

## MSME- A Makeover



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MSMEs are of national importance but the institutional credit flow to this segment historically has not grown as desired despite initiating several measures by Government of India and Reserve Bank of India, including enactment of MSMED Act 2006 to facilitate promotion and development and enhancement of the competitiveness of Micro, Small and Medium Enterprises and enhance the flow of credit from institutional agencies. During the last fifteen years, although in absolute figures the bank credit has gone up, in relative terms i.e., MSME credit as a proportion of gross bank was falling continuously, except 2007-08 and 2008-09 on account of revised definition of MSMEs. What is surprising to note is that the growth rate of MSE credit supplied by PSBs has been lower than that of private and foreign banks. Whatever be the measure, there is unanimity amongst researchers, policy makers and bankers that this sector is deprived of its due share when it comes to bank credit. However, since revised growth strategies stipulated by Government of India, the growth rate has increased substantially by 12.4% in 2011-12 and 20.30% in 2012-13.

### Essentials of the Suggested Action Plan

1. Creating dedicated Bank branches for SME with dedicated marketing team to work under the branch head. These branches may be termed as "SUBIDHA" branches that are the branches for quick credit delivery and facilitation of potential SME borrowers.
2. The number of SUBIDHA branches may be opened all over the country in phases.
3. Due diligence and pre-sanction inspection may be taken care of by SUBIDHAs along with other branches if any in the locality.
4. Proposal exceeding Rs.25 lacs, of other banking branches in SUBIDHA centre may be referred to SUBIDHA only, even if the same falls under branch delegation to improve turnaround time and technical bottleneck if any.
5. The limits up to Rs.1.00crore are to be sanctioned by the SUBIDHA head. If the amount is more than Rs.1.00crore, the sanction is to be made by a committee approach to marginalize NPA in large exposures.
6. All SUBIDHA branches should be provided with SME trained officers.
7. A liberal credit rating approach should be followed for MSME sector. Credit appraisal system should give more emphasis to softer strengths (viz. Managerial, technical, business competence of the promoter, potential of the industry, credit history etc) than financial papers.
8. Excess of prime security value in form of plant, machinery, land, building etc. over the Term Loan outstanding should be treated at par as collateral security

9. Innovating new schemes/ modifying existing ones to meet the needs of the borrowers of MSME sector
10. To allay the fear of accountability amongst the bank officials, which is largest bottleneck in credit dispensation to MSME sector due to rise in NPA in this segment.
11. To create awareness about the benefit of CGTMSE coverage amongst potential borrowers as well as Bank officials.

### **Employment in MSE sector:**

The total employment in the MSE sector as per the third All India Census of MSEs in the year 2001-02 was 249.33lacs. As per the estimate for the year 2007-08 the employment was 842.23lacs persons, which has increased substantially to 1012.59lacs persons by 2011-12. In the manufacturing and the service sector, the share of MSEs in the total employment is around 34.93 percent.

Realising the importance of service sector in the economy, the government has brought various changes in its approach to take care of this sector. One of the major breakthroughs is the enactment of MSMED act which brought the enterprise concept in place of industry concept.

### **Micro Small and Medium Enterprises Development Act**

“The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 came into being to provide for facilitating the promotion and development and enhancing the competitiveness of micro, small and medium enterprises and for matters connected therewith or incidental thereto. The act was passed by the Lok Sabha on May 18, 2006 and passed by the Rajya Sabha on May 22, 2006. The president of India accorded his assent to the above legislation on June 16, 2006. The act became effective from October 2, 2006. There is no doubt that the enactment of this Act was a landmark initiative taken by GOI through which services sector has been included by replacing the

term ‘industry’ by ‘enterprises’. The salient features of the act are as under.

### **Classification of Enterprises**

#### **Introduction of the concept of 'Enterprises' as against 'Industries'**

For the first time the concept of ‘enterprises’ has been introduced in MSMED Act to replace ‘industries’. Earlier SSIs are now replaced with Small Enterprises to incorporate the small units from services sector. Thus, the act provides for micro, small and medium enterprises in ‘manufacturing’ (traditional category) and ‘services’ (new category) sectors. Though the Act is in furtherance to the Industries (Development and Regulation) Act, 1951, it overrides the act in so far as classification of enterprises is concerned.

#### **1.3.1 Enterprises classified broadly into:**

- i. Enterprises engaged in the manufacture/ production of goods pertaining to any industry &
- ii. Enterprises engaged in providing/rendering of services.

#### **Manufacturing Enterprises:**

Defined in terms of investment in plant and machinery (excluding land & buildings) and further classified into:

- Micro Enterprises - investment up to Rs.25lacs.
- Small Enterprises - investment above Rs.25lacs & up to Rs.5crore.
- Medium Enterprises - investment above Rs.5crore & up to Rs.10crore.

