Summary of Macro Research Report (2020-21)

A Report on Issues and Challenges in Financing MSME in Pune, Maharashtra

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"You can't connect the dots looking forward; You can only connect them looking backwards. So, you have to trust that the dots will somehow connect in your future. You have to trust in something-your gut, destiny, life, karma, whatever. This approach has never let me down, and it has made all the difference in my life"

- Steve Jobs

Micro, Small and Medium Enterprises (MSMEs) are growth drivers for our economy. They contribute through innovations, investments, growth and employment. Bank finance will continue to be crucial for MSME sector. Governments, banks, financial institutions, intermediaries have been trying to boost MSMEs growth. There are good numbers of schemes for MSMEs but still we are yet to achieve the expected results considering our potential. The study has identified the problems in financing MSMEs in Maharashtra with specific reference to Pune. Apparently, all the stakeholders have been contributing for MSMEs development but why expected growth in MSMEs is still not taking place? This question has not been previously studied in depth. We studied this question in detail. Through our study we found that over the years the appraisal methods have undergone revisions, but those were suitable for domestic scenario now the industry has to compete internationally, with existing appraisal methods the financial assistance available to MSMEs is not giving the expected support to compete with global counterparts. All stakeholders have been contributing for the forward and backward linkages but still there are lot of innovations that can be done to boost MSMEs growth and our real potential can be met.

The summary of various Chapters in this report are as follows:

Chapter 1 elucidates on the reasons for MSMEs commanding a focused attention for developmental initiatives. This segment is vulnerable to facing financial difficulties during its life cycle compared to large corporates. It is making a sizeable contribution to employment and exports, and its potential to contribute more is also recognized. Banks and other lending institutions are trying to adopt an appropriate system of timely and adequate credit delivery to borrowers in this segment.

Chapter 2 provides a snapshot of the role of MSME, in the Indian and global economy and their role and significance in Maharashtra and Pune. It goes on to quantify its contribution to important growth parameters for an economy viz. GDP (Gross Domestic Product), employment and exports both globally and in India. It is interesting to study Pune as an emerging destination for investment by MSMEs as there is a conducive environment for businesses to flourish. The largest number of MSMEs are in Konkan (including Mumbai) which accounts for 37% of the total MSMEs in Maharashtra. And Pune has the second largest share of MSME at 27%. Pune has topped in Maharashtra in terms of investment in

Special Economic Zones (SEZs). It states that world over definition of MSMEs is based on three main criterias viz. & number of employees, assets, and turnover or sales.

Chapter 3 gives a brief on the relevant recent past studies on issues and challenges in financing MSMEs. In the recent past many studies were published on the impact of COVID-19 on MSMEs in general and specific to sectors, issues and challenges in financing MSMEs taking into consideration, the challenges faced by both lenders and borrowers individually and collectively but with a limited scope.

Chapter 4 enumerates on the research methodology used for the study. This study meets its objectives through analysis of six research questions. The first research question was **"What is the lending scenario with regard to MSMEs by Financial Institutions in Maharashtra ?"** To analyze this question, information from SLBC (State Level Bankers Committee), Maharashtra website was taken and two hypothesis were developed and a regression analysis was conducted to arrive at the results. The two-hypothesis constructed were:

H1: More number of branches leads to a greater number of MSME accounts.

H2: More number of MSME accounts would lead to more credit.

The second research question was **"What are the issues and challenges faced by banks and financial institutions in financing MSMEs?"** To analyze this, questionnaire was designed to elicit responses through focus group discussion, interviews and using online google forms. Stratified convenient sampling technique was used. 500 responses were elicited from branches of Public Sector Banks (PSBs), Private Sector Banks (PVBs), Cooperative banks and NBFCs (Non-Banking Finance Companies) in Pune district, Aurangabad, Sangli, Nasik, Ahmednagar, Nagpur, Kolhapur and Satara.

