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MSME FINANCE: VIABILITY STUDY FROM BANKERS' PERSPECTIVE

Dr. Ram Jass Yadav*

Abstract: *SME is a growth engine of economy for any nation across the world. The importance of this sector in India as compared to corporate giants with respect to its contribution towards Indian economy can be best understood that they contribute 8% in Gross Domestic Product (GDP), 45% of manufactured output, 40% of exports, manufacture over 6000 products and provide employment to around 60 million person through 26 million enterprises as per latest 4th all India census of MSMEs. Recognizing the significant contribution of this sector in economic growth and also in employment generation in our country, Government of India has taken good number of initiatives to develop the sector such as erstwhile definition of 'Small Scale Industries' was enlarged by increasing investment ceiling in plants & machineries from Rs. One crore and trading activities in the ambit of MSMEs by enactment of Micro, Small & Medium Enterprises Development (MSMED) Act from 2nd October 2006. Also the Act recognizes the term 'Enterprises' instead of 'Industry' to include service in MSME segment. MSME sector is the second largest employment provider in our country and it is good vehicle to achieve inclusive and distributed growth besides a profitable avenue for the banks in India. A viability study has been undertaken on various issues relating to MSME finance from banks taking the published statistics, to examine the reasons why banks shy away to lend to the sector and what are possible remedies to improve credit-off take to the sector by banks. Today's SMEs are emerging Tomorrow's multinational companies (MNCs) and it is bonanza for sustainable growth of banking; hence MSME finance is a viable proposition for banks.*

Keywords: *BPR, CGTMSE, GDP, MSME, NBC, NMP, NPA, PSB, SCB, TAT*

**Chief Manager & Faculty, Bank of Baroda, Staff College, Ahmedabad (India)*

1. MSME – A VEHICLE OF INCLUSIVE GROWTH OF ECONOMY

Indian economy is dominated by a vibrant set of enterprises, which are prestigiously known as Micro, Small and Medium enterprises (MSMEs) for their scale of operations. Only 1.5 million MSMEs are in registered segment while the remaining 24.5 million that constitute 94% of the units are in unregistered segment[4]. The role of MSMEs in economic and social development of country is widely acknowledged. They are nurseries for entrepreneurship, often driven by individual creativity and innovation, and make significant contribution to country's GDP, manufacturing output, exports and employment generation. The labour-capital ratio in MSMEs is much higher than in larger industries. Moreover, MSMEs are better dispersed and are important for achieving the national objective of growth with equity and inclusion. MSMEs are broadly classified into two sector i.e. manufacturing and services. The units engaged in manufacturing or producing and providing or rendering of services has been defined as micro, small & medium under MSMED Act on basis of original investment in plant & machinery and equipment as under –

Enterprises	Manufacturing	Service
Micro Enterprises	Up to Rs.25.00 lacs	Up to Rs.10.00 lacs
Small Enterprises	Above Rs.25.00 lacs to Rs.500.00 lacs	Above Rs.10.00 lacs to Rs.200.00 lacs
Medium Enterprises	Above Rs.500.00 lacs to Rs.1000.00 lacs	Above Rs.200.00 lacs to Rs.500.00 lacs

In order to expand the scope of micro and small enterprise (MSEs), the threshold of investment in plant & machinery and equipment for MSEs is recommended to enhance from above limit to Rs.50 lacs & Rs. 800 lacs for manufacturing MSEs and Rs.20 lacs & Rs. 300 lacs for MSE under services respectively by Nair Committee in its report dated 21st February 2012[3].

Looking to the significance of SME sector, it is estimated that if India wishes to have growth rate of 8-10% for next couple of decades, it needs a strong MSME sector, without which it would be difficult to realize. Today there are about 30 million MSMEs in the country and this sector has shown an average growth of 18% over the last five years. In this backdrop, MSME is considered to be fast growing sector of economy and the sector gaining more importance to realize theme of 12th Five Year Plan (2012-2017) approach paper ***"faster, sustainable & more inclusive growth***". So, this sector offers opportunities of entrepreneurship to younger generation, new areas of MDPs for management institutes, business prospects to lending institutions, issues to regulators & policy makers and areas of research to scholars for making the sector more vibrant and faster.

2. METHODOLOGY & SAMPLING

2.1 Methodology

MSMEs have acquired high place in financial inclusion which is top agenda of Union Government for equitable development of the nation. The sector mainly relies on bank finance for funding its operations that involves a good number of financial and non-financial issues. In view of wide spectrum of MSME finance, secondary data which are published by Reserve Bank of India, SIDBI, GOI and banks in their various committee reports, speeches and periodical reports; have been used in the present study. In addition to published statistics on banking, primary information has also been gathered from branches for a case analysis to assess viability of SME credit over other segment of loans in large size credit old branch vis-à-vis new generation branches of a MSME cluster zone in north part of the country. Primary source of data for case analysis was of smaller size in sample and analysis period was of 3 years (2008 to 2010), but its findings are integrated and tested with the industry level observations taking all scheduled commercial banks (SCBs) into sample. The period of data used in the study ranges from 2 years to 11 years with large number of banks in sample thus findings and recommendations based on the empirical observations may be considered relevant to MSME Finance. Important statistical techniques such as ratio analysis and comparative growth analysis are used to draw inferences & findings presented in the paper. Study is based on primary as well as secondary data, which have inherent limitation but the author has made sincere efforts to maintain data integrity at all levels.

