

*Empowering MSMEs for Financial Inclusion and Growth – Role of Banks and Industry Associations**

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It is a matter of great pleasure for me to be present here today at the 'SME Banking Conclave 2012' and share some of my thoughts and experiences on the development of Micro, Small and Medium Enterprises (MSMEs) which is a vital sector of our economy. This Conclave gains importance in the context of globalisation when the Small and Medium Enterprises (SME) face challenges and take advantage of opportunities created. Such a forum helps in garnering and shaping public opinion, building consensus, crystallising policy inputs and giving us feedback on our policy initiatives. I congratulate SME Chamber of India for organising the 'SME Banking Conclave 2012'. The SME Chambers has succeeded in bringing a large number of MSMEs under a single umbrella, thereby, making it a potent and active forum for dialogue with the potential partners in the development of the MSME sector in the country, which includes the industry, the financial sector and the Government.

Importance of the MSME sector

2. As all of you are associated in some ways with the MSME sector, its critical role and place in the Indian

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economy is very well-known to all of you in terms of employment generation, exports and economic empowerment of a vast section of the population and I do not want to spend a lot of time overemphasising it. But let me quote just a couple of statistics. As per available statistics (4th Census 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 per cent of the manufacturing output and around 40 per cent 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.

3. 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 ₹4,785.27 billion as against ₹3,622.90 billion in March 2010 registering an increase of 32 per cent. The outstanding credit for the last four years to the MSE sector is given in Table 1.1 below:

4. The total MSE Credit as percentage of Adjusted Net Bank Credit (ANBC) has been increasing since 2007 as shown below in Chart 1.1. In March 2011, it stood at 14.8 per cent for the Public Sector Banks (PSBs).

5. Despite the increase in credit outstanding to the sector, the MSME borrowers feel that the lenders are not doing enough for the MSMEs and are catering more to the needs of the large corporates. This gap in perception needs to be bridged.

Table 1.1: Outstanding credit to the MSE sector by SCBs

Year	Public Sector Banks		Private Sector Banks		Foreign Banks		All Scheduled Commercial Banks	
	No of A/Cs	Amt O/s	No of A/Cs	Amt O/s	No of A/Cs	Amt O/s	No of A/Cs	Amt O/s
Last Friday of								
March 2008*	3.967	1511.374	0.819	469.118	0.065	154.892	4.851	2135.386
March 2009	4.115 (3.73%)	1914.083 (26.64%)	0.678 (-17.21%)	466.563 (0.54%)	0.058 (-10.78%)	180.634 (16.61%)	4.851 (No change)	2561.280 (19.94%)
March 2010#	7.217 (75.38%)	2763.189 (44.36%)	1.131 (66.81%)	648.247 (38.94%)	0.157 (170.69%)	211.470 (17.07%)	8.505 (75.32%)	3622.907 (41.44%)
March 2011	7.398 (2.51%)	3694.30 (33.70%)	1.718 (51.90%)	881.16 (35.93%)	0.186 (18.47%)	209.81 (-0.78%)	9.302 (9.37%)	4785.27 (32.08%)

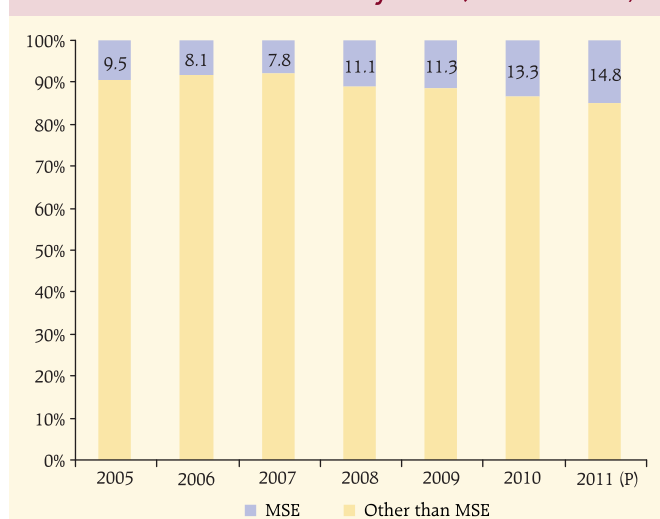
* change in definition of the sector as per the MSME Act 2006 advised to banks in 2007. # Retail trade included in service sector.