The third research question was **"What are the issues and challenges faced by MSME borrowers in availing assistance from lending Institutions?"** To analyze this, questionnaire was designed to elicit responses from MSME borrowers through focus group discussion, interviews and using online google forms. Here, again stratified convenience sampling was used and responses were elicited from entrepreneurs who were categorized into micro, small and medium enterprises. Around 500 responses were recorded for analysis from borrowers in Pune district, Aurangabad, Sangli, Nasik, Ahmednagar, Nagpur, Kolhapur and Satara.

The fourth research question was **"What are the issues and challenges faced by the MSME borrowers from the perspective of consultants?"** To analyze this question, questionnaire was designed to elicit responses from Chartered Accountants (CA) and other Consultants who were helping MSMEs in preparing loan proposals and giving guidance for all other facets of their business. Here, again convenient sampling was used. 50 responses were recorded for the analysis from borrowers in Pune district, Aurangabad, Sangli, Nasik, Ahmednagar, Nagpur, Kolhapur and Satara.

The fifth research question was **"How are lending Institutions appraising the MSME loan proposals for sanctioning loan/refinance/restructuring?"** To find answers to this question, case method was used i.e. cases (loan proposals) were collected from branches of lending institutions from Pune and all, over Maharashtra pertaining to different businesses. The collected cases were of defence unit, energy unit, flour and food unit, machine manufacturers unit, intellect systems unit, dairy unit, specialized structural engineering unit, textiles unit, sugar manufacturing unit, ceramics unit, pharmaceuticals unit, educational institute, winery unit, beauty parlor unit, petrol pump unit, agro tourism unit, paint manufacturing unit and construction company. These cases are presented in a concise manner in the report followed by thorough analysis of major setbacks of the case and conclude with observations which have been converted to recommendations.

The sixth research question was **"Which are the prevailing global practices with regard to MSME financing?"** To analyze this question existing literature available on online platforms and information gathered through extensive discussions with the stakeholders has resulted in earmarking certain countries whose strategies/policies can be studied and replicated in India. Those countries are Bangladesh, Canada, European Union, and Hong Kong.

The seventh research question was **"By studying the issues and challenges faced by lenders to MSME and borrowers under MSME, can a credit delivery model be designed that can be replicated to other states?"** To design this model, the actual issues faced by borrowers and lenders were collected through this study.

Chapter 5 analyses total lending to MSME in Pune and in Maharashtra. Pune district had the highest registrations of micro enterprises, which are 3.9 per cent of the total registrations till December 2020. Since March 2016, achievements under the Annual credit plan for Pune was lowest for the year March 2020 at 85% and March 2021 at 73% respectively. The period of (01.04.2021 to 31.12.2021) was considered crucial as vaccination drive for COVID-19 was in full swing and the economy was on the recovery track but was severely devastated due to the second wave. During this period granular tails of amounts disbursed reveal that in "Micro" segment, Public Sector Banks (PSBs) have a market share of 54% as against 43% by Private Sector Banks (PVBs). In the "Small" category, PSBs have 38% as against 62% by PVBs and the gap widens towards Medium, where PSBs have a 26% share as against 74% of PVBs. Interestingly, as regards, Khadi & Village, PSBs have a 43% share as against 54% for PVBs - identical to the Micro category first mentioned in these paragraphs. In the "others" category (as given in the data provided by SLBC (State Level Bankers Committee), PSBs are totally dominant with 99%. Going further into the lending styles, PSBs credit disbursement portfolio ratios to Micro-Small-Medium are 49:34:17, PVBs ratio is 23:40:37 and, in the case of SFBs, it is 90:6:4. This underscores the lending style of PVBs in favor of small and medium category.

Granular details of accounts (number of borrowers - beneficiaries), PSBs have 39% of market share as against 46% of PVBs and 15% by SFBs. In Micro, PSBs have a 42% share as compared to 40% of PVBs. The share of PSBs in "small" reduces to 28% for PSBs against 71% for PVBs and further widens in Medium from 7% for PSBs to 93% for PVBs. The credit disbursement portfolio ratios (excluding Khadi and Others) to Micro-Small- Medium in respect of PSBs, is 80:9:1, and in respect of PVBs is 65:20:15, whereas in the case of SFBs it is 99:1:0. This further underscores the fact that the lending style of PSBs is comparatively more skewed towards Micro, whereas in the case of PVBs, it is more skewed towards Small and Medium.