2.2 Study Sample

Different group of banks are taken into sample for extant analysis. The latest data on select important items such as net bank credit, MSE credit, loans to micro enterprises, reasons of sickness, non performing assets (NPAs) pertaining to SME sector for scheduled commercial banks, excluding regional rural banks, from 1999-2000 to 2010-11 published by various authorities has been used for this study. Primary information used for the case analysis cited in the paper. Sample size includes Scheduled Commercial Banks which are around 80 in numbers broadly categorized in 3 groups such as public sector banks (PSBs) including IDBI Bank Ltd, private sector banks and Foreign banks which may be considered reasonable sample to represent banking industry in our country. Also findings of case analysis referred in the paper with smaller sample size have been testified with the observations derived from industry sample and almost all inferences of case analysis found relevant and also fall in line with the industry behavior towards SME finance.

3. OBSERVATIONS - CREDIT FLOW TO SME SECTOR

Loans to Micro & Small Enterprises (MSEs) are reckoned as part of priority sector lending target of 40% for scheduled commercial banks. It is surprisingly noticed that about 5% MSMEs are covered by institutional funding given that approximately 95% of units require to bring into banking fold. The present study has analyzed credit flow to this sector and important observations relating to SME financing are presented in the paper.

3.1 MSE Finance by PSBs – A decade analysis (2000-2011)

3.1.1 Percent share of MSE credit declined: Pre-enactment of MSMED Act (2000-2007)

The wonderful growth in absolute term had been registered in credit to MSE sector by Public Sector Banks during last decade indicates that sector has business potential for banks. Credit to MSEs has increased over 8 times from Rs.46045 Crs in 2000 to Rs.369430 Crs (Table-1) in 2011 but percent share of MSE credit to net bank credit (NBC) has consecutively declined from 14.60% in 2000 to 7.80% in 2007.

3.1.2 Legislative change enhanced business prospects: Post MSMED Act era 2008-2011

There was sharp increase in percent share of MSE credit to net bank credit from 7.80% in 2007 to 11.10% in year 2008 with marginal hike to 11.30% in year 2009. This higher growth during the above review period had mainly happened owing to change in definition of MSEs following the provisions of MSMED Act. The investment limit of small (manufacturing) unit was raised from Rs.1.00 crore to Rs.5 crore and small (services) was added to the sector with an investment in equipments & instruments up to Rs. 200 lacs. Also the coverage of service enterprises were broadened by taking tertiary sector into MSE sector such as small road and water transport operators, small business, professional and self employed and all other service enterprises as per definition provided under the Act. Further this ratio accelerated to 13.10% in 2010 that might be because of regulatory change of taking retail trade into service sector. The advances to this sector further increased to 14.81% in year 2011. The credit acceleration in the sector had significantly noticed in absolute growth but proportion of MSE credit in net bank credit has been more or less at same level of 14%

which was way back in year 2000 despite widening the coverage of the MSE sector. It reveals that real growth in finance to MSE sector is not adequate in light of significant contribution of the sector in economy such as employment, manufacturing and export of the country. Low share of MSE credit does not only hamper equitable growth of economy but also fails the banks to fulfill their social commitment to the growing society. Banks should therefore, come out with a strategy to improve the percent share of MSE credit to their net bank credit which is stagnant between 13-14% since a long period.

3.2 Finance to Micro Enterprises: 5 Years analysis (2007-2011)

The latest 4th all India Census of MSME sector has revealed that of the total working enterprises 95.05% belong to micro enterprises, 4.74% to small enterprises and balance 0.21% are medium enterprises. Also it is observed that 45.38% enterprises are operating in rural areas. Though MSE sector, micro in particular is of great importance with respect to generating employment and contributing inclusive growth of the economy, this segment of industry is deeply credit constrained. Analysis of finance to Micro Enterprises by banking industry revealed some of the important findings mentioned below.

3.2.1 Prescribed share of credit not provided to Micro Enterprises

Recognizing the proportion of micro enterprises at 95.05% and MSE put together 99.79% in total working MSMEs, their share in bank credit is really ironical because micro gets merely 5-6% place in net credit of domestic banks which is very negligible though it is showing consecutive growth from 2.86% share in 2007 to 6.54% in year 2011. As regard the mandatory lending prescription to micro within MSEs credit is concerned, the micro enterprises should have at least 50% outstanding share in banks' total MSE credit as on 31st March 2011 which was 46.87% (Table-1). Furthermore it was observed that their share was declined from previous year (2010) level of 48.19% and public sector banks had not yet given their legitimate proportion of 54% which was way back in year 2000. Under this circumstance MSE borrowers' belief that the lenders are not doing enough as only about 5% of MSEs are covered by institutional finance need to be introspect by lenders themselves against their claim that banks are doing enough for the sector in providing them finance. Also the empirical observations substantiate the recommendation of Nair Committee which prescribed sub-target of 7% of net bank credit for lending to micro enterprises to be achieved in stages latest by 2013-14 and banks miles to go for achieving 60% of MSE advance to Micro enterprises by 2012-13; thus this sector has business opportunities and potential.