Note: Figs. In parentheses indicates Y-o-Y % growth/decline.

Source: Scheduled Commercial Banks.

6. SMEs face a number of problems, such as, absence of adequate and timely banking finance, limited capital and knowledge, non-availability of suitable technology, low production capacity, ineffective marketing strategy, identification of new markets, constraints on modernisation & expansion, non availability of highly skilled labour at affordable cost, follow up with various government agencies to resolve problems, *etc.* More recently, the MSME Association/Chambers feel that the global recession, inflation and depreciation of the rupee is affecting them adversely.

7. I would now like to highlight some of the major constraints faced by the MSME sector and the important measures taken by Government of India and Reserve Bank of India to address them:

Chart 1: Credit to the MSE by PSBs (as % to ANBC)

Increase in 2008 is due to change in definition of MSEs following MSME Act 2006

(i) Access to Credit

Access to timely and adequate credit is critical for MSMEs growth and development. To ensure enhanced credit flow to the sector, and more so to the micro units, in terms of the recommendations of the Prime Minister's Task Force on MSMEs (Chairman: Shri T.K.A. Nair, Principal Secretary, Government of India) constituted by the Government of India, banks have been advised to achieve a 20 per cent year-on-year growth in credit to micro and small enterprises; the allocation of 60 per cent of the MSE advances to the micro enterprises is to be achieved in stages, *viz.*, 50 per cent in the year 2010-11, 55 per cent in the year 2011-12 and 60 per cent in the year 2012-13 and achieve a 10 per cent annual growth in number of micro enterprise accounts. The Reserve Bank is closely monitoring the achievement of targets by banks on a quarterly basis. The matter is followed up with the laggard banks to know their constraints and impress upon them the need to devise strategies to gear up the credit mechanism for the sector. While the banks have achieved the target of 20 per cent y-o-y growth in credit to the sector the target for the micro units is still an area of concern. The banks have been advised to devise strategies to step up their lending to micro units.

I would, however, like to clarify to the MSME units, the difference between credit and money which should be clearly understood. Unlike money, credit has to be self-liquidating on a viable project and has a cost. It is to be appreciated that banks are highly leveraged bodies that lend money placed by depositors with them and

therefore, 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 rates have been deregulated by Reserve Bank of India, my message to the MSME sector is that as interest costs are a very small fraction of their operating costs, only approximately 4 per cent, do not ask for low interest rates from the banking sector, and instead ask for credit at competitive rates.

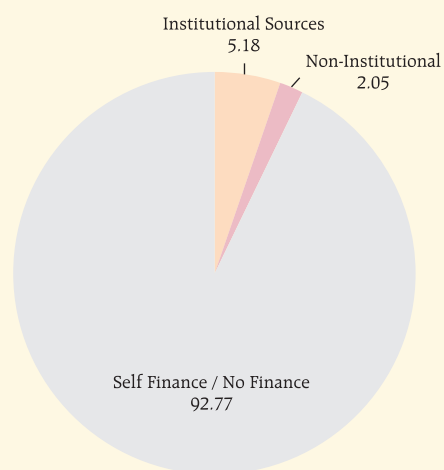
Further, the extent of financial exclusion in the sector is very high as shown in Chart-1.2 below.

The statistics compiled in the Fourth Census of MSME sector September 2009 revealed that only 5.18 per cent of the units (both registered and unregistered) had availed of finance through institutional sources, 2.05 per cent had finance from non-institutional sources the majority of units, *i.e.*, 92.77 per cent had no finance or depended on self finance

There is, therefore, a need to ensure access of banking facilities in the remote unbanked/under banked areas. Financial inclusion, including MSME finance and the drive to universal access is the national mandate. Financial inclusion makes growth broad based and sustainable by progressively encompassing the hitherto excluded population.

