there for NPA classification.

The committee reduced the time span from two and half years to one year but suggested that the unit has to wait for one year to become sick even if NPA classification norms are reduced from 180 days to 90 days. Thus as present the unit is declared sick after one year or Nine months after it became NPA. Delay in identifying a unit as sick considerably affects its rehabilitation. By the time it is identified as a sick unit, its net worth is eroded to almost zero. To keep pace with NPA classification norms and in order to quicken the process of identification of sick units, it is imperative that the time span for declaring a unit be reduced from 160 days to 180 days. In other words, if an MSE account remains NPA for more than 3 months, it should be declared sick.

The second condition for identifying a unit as sick is that there is erosion in the net worth due to accumulated cash losses to the extent of 50 per cent during the previous accounting year. Cash loss refers to losses incurred on account of cash transactions and they are computed without providing depreciation. Such losses normally reflect negative cash flows.

Accumulated loss on the other hand is a much wider terminology and has a direct impact on capital. In banking terminology, accumulated losses are used for calculation of net worth and not cash losses. Hence there is a strong

case to migrate to accumulated losses from cash losses.
The present stipulation of the unit in commercial production for at least 2 years needs to be removed so as to enable the banks to rehabilitate units where there is delay in commencement of commercial production and there is a need for handholding due to time/cost overruns etc.

Analysis of the sick units' data for the period ending March 2011 reveals that banks found 84.88% of the units not viable and they accounted for 68.87% of the amount outstanding in respect of sick small enterprises. 91.39% of units whose viability was yet to be decided. It may be appreciated that timely action on assessing the viability of a unit is critical. It may be stated here that RBI so far as not prescribed any procedure to be followed by banks before a sick unit is declared unviable.

It is therefore, proposed that along with changing the definition of sick units it is also necessary to prescribe a new set of guidelines to make viability study an effective tool for rehabilitation of sick micro and small units. Thus, the suggestions of the Working Group on procedure to be followed by the banks before declaring any sick micro and small enterprise as unviable as follows may be accepted for implementation.

5.3 Collateral free lending to MSE sector and Credit Guarantee Cover

In terms of RBI guidelines dated May 6, 2010 banks have been mandated to provide collateral free loans up to Rs.10 lakh to MSE enterprises, based on the recommendations of the Working Group (WG) on CGTMSE. The banks could take cover for the collateral free credit facilities under Credit Guarantee Scheme (CGS) to cover their risk in the event of default. As per the practice internationally as well as in India, the CGS seeks to reassure lenders that, in the event of a default by MSE unit covered by the guarantee, the Guarantee Trust would meet the loss incurred by the lender up to a certain per cent of the outstanding amount in default. Thus, Credit Guarantee Schemes are instruments of credit enhancement for targeted sections.

It is, however, observed that the CGS Scheme has not picked up so far. As on March 2011, only 24.70% of the collateral free loans up to Rs 25 lakh were covered under CGS as against 21.97% as on March 31, 2009 i.e. as at the time of the WG's study.

The reasons for the CGS cover not picking up were examined, in detail, by the WG, which included, among others, need for simplification of procedural issues in settling claims by the Trust in addition to the fair value of the guarantee fee, inadequate publicity, etc.

The WG has suggested that the guarantee fees for credit facilities up to Rs.10 lakh, to micro enterprises, may be borne by the Trust. There could broadly be three options of bearing the guarantee fees:

Guarantee can be borne by the borrower ; or By the banks; or By the Government of India/Trust

It would be difficult for the borrowers to bear the guarantee fee as they cannot afford the same. It was therefore; felt that the borrower should not be burdened with the fees. As 92% of the sector is financially excluded, it is imperative that the MSE sector and within them, the micro units and first generation entrepreneurs, are financially included into the formal banking system. Micro enterprises generally have a weak financial structure and banks are generally reluctant to finance them for this reason. The need for credit enhancement either by secondary collateral security or by a third party guarantee gets accentuated in these accounts. However, most such entrepreneurs, being very small, have little or no secondary collateral security to offer.

Further, if banks were made to bear the fee, they would either discourage lending to MSEs, especially Micro Enterprises, or somehow indirectly load the same on the customer by charging a higher rate of interest on the facility provided thereby defeating the very purpose of fostering and developing the MSE sector. Moreover, banks being the commercial entities, any scheme for banks has to be a reasonable business proposition for it to be a readily acceptable.

As guarantee schemes are primarily a safety net for MSEs, the government may bear the credit guarantee fees formicro enterprises in order to encourage financial inclusion in the sector. In this context, it may be mentioned that Government of India had made initial contribution to the Guarantee Fund and as such, the Government had already taken the burden for the MSE borrowers.

5.4 Government to set up Rs 5,000-crore venture fund for MSMEs, introduce MFI Bill: Union budget 2012-13

The country's micro, medium and small enterprises (MSMEs) and agrarian sectors got a boost from finance minister Pranab Mukherjee, as he unveiled a host of fiscal measures designed to shore up the often-embattled sectors. MSMEs will have access to a government-sponsored venture fund with a corpus of Rs 5,000 crore. The India Opportunities Venture Fund will be channeled through the Small Industries Development Bank of India, which had also recently asked the government for the same amount, to lend to the sagging MSME sector, which comprises of more than 25 million units.n545

The Finance Minister also recommended the sector to involve itself in the manufacture of low-cost medical devices, and proposed reducing basic customs duty to 2.5% with concessional CVD of 6% on specified parts and components for the manufacture of disposables and instruments.

State-run National Bank for Agriculture and Rural Development (NABARD) will be allocated Rs 10,000 crore to refinance regional rural banks, through a short-term credit refinance fund. The much-anticipated Microfinance Institution Regulation Bill, along with a host of others, will be introduced in the current parliamentary session.