3.2.2 Over 50% banks have less than 7% finance to Micro Enterprises

Bank-wise position of finance to micro enterprise is also not encouraging so banks to draw a roadmap for achieving the mandatory lending to this sector because 45% domestic SCBs (Table-2) were attaining minimum recommended credit to the extent of 7% and 25 scheduled commercial banks (PSBs-14, Private banks-11) were behind the level of 7%. It is surprisingly observed that 13 domestic banks had their finance level below 4% to this sector and they need to come out with special measures to fall in line with the achievers for avoiding any penalty provisions to be imposed by policy makers.

3.2.3 Sector gets lesser credit under proposed norms of 7% lending to Micro Enterprises

Reserve Bank of India (RBI) has released the report of Nair Committee on priority sector lending on 21st February 2012 on its website and has sought views/comments on the report from public. The present study of credit flow to micro enterprises reveals that 7% of net bank credit for domestic SCBs worked out Rs. 211894 crores (Table -2) in March 2011 while the proportionate share of lending to micro enterprises as per mandatory credit norms to the sector at 60% of MSEs should be Rs.274528 Crores (Table-3) in March 2011 which arises the conflicts between two types of mandatory norms of lending to micro enterprises. This comparison of both the norms taking together indicates that proposed recommendation of Nair Committee for micro enterprises lending at least 7% of net bank credit needs to be integrated with extant guidelines of 60% share of micro enterprises within MSEs lending which is higher in the above analysis. If it is the case the proposed recommendation of 7% should be somewhat between 9-10% of net bank credit provided committee intends to improve the proportionate share of micro enterprises from present level which is already more than 7% under extant norms of 60% MSE credit to be given to micro enterprise segment. The policy makers may take call on the issue before final version of priority sector lending mandate for micro enterprises credit by banks in India.

3.3 MSE sector: Key to faster & sustainable Growth

3.3.1 Absolute credit surged by 124%

Bank finance is considered to be primary route of funding to MSMEs as a public policy objective to provide timely and adequate credit to the sector. It has been also witness that over the years there is significant increase in credit extended to this sector by banks. Outstanding credit to the sector by all scheduled commercial banks (SCBs) had surged by 124% from Rs.213539 crores in year 2008 to Rs. 478527 crores in year 2011 (Table-3).

3.3.2 Enhancement of existing limits contributed higher growth – Target fresh credit

Y-o-Y growth during review period is showing uneven trend, however, it was observed 19.94% in year 2009 which was grew by 41.44% in year 2010 and the growth rate was declined to 32.08% in year 2011. The abnormal acceleration in year 2010 might be occurred owing to inclusion of retail trade in service sector and therefore, normal growth placed in year 2011. This observation is also validated with a abnormal increase in number of accounts from 48.51 lacs in 2008 & 2009 to 85.05 lacs account in year 2010 registering growth of 75.32%. Since retail trade of loan limit upto Rs.20 lacs were allowed to include in service sector which are normally huge in number thus the quantum of accounts jumped abnormally.

Outstanding credit of all banks grew by 9.37% during year 2011 in number of accounts as against the mandate growth rate of 10% which is now going to be enhanced to 15% as per Nair Committee recommendations. The growth rate in amount and in accounts might be imbalanced owing to the reasons that banks have enhanced credit to their existing clients to increase their outstanding amount but not targeting the new entrepreneurs into their fold. This type of lending does not only cause non-adherence of mandatory lending norms to the sector but also attracts high concentration risks. It does not support equitable and inclusive growth of economy. Banks must equally target credit expansion in new accounts.

3.3.3 Sector responds faster – Its annual growth rate higher than industry rate

Banks in India are mandated to register at least 20% YoY growth in credit to Micro & Small enterprises and 10% annual growth in number of micro enterprises accounts which is now recommended to grow at least by 15% in number of account every year. Public sector banks had registered higher growth rate over the stipulated norms of 20% (Table-3) such as 26.64 %(2009), 44.36 %(2010) and 33.70 %(2011). The growth rate of private sector banks was negative (-0.54%) in year 2009 which further geared up to 38.94% in year 2010 and then declined to 35.93% in year 2011 which shows compliance of lending norms in terms of growth rate. However, foreign banks grew their advances by 16.62% & 17.07% in year 2009

2010 respectively but had negative growth (-0.78%) in year 2011 which require corrective measures to adhere to the norms for growth of credit to MSE sector.

3.4 MSMEs – Big Bazar for financial inclusion

To recognize the importance of MSME sector from financial inclusion and earning point of view, following findings have been derived by making a pragmatic analysis to grab earning opportunities from the sector.

3.4.1 93% Financial Exclusion – Key to 12th Plan theme of inclusive growth

It is observed that 92.77% MSME beneficiaries have no finance, 5.18% avail finance from institutional sources and 2.05% through non-institutional sources. It is an indicator for the banks that they need to focus on SMEs to achieve national agenda of financial inclusion because exclusion over 92% of MSME units is indeed matter of concern in the history of independence for over 64 years and about 43 years of banks nationalization in our country. Also the study validates the observation that MSMEs are undoubtedly like *big bazar* group to be tapped by formal credit delivery channel because 93% of MSMEs still rely on self finance. So this sector will be key to realize theme of inclusive growth of 12th Plan.

3.4.2 Enhance data integrity

There is one astonishing observation which indicates that MSEs avails bank loans in 48.51 lacs accounts in year 2008 & 2009 from all SCBs (Table -3) out of total MSME units 261.01 lacs which constitute 18.59%. While only 5 percent MSEs are covered by institutional finance as per latest 4th census of MSME and also notified in a good number of speeches by RBI and its various reports recently released including Nair Committee. This observation leads to the conclusion that number of accounts are not picked up through unique customer ID allocated by banks to their clients and so duplicity in figures. Banks require streamlining MIS for reliability and consistency in data for analysis which facilitate in drawing right policy measure by the regulators and also enhance data efficiency.