With an objective of ensuring uniform progress in provision of banking services in all parts of the country,

Chart 2: Financial Exclusion in MSME Sector



Source: Highlights of 4th Census on MSMEs

banks were advised to draw up a roadmap to provide banking services through a banking outlet in every unbanked village having a population of over 2,000 by March 2012. The Reserve Bank advised banks that such banking services need not necessarily be extended through a brick and mortar branch but could be provided also through any of the various forms of Information and Communication Technology (ICT)-based models, including Banking Correspondents (BCs). About 74,000 such unbanked villages have been identified and allotted to various banks through State Level Bankers Committees (SLBCs). As at the end of September 2011, as reported by the State Level Bankers' Committees of various states/Union Territories, banking outlets have been opened in 42,079 villages across the various States in the country. This comprises of 1,127 branches, 39,998 business correspondents and 954 other modes like rural ATMs, mobile vans *etc.* In addition, the Reserve Bank of India has advised banks to roll out the Financial Inclusion Plans (FIP) for drawing up an action plan to provide banking facilities in villages with population less than 2,000 through multiple channels.

(ii) Need for Venture/Risk Capital

Venture/Risk capital is often a more appropriate financing instrument for high-growth-potential and start-up SMEs. Although MSMEs commonly use traditional debt, this type of financing is often not accessible for fast-growth and start-up firms. During their initial phase, firms need finance to study, assess and develop an initial concept (seed phase) or for product development and initial marketing (start-up phase). At this stage, firms may be in the process of being set up or may exist, but have yet to sell their product or service commercially. High-growth firms usually develop an idea, concept or product that requires an incubation period before generating revenues and profits. Firms, typically, look for venture capital to provide them with the financing they need to expand or break into new markets and grow faster. Thus, the ability of MSMEs (especially those involving innovations and new technologies) to access alternative sources of capital like angel funds/risk capital needs to be enhanced considerably. For this purpose, removing fiscal/regulatory impediments to the use of such funds

by the MSMEs should be considered on priority. The Government of India, in terms of the recommendations of the PM's Task Force on MSMEs, is looking into the area.

(iii) Access to Equity Capital

Access to Equity capital is a genuine problem. At present, there is almost negligible flow of equity capital into this sector. Absence of equity capital may pose a serious challenge to development of knowledge-based industries, particularly those that are sought to be promoted by the first-generation entrepreneurs with the requisite expertise and knowledge. There is a demand for a dedicated Exchange for MSMEs and SEBI has permitted BSE and NSE to set up an Exchange for MSMEs in terms of the recommendations of the PM's Task Force on MSMEs.

(iv) Need for Skilled Labour

The sector often feels the constraint of non-availability of skilled labour. It is indeed ironic that in a nation of more than a billion individuals, skilled labour is cited as scarce. In this regard, I feel that we are a very young nation – just over 64 years since independence – setting out on a path of sustained economic growth, for decades to come. As per the National Commission on Population, the age-wise distribution of the population of India is going to change significantly in the coming years. By 2016, approximately 50 per cent of the total population will be in the age group of 15 - 25 years. Thus, there would be a tremendous increase in the number of youth entering the education and job market in the ensuing years. On an average, it is estimated that around 1.5 crore persons per annum would enter the employment market during the next 30 years. Each person, in this bold new generation, will be in the prime of his or her life, striving for a better tomorrow – creating, in the process, new growth opportunities, for budding entrepreneurs! We need to capitalise on this unique demographic advantage. At present, there are various organisations at the national and State levels offering support to entrepreneurs in various ways. The Government of India and various State governments have been implementing a number of schemes and programs over the years. The Rural Self Employment

Training Institutes (RSETIs) are working in this direction. There is, however, a need to examine the impact of RSETIs.