#### **Service Enterprises:**

Defined in terms of their investment in equipment and further classified into:

- Micro Enterprises - investment up to Rs.10lacs.
- Small Enterprises - investment above Rs.10lacs & up to Rs.2crore.

- Medium Enterprises - investment above Rs.2crore & up to Rs.5crore.

### **Union Budget 2015-16 propositions:**

The Government has well understood difficulties faced by MSMEs in its working capital cycle and hence introduced bill discounting schemes. This will be kind of relief to the MSMEs who are suffering from working capital issues.

The Union budget has mitigated some of the main concerns of the MSME enterprises by allocating Rs.20000crore for Mudra Bank to enhance credit for SMEs, another Rs.1000crore for supporting start-ups and a new National Skill Mission to spur job creation.

### **Problems/Challenges in Financing MSMEs**

Although the MSME sector's performance has been rather commendable, it appears that the banking system still continues to view SME lending as 'mandated' lending though the market realities have changed substantially. It needs no discussion that the lending opportunities to SMEs in India are huge. We make an attempt to summarize some of the important constraints in SME finance in Indian context.

#### **1. Infrastructural constraint:**

- Poor / non- availability of roads / transportation facilities
- Shortage of storage/ ware housing facilities
- Shortage/ poor quality/ absence of power
- Poor communication facilities in villages/ remote areas

#### **2. Inadequate Managerial Competence:**

- Lack of financial knowledge
- Lack of education
- Dispute among promoters
- Lack of professionalism

#### **3. Poor Marketing:**

- Non availability of market information
- Lack of proper marketing strategy/plan
- Lack of demand

- Fragmented markets
- Over dependence on single buyer
- Lack of knowledge with regards to product life cycle
- Unable to explore new/overseas markets
- Lack of product innovation, design, packaging.

#### **4. Obsolete Technology:**

- Lack of technical expertise
- Inadequate product development expertise
- Averse to technological up gradation
- Lack of IT orientation
- Lack of knowledge of new technology

#### **5. Financial problems:**

- Inadequacy of working capital
- High cost of borrowed funds
- Diversion of funds
- Inadequate equity/capital
- Cost overrun due to delayed credit
- Demand of collaterals by lenders
- Improper fund management
- Delay in realization of receivables
- Low profitability
- No proper accounting
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#### **6. Inadequate inputs/skills:**

- Lack of skilled manpower
- High cost and high turnover of skilled manpower
- Non- availability of raw materials at competitive prices
- Seasonal availability of raw material
- Absence of R & D
- Absence of cost control exercise

#### **7. Government Policies:**

- Frequent change in government policies
- Bureaucracy in getting subsidy, licenses, incentives etc.
- Lack of awareness of government policies/ schemes

- Little publicity by Govt. departments, Ministries

In addition to the above problems and challenges faced by the MSMEs, the Banks also perceive SME financing is a risky and non-profitable proposition. But looking to the employment potential, contribution to GDP, industrial growth, export etc., the Government as well as the regulator have constituted several committees and enacted different laws for the growth of MSME sector. Based on the recommendations of the said committees and policies of the government, RBI has issued specific guidelines/ instructions to the Banks to ensure timely and smooth flow of credit to the MSME sector and minimize the incidence of sickness.

#### **Creating a dedicated marketing team to work under the SUBIDHA Head:**

Generation of lead and finally closing the deal plays an important role in increasing the credit flow to MSME sector. Moreover, in many cases, there are protracted queries for which considerable time is wasted before the proposal is sanctioned or declined. To obviate this formation of a specialized branch for MSME named SUBIDHA is proposed. These branches will have dedicated marketing team under the branch Head. The role of the Marketing Officers will be to scout the proposals complete in all respect and hand over the same to the SUBIDHA Head for further action. Before asking for complete set of proposals, the Marketing Officer in co-ordination with the credit processing officer will evaluate the possibility of lending to those prospective customers. This will save the time spent on making queries to the party and also in receiving the missing/ required papers. It is an established fact that the major bottleneck in adhering to the prescribed TAT is the delay in compliance to the queries. The above system will reduce the TAT and also help in reducing the customer dissatisfaction due to delay in disposal of proposals. The proposed organization structure of the SUBIDHA, workflow and key business

responsibilities of the marketing team will be as under.

#### **Key Business Responsibilities of Marketing Officers.**

- Each Marketing Officer will be allotted a particular area for marketing of the products.
- He will be responsible for generating leads and also pursuing the customers to avail loan and open an business account with the bank.
- Conducting business meetings with business circles/industrialists in the area.