Descriptive and inferential statistical analysis tool utilized on the data of MSME, disbursal of loans both district wise and bank wise (under Maharashtra) for the year 2020-21 shows that maximum amount of correlation is between: -

- Total branch and number of accounts (0.7793)
- Total branch and Total amount under MSME accounts (0.7836)
- Total number of account and Total amount under MSME accounts (0.9410)

Two hypothesis were developed and a regression analysis was conducted to arrive at the results. The two hypothesis constructed were:

H1: More number of branches leads to a greater number of MSME accounts.

H2: More number of MSME accounts would lead to more credit.

First model which was for testing for H1 showed that total number of branches is a significant factor which leads to increase in total number of accounts (p value < 0.05) thus rejecting null hypothesis.

Further test for heteroscedasticity (Het test) is done to satisfy the regression assumptions and to be able to trust the results, the residuals should have a constant variance. As the p-value is less than 0.05 the null hypothesis is ignored thus stating that there is presence of heteroscedasticity in the data.

Second model which is testing for H2 shows that Number of accounts under MSME sector is highly significant to determine the amount of credit under MSME sector. (p- value < 0.05), rejecting the null hypothesis.

Heteroscedasticity test for same interprets the presence of non-constant variance as p - value < 0.05

Chapter 6 analyses the responses collated from 500 accounts of MSME borrowers which was given by branch managers of banks/financial institutions and from MCCIA (Mahratta Chambers of Commerce, Industries and Agriculture) regarding the challenges faced while lending to MSME borrowers. The information was collected through survey with the help of questionnaires, focus group discussion and interviews. The information was broadly collected under three heads:

(a) Efforts taken by the branch in reaching out to MSMEs.

(b) Status of MSMEs (in terms of sector, volume, NPA, interest rate, type of loan) loans advanced.

(c) Areas where change/improvement is required.

A snapshot of findings is given as under:

1. It has been found that most of the banks are having minimum one dedicated MSME vertical and each zone is having minimum one SME city Centre (Centralized Processing Centre) where all MSME proposals above Rs.10 Lacs are processed.
2. Most of the respondents have cited lack of industry data, financial statements or record keeping, standard estimation of operating cycle, regular customer base regarding MSME business as the major challenges in financing MSME.
3. Average time taken to assess the proposal for loans to MSMEs is still around 2 weeks and 59-minutes appraisal is yet to be accomplished.
4. Lending Institutions increase risk premium by charging an effective interest rate of over 16% and also insisting on additional security if the MSMEs business is not generating positive EBITDA (Earnings Before Interest Tax Depreciation Amortization).
5. The NPA rates have spiked across the MSMEs segment.

Out of the responses received 50% have 35% to 45% accounts under SMA 0 (Special Mention Accounts), 60% have 16% to 25% accounts in SMA1 and 50% have 20% accounts in SMA 2 and the segments which contributed to it were highest from auto components business (30%) followed by agro-industries (25%) and micro units (20%).

6. 80% of the respondents have disbursed MUDRA loans up to 10 lakhs.

7. Risk mitigation has been largely done through collaterals followed by higher equity contributions and loan covenants.

8. Moveable assets as collateral are also gaining traction due to its acceptability by lending organizations.

9. Around 14% of MSME loan portfolio is under restructuring and the major cause is due to delay in payment from large corporates followed by muted demand for their products and services.

10. The lenders find it difficult to assess the net income of the MSME business as there is no proper segregation of business and personal assets, the payables and receivables are not recorded properly, there are no standard days for receivables and payables, there is difficulty in verifying the prices of raw materials.

11. Lenders are providing up to Rs.2 crore collateral free loans under the CGTMSE (Credit Guarantee Trust for Micro and Small Enterprises) scheme only on demand by the borrowers, who are aware of the scheme which shows the insensitivity of the stakeholder.