(v) Factoring to Tackle Delayed Realisation of Receivables

Considerable delay in settlement of dues/payment of bills by the large-scale buyers to the MSMEs units adversely affects the recycling of funds and business operation of MSME units. Though the Government has enacted the Delayed Payments Act, 1998 many of the MSME units are reluctant to pursue cases against major buyers. After the enactment of the Micro, Small and Medium Enterprises Development (MSMED), Act 2006, the existing provisions of the Interest on Delayed Payment Act, 1998 to Small Scale and Ancillary Industrial Undertakings, have been strengthened. The banks have been advised by Reserve Bank of India 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. In practice, however, the legislation did not improve the position of MSEs because of their dependence on large businesses for continued business. This problem has to be institutionally tackled by factoring and banks should provide such services particularly for MSMEs. To facilitate factoring services the Government has recently passed the Factoring Regulation Bill that would address delays in payment and liquidity problems of micro and small enterprises. Factoring provides liquidity to small and medium enterprises against their receivables from customers and is regarded as a cash management tool. Besides, factors would be entitled to take legal recourse for recovering assigned debt and receivables from buyers of goods and services. The Factoring Bill creates the legislative environment for factoring and makes the process easier.

(vi) Sickness

Growing incidence of sickness of SSIs is yet another area of concern. When the sickness prolongs it leads to the closure of units and unemployment. The mortality of the SSI units is high. This has wider implications including locking of funds of the lending institutions, loss of scarce material resources and loss

of employment. The data showing the position of sick small and micro enterprises as at the end of March 2010 & 11 is given below:

The number of units identified as potentially viable as a percentage to total sick MSE units is around 8 per cent whereas the number of sick units found unviable was as high as 85 per cent. The units placed under nursing as a proportion to the total number of sick units stood at 5.22 per cent. I would like to emphasise that timely detection of sickness is critical as any delays in this regard makes the possibilities of its revival of potentially viable sick units recede. As any other sickness, the need for timely treatment after identification of sickness cannot be overemphasised in MSMEs. In order to hasten the process of identification of a unit as sick, a proposal for modifying the extant definition of sickness, in line with the recommendations of the Working Group on Rehabilitation of sick SMEs, is under consideration of the Reserve Bank of India. For viable units, timely and effective rehabilitation by way of renegotiations of terms of loans, induction of fresh dose of funds, business restructuring, change of management *etc.* may become necessary. The process should not only be quick, efficient, cheap and fair to all stakeholders but also acceptable to and implementable by all, with necessary monitoring arrangements for implementation of the same. In case the unit is not found viable, recovery of the dues of lenders through a fair, efficient and swift legal mechanism should be the focus. As it is observed that rehabilitation of sick micro, small and medium enterprises could not be taken up due to non-availability of promoters' contribution in a large number of cases, we have recommended to the GOI to set up a Rehabilitation Fund for rehabilitation of sick MSMEs.

All Scheduled Commercial Banks have also been advised on May 4, 2009, to review and put in place MSE Loan policy, Restructuring/rehabilitation policy and

Non-discretionary One Time settlement scheme for recovery of non-performing loans, duly approved by their Board of Directors. Banks were advised in December 2009 to give wide publicity to the Non-discretionary One Time Settlement scheme for recovery of non-performing loans for the MSE sector by placing it on their bank's web-site and through other possible modes of dissemination.

(vii) Exit policy for MSMEs

An exit route for non-viable units is necessary to manage sickness. Worldwide, MSMEs are credited with high level of innovation and creativity, which also leads to higher level of failures. Keeping this in view, most of the countries have put in place mechanisms to handle insolvencies and bankruptcies. The present mechanism available in India for MSMEs is archaic. Business failure in India is viewed as a stigma, which adversely impacts individual creativity and development in the country. The existing legislations may have to be toned up so as to provide for efficient liquidation of non-viable businesses.

(viii) Infrastructure

To ensure competitiveness of the MSEs, it is essential that the availability of infrastructure, technology and skilled manpower are in tune with the global trends. MSEs are either located in industrial estates set up many decades ago, or have come up in an unorganised manner in rural areas. The state of infrastructure, including power, water, roads, *etc.* in such areas is inadequate and unreliable. Further, the MSE sector in India, with some exceptions, is characterised by low technology levels, which acts as a handicap in the emerging global market. Technological upgradation of the units would help in enhancing capacity and increase supplies which would also help to combat inflation. Need for marketing, research *etc.*