3.4.3 Huge credit gap – Open ways to faster growth

The present study has made an attempt to work out the gap in MSE Credit for the banks in India for last two years ended in March 2010 & March 2011 taking an assumption that 15% of total advances should go to the MSE sector. The assumption is reasonable owing to the fact that PSBs have already attained 14.8% share of MSE credit in year 2011. Continuing the same assumption of 15% share in total advances, potential level is worked out considering the annual credit hike of 20% if growth in economy is expected around 8% in subsequent years. However, credit growth of the sector is anticipated much higher because share of manufacturing in GDP is expected to be 25% by 2022 as per 12th Plan approach paper. Also 20% growth in MSE credit which falls in mandatory guidelines of lending to the sector is taken into account for estimated / projected level of outstanding from year 2012 to 2014. Based on the above working, it is observed that there was gap of Rs.162217 Crores in MSE credit in year 2010 which increased to Rs.166279 Crores in 2011 and this is continue to be widen to the extent of Rs.287329 Crores in year 2014 (Table-5). The potentials credit investment to the extent of 35% of actual/estimated outstanding is being missed by Indian banks which can be substantial business loss to the industry and may cause poor economic growth (GDP) to the country if it is not bridged in time.

3.4.4 MSE sector grows higher than overall advances of industry

The analysis made in this paper reveals that MSE sector is most sustainable and emerging segment of business for banking industry. While comparing the credit growth rate of domestic SCBs for last three years this statement has been validated by observing highest growth rate in Micro enterprises as compared to overall increase in net bank credit. Micro enterprises advances grew by 29.41%, 48.33% & 32.69% as against the increase in net bank credit by 22.97%, 21.10% & 19.03% in year 2009, 2010 and 2011 respectively (Table-6). Also the acceleration rate of credit in MSEs is by & large higher than the growth rate in net bank credit during review period so this sector contributes more to the overall increase in advances and this sector is viable proposition for banking industry to maintain sustainable growth in its business.

3.5 SME sector contributed less to incremental NPAs

The latest report on Trend & Progress of Banking in India released by RBI for the year 2010-11 reveals that SME sector contributed merely 20.7% in incremental NPAs of domestic banks against the highest of 44% by agriculture, 27.2% by non-priority sector and 8.1% by other priority sector. Percent NPA of MSE during the year 2011 for all domestic SCBs remained more or less same i.e. it was 17.0% in year 2010 which marginally increased to 17.6% in 2011. This statistics for year 2011 is reported not strictly comparable with 2010 because it pertains to 'micro & small enterprises' against erstwhile SSI, so the NPA percent if compared to previous years it would be far below than 17.6%. *The sector is therefore, more* *bankable & profitable as compared to other segment of business in banking.* This statement is also substantiated by an analysis done by RBI in its trend report of banking in India that despite increase in limit of collateral free loans to SME sector from Rs.5 lacs to Rs.10 lacs in May 2010, the NPA ratio of SME sector witnessed a decline in 2010-11 over the previous year[6].

4) MSME FINANCE: DRIVERS OF ITS VIABILITY

MSMEs across the world are gaining priority for policy makers and regulators who see the sector as key to solving the challenges of improving competitiveness, raising incomes, inclusive growth and generating employment. It is also observed that MSME is one of the fast growing sectors of economy that has huge potential for banks; this sector contributed less in incremental NPA and delinquency rate reportedly declined during last year 2011 despite double the collateral free lending limit. Also the growth rate of credit in this sector is much higher than the overall credit acceleration rate in net bank credit of banks in India. *Furthermore, the realization of 12th Plan theme is largely relying on the growth of MSME sector*. Government of India is making all possible efforts to give boost the sector including financial and non-financial measures. Based on the empirical observations; the following attributes have been considered strong drivers for advocating MSME credit to derive the conclusion that financing to this sector by banks is indeed not a choice but it is chance to grab this business for sustainable growth of banking in India.

4.1 SME Advances – Less risky, faster growing & high yielding

US President Mr Obama in a banking summit in Washington DC in December 2009 had made a business case that SME lending is good for profit. A vibrant SME sector is a powerful driver for wealth creation and economic recovery. Empirical analysis made in the study reveals that *apprehension of considering SME as a high risk business is not tenable because default rate of SME loans is zero as compared to other business loans.* The important observations derived from a case analysis based on primary information gathered (Table-8) are narrated hereunder in the paper for the period from 2008 to 2010 which are still valid as some of the findings picked up from RBI report on trend & progress of banking in India 2010-11, substantiate the observations of the present case analysis such as:

4.1.1 Zero default rates in NPA testifies that SME loans bears lower or nil (Table-8) credit risk as against other segment of loans. Industry level trend observed by RBI in its report also evident that SME sector has contributed less in incremental NPA in last year 2011 and also NPA has declined in 2011 over its previous year despite increased collateral free limit under CGTMSE scheme.

4.1.2 Banks are mandated for collateral free lending which is guaranteed by CGTMSE and accounts considered *without collaterals are standard* which goes against the covenant of preferring security obsessed lending. This statement is validated by facts revealed by RBI in its trend analysis report too.