12. According to lenders, the challenges faced by the borrowers are that they find the annual guarantee fee for the CGTMSE Scheme high, their market knowledge is limited which affects the sale of their products and services, banks interest rate and charges are on the higher side, there is delay in the sanctioning of loans, restructuring and rehabilitation support is not adequately provided by the banks.

Suggestions

1. Generally, MSMEs are not comfortable in bringing more capital due to the fear that if they bring fresh capital, their cases will be taken up under scrutiny by Income Tax Authorities and they will have to face unnecessary enquiries from Income Tax Authorities. For arriving at the net income of the borrowers, along with capital, unsecured loans which are subordinated should be considered (of course with a condition that these loans will not be withdrawn during the tenor of the loan).

2. Main problems faced by MSME units are meeting the current ratios and TOL/TNW (Total outside Liability/Tangible Net Worth) and often they are forced to bring capital or unsecured loans for meeting promoters' equity. Due to this, MSMEs resort to borrowings in the form of unsecured loans from various NBFCs at the very high rate of interests. Majority of them give ECS instructions to the debit of their operating Cash Credit/Overdraft account for EMI repayments. Indirectly even these unsecured loans are also funded by working capital bankers only. Majority of MSMEs are of the view that they are not given need-based finance at an appropriate time. Delays in taking decisions for sanction/review of limits are the other problems faced by MSMEs. Steep increase in the cost of electricity charges, not getting refund of GST paid by them on

exports are major complaints given by MSMEs. Earlier banks were giving loans against export incentives receivables. Like that bank may grant loans against GST refund receivables (especially for Export oriented units where the refunds are delayed between 3 to 5 months) in the form of demand loans at soft interest rates with an understanding that the GST refunds received are used for liquidating these loans.

3. Basic parameters given for restructuring are not prepared based on the problems faced by MSMEs. For Example, Kamath Committee recommendations announced by RBI (Reserve Bank of India) in the year 2020 for restructuring are meant mainly for large scale industries but are not applicable for MSMEs. A separate set of guidelines need to be prepared for restructuring MSMEs.

4. Often smaller units are forced to give deposits for taking factory premises; electricity deposits etc., at present the maximum amount lent under the MUDRA scheme is Rs.10 lakhs. Hence, many MSMEs find it difficult to purchase machines, pay premises deposits, electricity deposit apart from ear marking funds for working capital. Hence, apart from Rs.10 lakhs ceiling on fund-based limits, certain portion of non-fund-based limit in the form of bank guarantees should be given. The electricity companies should be instructed to obtain bank guarantees instead of deposit amounts. In this way, MSMEs availing MUDRA loans will have more funds on hand. While paying premium on MUDRA loans, banks may pay premium on both funded and non-fund based limits so that the risk is covered by insurance.

Chapter 7 studies the survey responses collated from 500 MSME borrowers and 50 Consultants/ Intermediaries (who help MSME businesses in preparing credit proposals and suggesting best practices in business) with the help of questionnaires, focus group discussion and interviews.

The information was broadly collected under three heads:

(a) Business details of the borrower.

(b) Ease of availing finance from banks and other financial institutions.

(c) Challenges faced and expectations of the borrower from the lending institution.

The responses received were majorly from entrepreneurs classified as micro enterprises (55%), followed by small scale enterprises (37%) and medium enterprises (8%) out of which private limited company was 50%, sole proprietorship (30%) and partnership were (20%). The sector distribution of responses was (41%) from manufacturing business followed by (37%) from services and (22%) from both.

50 Consultants who participated in the study majorly were Chartered Accountants and Bankers who are delivering services as Consultants. The businesses covered in the study were retail sale of electronic products, manufacturing of various types of cables, electronic and electro-mechanical assemblies, electronic controllers, pharma and medical, marketing of pharma products, manufacturing of medical devices, biotech, ventilators, food and beverages, distilled water, food products, engineering precision components, orbital welding machines, plastic injection moulded products, plastic parts for automotive and white good industry, solar project works, etc.

A snapshot of findings is given as under:

1. The two major issues faced by the businesses were: running short of cash frequently and delayed payments from the customers followed

by low/declining margin, stiff competition and low marketing efforts.