End of	(Amount in ₹ billion)									
	Total No. of Sick Units		Potentially Viable		Non-Viable		Viability yet to be decided		Units put under nursing	
	Units	O/S	Units	O/S	Units	O/S	Units	O/S	Units	O/S
March 2010	777.23	52.33	91.60	9.65	644.03	38.91	41.60	3.77	23.60	4.79
March 2011	901.41	52.11	71.18	11.13	765.18	35.89	65.05	5.09	46.98	5.18

is also critical. The Prime Minister's Task Force on MSMEs recommended several measures having a bearing on the functioning of MSMEs, *viz.*, credit, marketing, labour, exit policy, infrastructure/technology/skill development and taxation. The comprehensive recommendations cover measures that need immediate action as well as medium-term institutional measures along with legal and regulatory structures and recommendations for North-Eastern States and Jammu & Kashmir. The implementation of the recommendations, in a time bound manner, is being monitored by Government of India at the highest level.

8. Global Slowdown and MSMEs

The recent past has been a challenging time for both the bankers and the MSME sector due to recession in many countries of the globe and depreciation of the rupee. The recession has led to slowing down of the global demand for goods and services. But I would urge upon the entrepreneurs to tap the huge demand in the local markets. MSMEs are the best vehicle to create local demand and consumption and also to fight with the global meltdown. The depreciation of the rupee has made the price of the products of exporting firms in the sector more competitive.

9. Role of Banks

Banks have a vital role to play in addressing several problems faced by the sector today. Banks have to view themselves not just as providers of credit but as partners in the growth of these enterprises, through a process of hand holding of first generation entrepreneurs, while they find their feet in the business. In financial management MSE enterprises do not have the size to support the competence they need. Operational skills, including accounting and finance, business planning, marketing and human resource management, *etc.* can often pose a challenge and necessitate support for the MSE borrowers. Typically, for instance, they operate with a woefully low productivity of capital and have either too little or too much cash. The tools for doing this work are fully developed *e.g.* cash-flow forecast and cash flow management. The financial management needs of these businesses are predictable. And worldwide they fall

into a small number of categories, well-known to any experienced banker. The rewards for building a firm providing these small businesses with financial management might be enormous. Banks should therefore, provide financial consultancy/financial management services to their MSE borrowers to give them holistic guidance and support and nurturing them. Banks could set up special industrial and management consultancy departments to address functional inadequacies and market gaps.

Bank branches need to ensure greater participation in the affairs of their MSME clients by convergence of credit services and non credit services. But for this, bank staff should be trained through customised training programmes to meet the specific needs of MSEs such as knowledge of markets, both domestic and global, use of technology, *etc.* Banks need to innovate to create products specifically suited to the requirements of MSMEs and should take a longer term view of its relationship with such entities while pricing such products.

As the availability of timely and adequate credit is a key requirement for this sector, banks should introduce single window facility for providing loans to MSMEs. For this purpose, they can set up Centralised Processing Centres specifically to cater to such clients, which will handle the appraisal, sanction, documentation, monitoring, renewal and enhancement activities. As in any area, there would be a higher failure rate for start-up MSMEs. However, despite the risk, the financing of these enterprises is a must for ensuring inclusive growth. Banks will, therefore, be required to build up their risk assessment and risk management capabilities and provide for any instances of failures as a part of their risk mitigation process. I would also urge upon the Top Management of banks to put in place a credible, proactive and a functional monitoring mechanism to review the progress in actual concrete outcomes.

Bank staff has to be sensitive to the need to nurture these enterprises and to ensure that they get the necessary support during the initial phase. The performance of branch managers in dealing with the sector should be included as a criterion for evaluation of their performance.