4.1.3 Though there is absolute growth in SME advances its share in total advances in large credit branch is still low ranging between 7-11% which is further a drive force for *sustainable growth* as large corporate advances are at saturation and this target group is very limited as compared to SMEs. This finding is duly supported by the higher growth rate of lending in MSE sector as compared to overall credit acceleration of the industry during last three years from 2009-2011 (Table-6)

4.1.4) Percentage interest earning to SME advances is much higher than interest earning rate of total advances i.e. it had been 5.58% and 9.76% in case of SME advances against 4.23% & 7.46% earning rate to total advances for the year ended 31.03.09 and 31.03.10 respectively in new generation branch. It signifies that *SME advances yield more* in terms of earning and bears less concentration risk. The earning rate is lower on SME in old branches mainly because of rupee export finance, which is offered at concessional rate of interest as per government policy directives.

4.2 Institutional, Policy & Government incentives: Enhance viability of MSME Finance

The dedicated organizational set up and also other special measures announced by the government for SMEs leveraging the banks over private lenders to enhance viability of SME finance. A few of them are cited in the paper-

4.2.1 Institutional advantages to Banks

a) Banks have set up dedicated processing cell & *SME Loan Factory* with a pool of specialized skills of SME credit. Also set up regional MSME care center giving different nomenclature by the banks to facilitate MSMEs for quick redressal of their grievances. Banks should therefore make best use of this capital investment in hardware and humanware of specialized delivery channels to create yielding portfolio of SME loan books.

b) Banks' *exposure limits* is much higher than any other private financers to cater financial needs of big amount

c) Banks are *one stop shop* i.e. loan syndication, advisory services, insurance, working capital, LC/BG and many more are offered by banks.

d) Wide *branch networks* and vested huge lending powers of various functionaries at branch levels for MSMEs.

e) Banks to achieve *mandatory lending* to MSME for inclusive growth such as 20% YoY growth in credit to Micro & Small enterprises, 60% of MSE advance to Micro enterprises by 2012-13 and now 7% of NBC by 2013-14 as recommended by Nair Committee, 10% annual growth in number of micro enterprises accounts which is now proposed to grow at least by 15% in number of accounts. *Adoption* at least one MSE cluster by each lead bank of a district.

4.2.2 Policy incentives for MSME finance by banks

a) Statutory *provisions requirement* for standard advances under SME advances is merely 0.25% as against 1.00% in case of real estate and 0.40% for other advances which is a reward for banks to make lower provision towards buffer capital on SME advances

b) Collateral free loans up to Rs. One crore are secured by CGTMSE guarantee which is *highly liquid* at par with cash security as compared to any other collateral in loan accounts

c) *Allocation of Zero risk weight* to SME loans guaranteed by CGTMSE for capital adequacy requirement

d) *Simplified computation*[5] of working capital limit to MSE units on basis of minimum 20% of their estimated annual turnover up to limit of Rs.500 lacs.

e) Union Government has schemes of felicitating Best Bank awards in recognition of contribution made by banks for promoting SME sector that builds *Corporate Brand* which is invaluable and add new feathers to the business of winner banks

4.2.3 Government enhances capacity building for competitive advantages to MSMEs

a) *Indian Opportunities Venture Fund* (IOVF) for Rs.5000 Crs with SIDBI is proposed to be set up for enhancing equity to the sector as per budget (2012-13) announcement.

b) *Two SME Exchanges* have started operations to greater access to finance

c) *Public Procurement Policy* introduced with a provision that every Central Ministry / Department / PSU shall set an annual goal for procurement from MSE sector at the beginning of every financial year. Objective is to achieve an overall procurement goal of minimum 20% of total annual purchases of products or services produced or rendered by MSEs.

d) *Limit of turnover* for compulsory tax audit of account has been raised to Rs.100 lacs (from Rs.60 lacs) in recent budget of 2012-13

e) *Capital gain tax* will be exempted on sale of residential property if sales consideration is used for subscription in equity of a manufacturing SME company for purchase of plant & machinery.

f) *National Manufacturing Policy* has aim to increase share of manufacturing in GDP to 25% and create 100 Mn new jobs by 2022; to achieve this target, MSME growth is considered to be an answer.

5. RECOMMENDATIONS – THE WAY FORWARD & CHALLENGES AHEAD

Bankers consider MSME lending more risky because of many reasons such as MSMEs don't have collaterals for loans, they have low equity base, absence of marketing tie-up, diversion of funds, poor book keeping, low technology level & so on. Despite these common weaknesses in MSME lending, private lenders assumes MSMEs at the best business model for higher profitability & sustainable growth due to numerous factors namely – Lesser default rate, high yield, dispersed credit risks, no complexities of legal / valuation search of properties and fraudulent title deeds because loans are collateral free, highly potential group for cross-selling like insurance cover of borrower, credit counseling and many more. In view of good number of incentives to banks and also driving force for MSME lending mentioned in the paper; following measures are recommended from bankers' as well as borrowers' perspective based on the empirical observations of the study which probably would help bankers in making their SME loan book strong for sustainable development of banking industry and inclusive growth of Indian economy.