2. Raw material cost was the major contributor to operating cost of the enterprises followed by labour and electricity and taxes. Other issues that were affecting their business were: shortage and retaining of manpower.

3. Most of the businesses got suppliers credit of around 30 days while the receivables period extended to customers was between 30 to 60 days and the cash conversion cycle was between 60 to 90 days.

4. 27% of the MSME businesses had long term contracts with their suppliers which extended to more than three years.

5. 80% of the businesses were registered on Udyam portal and the 20% who were not registered were due to lack of confidence in its benefits.

6. 46% of businesses did not have succession planning.

7. Most of the businesses (83%) are seeking credit facilities from the financial institution which is near to their business establishment. Few who are not availing credit facilities mentioned difficulties due to business hours of the lending institution which is not comfortable for the borrower.

8. The preferred source of funding is from banks compared to money lenders majorly due to low interest rates charged, various schemes available to meet the needs, legal and lenient recovery measures, less processing charges, huge amount can be availed as loan, safety and transparency in the process.

9. Most of the businesses are having maximum requirement of cash credit/working capital and overdraft facility followed by secured business loans and bills discounting facility. On a standalone basis, availing credit from a bank is not without hassles. The businesses require strong financials, there is an elaborate internal process for appraisal which is not clearly and timely put across to the borrowers, there is lack of coordination between the banks as same information is to be provided every time to all the banks, borrowers are called for discussion number of times.

Suggestions

1. There should be a relaxed yard stick on submission of collateral securities.

   Banks take collateral securities for mitigating lending risk, but the percentage of collateral cover should be reduced to say 40% of the loan value instead of 80 to 100% expected by the bankers. In order to ascertain the performance of units, banks should incorporate a condition in the sanction letter about mandatory submission of GSTR 1, 3B every month/quarter. Month wise monitoring of sales with the projected results should be undertaken. If the branches are under Concurrent Audit, the concurrent auditor should be instructed to compare the turnover in GSTR 1 and 3B with the actual credit summation and identify diversion of funds if any done by the borrowers. It will function as an early warning signal for identifying potential NPAs. Core Banking Solution (CBS) system used by the bank should give an exceptional reporting to the branch head if any ECS payments are made by the borrowers to any NBFCs. If any payments are made for real estate or stockbrokers, the same should be given in the form of exceptional reporting to identify diversion of funds.

2. Sufficient staff should be provided in the branch, and IT infrastructure should be bettered as there is too much downtime. Banks and financial institutions should understand the nature of business and capture the potential in the business rather than just looking at the documents. If the business prospects are good, it should lend to the MSMEs, even if a document is not available or the balance sheet shows some loss.

3. MSMEs need proper hand holding. Focus should be on helping MSMEs and not just a mechanical process of lending.

   Main reason for MSMEs restructuring is, it is rather forced on MSMEs i.e. When MSMEs are unable to pass on increased costs to customers, not getting orders for their products, production line or some of the basic machines becoming obsolete due to change in the technology.

Chapter 8 contains another important contribution made by this study. The issues that came into light for the MSME borrowers and the lending institutions after analyzing proposals collected from various lending institutes pertaining to different sectors are mentioned below.

A snapshot of the observations made regarding challenges faced by MSME borrowers are as under:

1. Entrepreneurs have experience of Production, Service and Management but not of financial literacy.
2. Entrepreneurs have Know Your Customer (KYC) documents, but they do not have documented plan for their business or service.
3. Micro enterprises have less capital and higher expectations. They would like to do the business with public money and, with minimum personal equity and are particular about financial security.
4. Entrepreneurs want facility of concurrent borrowings and prefer unsecured loans to formal credit products/schemes.
5. Entrepreneurs carry unknown pressure of tax payments.
6. MSMEs are faced with problems such as sub-optimal scale of operation, supply chain inefficiencies being so much engaged in their day-to-day operational issues that they don't have time and resources to acquire various techniques for improvement. They are burdened with problems due to technical obsolescence, increasing domestic and global competition, changes in manufacturing strategies, uncertain market conditions, fund shortage and non-use of special purpose vehicle.
7. Over dependence of entrepreneurs on their consultants for the compliance, project report preparation, preparation of loan proposals has led to masking the real picture of the existing business or the new initiative to the lender.
8. Credit Guarantee Trust for Micro & Small Enterprises (CGTMSE) Scheme is poorly utilized by the banks and the borrowers.
9. Green field entrepreneurs have first-hand information about the product and services, but they do not have the proper documentation for convincing the bank officials.
10. MSMEs are dependent on few big units for business.
11. Neither is the need of the borrower properly assessed by the lending institute nor is the business model understood.
12. The borrower does not have a financial plan hence stretched receivables adversely affected the cash flows of the business.