10. Role of MSME Associations/Chambers

The MSME Associations and Chambers have an important role to play in stepping up credit to this segment. They need to proactively engage themselves in organising workshops and training programs for their members to enlighten them about cash flow cycles, various financial products, accounting practices, *etc.* In this regard, the MSME Associations, Chambers of Commerce, *etc.* may like to collaborate with banks, NIBM or any other training institute in the area of banking and finance, basic accountancy and information technology for MSEs. I appreciate the effort of the SME Chambers in organising this Conclave. I would, however, urge upon the Industry Associations to play a more proactive role and bring forward specific cases where the MSME entrepreneurs are facing problems in accessing credit through the banking channels. Such issues could be discussed and resolved in such a forum. Even if we can resolve ten per cent of the cases of genuine problems being faced by a MSME entrepreneur, I would feel that such conclaves have been successful. By doing so, the industry associations can bridge the gap between banks and individual firms in reaching of objectives such as addressing problems common to all members, stimulating co-operative action among manufacturers and providing access to resources aimed at assisting manufacturers.

11. MSMEs should understand that banks are responsible to their depositors and shareholders and, therefore, they, *i.e.*, the MSEs, as customers of bank credit, have certain obligations to fulfill by way of repaying bank loans, maintaining proper books of accounts, submitting information correctly and more importantly, sharing information about financial problems when these arise so that they can work together with the bank in resolving these. It is in the interest of MSEs, to get themselves rated by independent rating agencies, as it could enable them to negotiate with their bankers for interest rate reduction, larger loan size or even obtain faster processing of their loan applications *etc.* MSEs need to be aware that if they default and their credit history is poor they will find it difficult to access bank finance, as banks have been mandated by the Reserve Bank to pass on all credit

history of their clients to CIBIL or any other credit bureau registered with the Reserve Bank.

12. Further, senior-level representatives of SME/SSI Associations in each State are members of the Empowered Committee set up by the Reserve Bank at each of its regional offices, with the SLBC Convenor, representatives of banks having predominant share in SME financing in the State, SIDBI, Director of Industries of the State Government *etc.*, are also members. MSE Associations need to use this Forum not only for removing bottlenecks in the smooth flow of credit to the sector and for reviewing the accessibility of bank finance to more and more MSEs, but also highlight gaps if any in the attitude and skills at the bank branch level. I would urge upon the Industry Associations/Chambers to take up region-specific issues relating to MSEs with the concerned Regional Director of Reserve Bank of India and the SLBC convener banks. Such issues that cannot be resolved at regional office level could be brought to the notice of central office of the Reserve Bank. They could also spread awareness of the Government Schemes and Code of Bank's Commitment to MSEs among their members. Lastly, the success stories of micro and small enterprises may be widely disseminated as it would inspire others to strive for excellence and thus contribute towards achieving greater heights in building a strong and prosperous India. The new entrepreneurs could also take a cue from the mistakes of their experienced counterparts and ensure not to repeat the same.

A Piece of Advice

13. While I have sought to highlight the expectations from various stakeholders in supporting the growth of MSMEs, it is important to remember that individual MSMEs, themselves, have to constantly seek to transform themselves, in line with changing environmental factors, to ensure that they end up among the success stories instead of the failures. I have, in the past also, drawn from the famed management thinker Peter F. Drucker's writings to highlight four typical mistakes that entrepreneurs need to avoid as they develop their businesses. These are, particularly relevant for MSMEs during the growth phase. These include the need to be open to potential new/

unintended markets or applications for products developed by companies; the need to focus on cash flows instead of focusing only on profits as these are the lifeline that keeps the company going; creating a management team as the business develops; and lastly, the need to constantly ask the question that what the business needs at this stage and whether one is concentrating on the right things.

Conclusion

14. Let me conclude by restating the fact that MSMEs will continue to play a very important and vital role in our economy where the twin problems of unemployment and poverty constitute a major developmental challenge. In fact, if India were to have a growth rate of 8-10 per cent for the next couple of decades, it needs a strong micro, small and medium sector. MSMEs are the best vehicle for inclusive growth, to create local demand and consumption. The MSMEs of yesterday are the large corporates of today and could be MNCs of tomorrow. Thus, the banks and other agencies should

take pride while servicing the MSMEs as they are playing an instrumental role in the formation of MNCs of tomorrow. MSMEs themselves have to be on their toes, in this rapidly changing business environment, and keep evolving to stay clear of all the potential pitfalls that confront them in their progress from small enterprises to large corporations.

I look forward to your feedback in creating an enabling environment for the promotion of MSMEs in the country.

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