a) Recommendations for Bankers

5.1. Handholding – Enhances business partnership

Bankers are expected to be proactive in offering financial and non-financial consultancy to MSMEs for innovation besides their role as credit provider. To enhance banks' participation in affairs of MSMEs through convergence on credit & non-credit issues like business planning, marketing, accounting & finance, human resource management, use of technology etc; top management of the banking industry should train their field staff through customized programme to meet specific needs of SMEs instead to focus on monitoring mechanism that starts at later stage after imparting funds. This sort of consultancy and convergence should make part of KYC process beyond the formal compliance of obtaining copies of certain documents relating to identity proof of business and entrepreneurs. This handholding & conciliatory approach deepens the relationship as true business partner of borrower and also help in identifying right beneficiary of public money. Thus what a banker requires is to be positive while dealing with MSMEs because there is need of human touch at the point of establishing business relationship. This warrants attitude transformation, which *change DRISTI (vision), not the SRISTI (world)* because it is one & same for all. Bankers to view that alone entrepreneur is not in need of money but bankers are equally searching entrepreneurs for lending money to earn interest for paying to depositors and subsidizing their intermediation / operational costs.

5.2) MSME risk management – Activity Based Credit (ABC)

Security is though one of the credit risk mitigation measures; it is not always workable because of non-realization of market value, non-marketable titles deeds as it has been witnessed in recent past that financial institutions who have built their sub-prime loan books had disappeared from the market due to either non-realization of market value or high diminution provisioning. Those who have focused on activity based lending could survive. Since credit requirement of MSMEs to the largest extent are small size which qualify for guarantee under CGTMSE that is highly liquid security as compared to any other tangible collaterals. It is therefore, recommended that banks to encourage collateral free & activity oriented lending which are of self liquidating in nature, building zero risk weight loan books which does not charge to the precious capital of banks.

5.3) Minimize Turn around Time (TAT) – Business Process Re-engineering

Time is money and it is said that *'if one wants more time to take correct decision in that case a correct decision is also wrong when it is taken too late'*. It has come across in many cases that lack of knowledge bounds a banker to become business diverter & decision shyer. It is thus recommended that credit operations should be driven by a Knowledge Banker which is considered to be super power that makes the man "*decision taker, today believer & tomorrow's beginner".* Some of the banks have already set up dedicated outlet such as central processing cell, SME Loan Factory etc for catering financial needs of SMEs equipped with skilled manpower of customized credit products & services as part of their business process re-engineering (BPR) to reduce turnaround time; but many more banks still require to take necessary measures of improvement in TAT norms. Adoption of right BPR models helps a bank in identification of wastage which led to more than 50 percent reduction in Turn Around Time (TAT) for customers' more than 50 percent reduction in duplication of work. Less number of handovers and system inputs that lower chances of error and reduced operating risks which will factor productivity and efficiency in lending operations.

5.4 Reserve limit for SME dues - Big corporate delay payments

Large corporate buyers of MSMEs normally delay in settlement of dues towards their bills of goods supplied that adversely affects the recycling of funds and business operations. Government has though strengthened the provisions of Interest on Delayed Payment after enactment of MSMED Act; banks are also directed to sanction separate sub-limits within the overall limits sanctioned to the corporate borrowers for meeting payment obligations in respect of purchases from MSME sector. The same is also to be certified by practicing Chartered Accountants while completing their audit of large corporate for which the professionals should be meticulous in their certificate and must use all due care. Monitoring of quick realization of SME dues by large corporate including public sector enterprises is required by banks to address this problem.

b) Recommendations for MSMEs

5.5 Purposeful use of credit

Money must be used for the purpose it is given and to be repaid in time enabling the lenders to provide lifeline to the productive & economic activities, which are backbone of any national growth. Diversion or siphoning off funds to be treated like illegal business of stealing bloods, kidneys & other parts of human organs which are criminal and life imprisonment offences and make unkind to the kind world. MSMEs must therefore, utilize the money for which it is granted to build lifeline of their business. Prior counseling of lender is mandatory in case change in use of money is warranted to mitigate risk of failure.

5.6 Demand credit – For dream project at competitive rates

Entrepreneurs should understand that the activity, which is conceived rather than which is influenced by others because perceiving the idea make slave and normally do not allow to be independent whole life. If this approach is adopted since beginning then major problems like demand of products, its marketing and other relating problems will never be faced by entrepreneurs. Conceiving the project is like giving birth to a child by a biological mother who ensures all round development of child as sure as rising the sun whilst perceiving is as good as stealing franchise without patent right & fees, which is not only a punishable offense but also sounding closure sign of the project as sure as death.

MSMEs should also understand difference between money and credit. Unlike money, credit has to be self-liquidated on a viable project and has a cost. One must appreciate that banks are highly leveraged institutes that lend money placed by depositors with them and thus have to practice prudent lending and be cautious and sure of the safety of the money of their depositors. On the cost of credit, while interest rate have been deregulated by RBI, interest costs to SME is a very small fraction of their operating costs, which works about 4%, thus SMEs should not ask for cheaper credit from the banking sector, but *ask for timely & adequate credit at competitive rates*.

5.7 Equity market for SME: Alternate source of funding

SME funding at a point when banks deny or reluctant, the equity capital is then necessary thus access to equity market is a genuine problem. At present, there is almost negligible flow of equity capital into SME sector. The much awaited SME platform of Bombay Stock Exchange (BSE), for SME companies has started its operations from 13th March 2012. This move has come at a time when smaller companies find raising funds through debt difficult. Around half a dozen small and medium companies have given approval to enter the capital market and an equal number of applications are in the pipe line with BSE. Also it is anticipated that around 100 small companies would be listed in subsequent 18 month. MSME sectir expects Rs.2.5 lacs Crores through equity route & Rs.4.7 lacs Crs through banks loans during current fiscal as per estimates of MSME ministry[2]. Besides, BSE the National Stock Exchange (NSE) has also launched its exchange for SME called 'Emerge' on same day i.e. 13th March 2012.