#### **The number of SUBIDHA branches may be increased gradually to cover the entire area of operation of the Banks over a planned period.**

With the passing of MSME Act and its subsequent developments, majority of the existing advances accounts as well as the new advances accounts will be from MSME sector. Hence, for focused marketing, to bring qualitative improvement in credit appraisal, reduce TAT and enabling the branch staff to concentrate more on business development activities, more number of SUBIDHAs may be opened in potential centres in phased manner, gradually covering the entire operational area of the Bank.

#### **Due diligence and pre-sanction inspection may be taken care of by SUBIDHA.**

Due diligence and pre-sanction inspection play a vital role in considering credit facilities. If conducted properly these also reduce the chance of rejection of the proposal at a later stage. The target time allotted for this activity is six days which is almost 40% of the prescribed TAT of 14 days. Hence due diligence and pre-sanction inspection part, if taken care of by the SUBIDHAs, will add to the available time for developmental work of the branch. Moreover, the credit officers at SUBIDHAs through their experience can perform better due diligence activities. The CPCs of some of the peer banks are

also conducting the due diligence and pre-sanction inspection.

**The limits up to Rs.1.00crore are to be sanctioned by the SUBIDHA head. If the amount is more than Rs.1.00crore, the sanction is to be made by a committee for a better asset quality of large borrowal accounts.**

The limits up to Rs.1.00crore are to be sanctioned by the SUBIDHA head. If the amount is more than Rs.1.00crore, the sanction is to be made by a committee. This will improve the quality of the decision with collective wisdom of the members. This will further reduce the fears of accountability and help in improving the asset quality.

#### **Credit Rating / Pricing:**

**Liberal credit rating approach should be followed for MSEs.**

Taking into account the inherent problems of the sector namely not so satisfactory financials, inadequate collateral, inadequate equity etc., a liberalized credit rating/scoring model is required to make this sector eligible for smooth flow of credit.

- i. To start with, a simplified credit scoring model may be put to practice. This simplified credit scoring model will have more emphasis on personal details and business aspects than the financials.
- ii. The minimum score should be 60% in the aggregate subject to minimum 50% entry level score in each parameter.

**Better pricing for good rated take over accounts.**

In case of takeover accounts if the present credit rating is higher, then the pricing should be made accordingly to offer competitive rate of interest, instead of the practice of minimum pricing level at entry practiced by many banks.

#### **Improving branch performance.**

**1. Strict enforcement to adherence to Turn around Time (TAT).**

**2. Excess of prime security value in form of plant, machinery, land, building etc. over the Term Loan outstanding should be treated at par as collateral security**

The plant, machinery, land and building form fixed assets of the company. Moreover, the land and buildings are also mortgaged to Banks. The term loan outstanding reduces with repayment of instalments and at the same time the value of land usually appreciates. Thus in such a situation, the value of security is higher than the loan outstanding amount. Hence it is suggested that the excess value of these primary securities over the outstanding in Term Loan may be treated as security in deciding the collateral coverage as well as rating.

**3. Flexibility to cross the sub limits of delegation for TL/WC/NFB limits within the overall delegation.**

The requirement of unplanned short term fund as well as TL is not uncommon for MSMEs. The cap in sub limits of delegation under TL/WC/NFB limit at times prevents the sanctioning authority to consider the genuine requirements of MSMEs, even though the total limit sought for is within the overall delegated power. The sanctioning authority may be permitted to cross the sub limits within the overall delegated authority.

**Innovating new products/ modifying existing products to meet the needs of the borrowers of MSME sector**

To make it competitive and borrower friendly, it is necessary that the products must be innovated and modified time to time looking into the needs of borrowers.

#### **Products:**

**Stand by Term Loan**

The MSME borrower will apply for this stand-by term loan along with the renewal request for his existing working capital facilities. Thus a pre-approved term loan remains at the disposal of the borrower for the entire year. He can utilize this

amount at any time during the year depending upon the requirement without any hassle. The salient features of the stand-by term loan suggested may be as under.

- To meet any genuine commercial purposes in line with the regular business line of activity of the customer.
- The Validity of sanction will be for 12 months and can be utilized any time during the period of sanction.
- There will be no penalty for unutilized/unavailed limit.

#### **Scheme for Line of Credit:**

Banks can formulate a scheme to provide single Line of Credit for meeting SME borrowers' working capital (fund based and non-fund based) as well as long term requirements within the

overall limit approved by the bank taking into account nature of business, cyclical trends, cash flow projections, peak time requirements and any eventuality of unforeseen spurt in the business.

#### **Utility and Limitations of the Study**

Despite best efforts and conviction, the present study is not without limitations. A topic of the nature that has been selected requires a very detailed investigation. Hence, the conclusions drawn here may have their own limitations. Many of the suggestions made may already be in places in many banks. However, it may be useful for few Banks in revisiting their structure and schemes of MSME financing to take this financing as a profitable growth opportunity with simplified modules-suggested.