This beginning has opened the ways for the players to get funds without interest on the basis of their credentials, which was difficult to get from the banks. Companies with post issue paid up capital of less than Rs.25 crores are eligible to be listed on the SME platform. This would fetch much lesser fees for merchant bankers, who charge a percentage of the issue size. The mechanics of listing on a stock exchange such as audited balance sheets, being subject to corporate governance norms would address many of the transparency and informational asymmetry constraints that banks face in lending to the SME sector. Besides, equity financing lower the debt burden leading to lower financing costs and healthier balance sheets for the firms. Also the continuing requirement for adhering to the stock market rules for the issuers lower the on-going information and monitoring costs for the banks. The new opening of alternate market for SME funding would be challenge before banking industry with a clear mandate to come out with need based SME products at reasonable price offer with lesser paper formalities & documents to retain their business share. Also it is imperative for SMEs to keep them ready for forthcoming challenges from adoption of IFRS in future, which are though exempted for SMEs at present.

5.8 Educate SMEs & create credit awareness – Role of Chambers & Associations

Togetherness enhances efficiency of any system. In this context, there is need to understand by SMEs that banks have obligations to their depositors and other stakeholders to safeguard their interest. SMEs as customers of bank credit have therefore, certain duties towards banks such as repaying bank loans, maintaining proper books of accounts, submitting information correctly and more importantly sharing information about financial problems if arise so that they can work together with the banks in resolving them. Also it is in welfare of MSEs to get them rated from rating agencies, as it could enable them to negotiate with their bankers for interest rate reduction, larger loan size or even obtain faster process of their loan application. They must also aware that if they default and their credit history is poor they will find it difficult to access bank fiancé, as banks have been mandated to pass on all credit history of their clients to CIBIL or any other credit bureaus registered with RBI. MSME chambers or associations to collaborate with banks, training institutes, business schools and management institutes to organize workshops & training programmes for their member on basic accountancy, information technology, cash flow, various financial products for MSMEs. Such awareness campaigns will help the entrepreneurs for easy access to bank credit because while availing finance from banks which is based on financial statement. If borrowers have informative financial statements with a strong financial condition as reflected in terms of financial ratios; it will expedite credit process and ensure timely & adequate credit supply.

CONCLUSION

Most economies of the world are in serious crises owing to worst social and economic symptoms such as a high level unemployment and especially of younger generation. The United Nations, on the eve of 2011, made a significant warning that at least 22 million new jobs need to be created immediately, to avoid the world plugging into a more crises in subsequent years. The key of this problem is with MSMEs. In India, the latest findings from the 4th MSME census indicate a mixed picture of sector. An overall scaling up is visible, both in terms of units and of the average investment size. Growth rate of the sector is greater than that of overall growth of economy. The death rate has come from 39% (2001-02) to 21.6% (2006-07)[8]. 12th Five Year Plan has a logical strategy for MSME sector. GOI through National Manufacturing Policy (NMP) seeks to achieve inclusive growth of Indian economy with broad objectives such as increase share of manufacturing in GDP to 25%, create 100 million new jobs by 2022 and many more. Innovation is the *sine quo non* for ambitious growth of the sector and credit alone will not help; what is needed is relevant financial product that address life cycle of MSE firms. Banking sector has therefore, huge opportunities of viable business from MSMEs because this sector stands as strong source of inclusive growth in an economy. However, Banks now have challenge to customize their products to meet innovative needs of MSMEs at competitive rates for the sector to grow. It is witness from the findings of study that growth rate of MSME sector has always much higher than the overall credit growth of baking industry that coins the phrase ***"…Small is mighty, profitable & good for sustainability …"***

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STATISTICAL TABLES

Table-1: Credit Flow by PSBs to MSEs from 2000 to 2011

(Rs in Crores)

Year	Net Bank Credit (NBC)	Credit to MSEs	% to NBC	Credit to Micro Enterprises	Credit to Micro Enterprises as % of MSE credit	Y-o-Y Growth (%)
2000	316427	46045	14.60	24742	54.00	-
2001	341291	48400	14.20	26019	53.70	5.11
2002	396954	49743	12.50	27030	54.30	2.77

2003	477899	52988	11.10	26937	50.80	6.52
2004	558849	58278	10.40	30826	52.90	9.98
2005	718722	67634	9.40	34315	50.70	16.05
2006	1017614	82492	8.10	33314	40.40	21.97
2007	1314744	102550	7.80	44311	43.21	24.32
2008	1361595	151137	11.10	66702	44.13	47.38
2009	1693876	191408	11.30	83945	43.88	26.65
2010	2109076	276319	13.10	133154	48.19	44.36
2011	2493498	369430	14.81	173156	46.87	33.70

Source: Various RBI Reports on Trend & Progress of Banking, Committees' & Banks' reports

Table -2: Finance by banks to Micro Enterprises (After enactment of MSMED Act)

Year	Micro Enterprises (Rs in Crores)			Adjusted Net Bank Credit (ANBC) –Rs in Crores			%age of Micro loans to ANBC – Rs in Crores		
	PSB	Private Banks	Domestic SCBs	PSB	Private Banks	Domestic SCBs	PSB	Private Banks	Domestic SCBs
2007	44063	3256	47320	1317705	336589	1654294	3.34	0.97	2.86
2008	68937	8830	77767	1364267	343396	1707663	5.05	2.57	4.55
2009	89505	11130	100635	1693437	406543	2099980	5.29	2.74	4.79
2010	133154	16113	149268	2074472	468649	2543121	6.42	3.44	5.87
2011	173156	24911	198068	2493498	533560	3027058	6.94	4.67	6.54
Bank Group wise position of lending to micro enterprises – 31.03.11									
	Below 4% to ANBC						5	8	13
	4% to less than 7%						9	3	12
	7% & above						12	9	21

Source – Reports of various banks, data extracted from Nair Committee Report (February 2012)

Table-3: Credit flow by SCBs to MSE Sector

(A/cs – in Lacs & Amount – in Rs Crores)

Banks	March 2008		March 2009		March 2010		March 2011	
	A/cs	Amount	A/cs	Amount	A/cs	Amount	A/cs	Amount
PSBs	39.67	151138	41.15	191408	72.17	276319	73.98	369430
			3.73%	26.64%	75.38%	44.36%	2.51%	33.70%
Private	8.19	46912	6.78	46656	11.31	64825	17.18	88116

Sector Banks			-17.21%	-0.54%	66.81%	38.94%	51.90%	35.93%
Foreign Banks	0.65	15489	0.58	18064	1.57	21147	1.86	20981
			-10.78%	16.62%	170.69%	17.07%	18.47%	-0.78%
All SCBs	48.51	213539	48.51	256128	85.05	362291	93.02	478527
			No Change	19.94%	75.32%	41.44%	9.37%	32.08%

Source – Data extracted from RBI keynote paper dated 4th February 2012. Figures in %age indicate Y-o-Y growth/decline in outstanding credit

Table – 4: Distribution source of finance to MSME sector

Source of finance	Distribution of MSME units			% Distribution		
	Regd	Unregd	Total	Regd	Unregd	Total
No Finance / Self Finance	1362568	22850626	24213194	87.77	93.08	92.77
Finance through Institutional sources	174060	1177212	1351272	11.21	4.80	5.18
Finance through Non-Institutional Sources	15864	520467	536331	1.02	2.12	2.05
Total	1552492	24548305	26100797	100	100	100

Source – Summary Results of 4th All-India Census of MSME

Table -5: Prospects of MSE Credit

Banks	Gap in MSE Credit (Rs in Crores)				
	2010	2011	2012	2013	2014
PSBs	128834	126415	151698	182037	218445
Private Banks	30041	31514	37817	45380	54456
Foreign Banks	3342	8350	10020	12024	14429
All SCBs	162217	166279	199534	239441	287329
% gap to outstanding MSE advances	45%	35%	35%	35%	35%

Source: Computed by Author from published data of banks various reports

Table -6: Annual Growth in Net Bank Credit vis-à-vis MSE Credit

Year	% YoY growth in Micro Enterprises			% YoY growth in MSEs			% YoY growth in NBC		
	PSB	Private Banks	Domestic SCBs	PSB	Private Banks	Domestic SCBs	PSB	Private Banks	Domestic SCBs

2009	29.84	26.05	29.41	26.64	-0.54	20.20	24.13	18.39	22.97
2010	48.77	44.77	48.33	44.36	38.94	43.30	22.50	15.28	21.10
2011	30.04	54.60	32.69	33.70	35.93	34.12	20.20	13.85	19.03

Source – Data extracted from Nair Committee Report (February 2012) & author computed growth rates

Table- 7: Reasons for Sickness in MSE Sector

S No	Reasons for sickness / incipient sickness	% of sick units*
1	Lack of demand	71.6%
2	Shortage of working capital	48.0%
3	Non-availability of raw material	15.1%
4	Power shortage	21.4%
5	Labor Problems	7.4%
6	Marketing problems	44.5%
7	Equipment problems	10.6%
8	Management problems	5.5%
*The total will exceed 100%, as some units have reported more than one reason		

Source: SIDBI Report -2010 on MSME Sector (Table 5.20)

***Table-8**:* SME Credit of a New Generation & old large size credit Branches

Particulars ***(Rs in Crs)***	Large Credit Branch (33 Years old)			New Generation Branch (2 Years old)	
	31.03.08	31.03.09	31.03.10	31.03.09	31.03.10
Total Advances	91.48	125.24	155.51	4.72	11.13
SME Advances	6.76	9.20	17.87	2.51	5.33
(% to Total Advances)	7.39	7.35	11.49	53.18	47.89
Total NPA	0.98	1.22	2.35	-	-
Of which – NPA in SME	-	-	-	-	-
Advances under CGTMSE	-	-	4.50	0.05	0.74
Of which – NPA	-	-	-	-	-
Total Interest Earned	10.12	13.12	16.50	0.20	0.83
(% Interest to total advances)	11.06	10.47	10.61	4.23	7.46
Interest on SME Advances	0.52	1.00	1.60	0.14	0.52
(% to total SME Advances)	7.69	10.87	8.95	5.58	9.76

Source: Primary data collected from Bank Branches