13. Promoters were not able to maintain key professionals in the business.
14. Restructuring was considered on the basis of revaluation of the security. Delay in restructuring of a viable unit caused tremendous loss to all the stakeholders.
15. Ground reality of the business of the borrower was not understood. Abrupt reduction of working capital limits leads to failure of the business.
16. Critical review of schemes initiated for MSME borrowers have not been conducted before their approval.
17. There is a lack of contingency plan for the borrowers. Only loan availability is assured but there has been lack of hand holding by the lending Institutes.
18. Assessment is done by banks without any proper provision for market risk.
19. Factoring services are utilised by a select group of enterprises because of stringent norms of factoring companies.

Observations made regarding challenges faced by lending Institutions

1. The borrower is ignorant regarding various acts.
2. Lack of provision of additional finance to the borrower has led to business failure.
3. Banks need certification from the Chartered Accountants at various stages. The purpose of certification is for compliance purpose which delays the disbursement.
4. There is lack of awareness among borrowers about CIBIL Reports.
5. Techno Economic Viability (TEV) guidelines are conveniently interpreted by various bank officials.
6. Sudden declarations about certain sectors in the economy spoil the efforts of all the stakeholders.
7. Relationship banking is crucial, but now such relationship with the borrower is viewed with suspicion by the investigating agencies when the loan account is under stress.
8. Certain Government departments insist on the bank guarantees in their prescribed form which are not permissible as per the Indian Banks' Association (IBA) or Reserve Bank of India (RBI) guidelines.
9. There is lack of expertise for the bank guarantee or letter of credit limit at branch level.
10. The practice of opinion reports of the banks is almost discontinued in the name of competition.
11. There is hardly any sharing of information amongst the consortium members.
12. Multiple banking arrangement is risky for banks and customers.
13. Banks are working with core banking solutions and have been facing serious issues regarding correctness of data entry in respect of basic parameters like
    - Activity code
    - Segment
    - Original value of investment in plant and machinery, equipment
    - Details of primary security and collateral security
    - Loan disbursement schedule
    - Loan repayment period
    - Contact details, email - id, address for communication

- Credit Guarantee Trust for Micro & Small Enterprises cover flag
- Amount of loan instalment

In the absence of the data integrity and periodical verification of correctness of the input, it is difficult for the bank to monitor the sector wise exposure norms. As a result, banks are maintaining the margin of safety and restrict finance in those sectors without understanding the business potential of that sector.

14. Committee approach to taking lending decisions is beneficial only to the banks as every committee tries to safeguard banks interest and in the process the borrower is clueless.

Chapter 9 This chapter focusses on International best practices on lending to MSMEs in the following countries.

Bangladesh - The new National SME Policy 2019 of Bangladesh guides SME financing and sets targets for financial institutions which will be monitored through a three tier - monitoring system (Head Office, Branch Office and Banks).

Canada - The Growth Driver Program run by the government-owned Business Development Bank of Canada (BDC) in Canada provides selected companies across all sectors with formal management training, peer-to-peer networking, and other tailored non-financial services. It is executed through a small team of experienced advisors collaborates with firms to assess their needs and identify solutions to their challenges, including planning a multiyear growth outlook and preparing a management plan-as well as providing targeted support for CEOs and leadership teams.

European Union - The European Union supports SMEs through various focused programmes. The most important initiatives that will support MSMEs during the period 2022-2027 will be Single Market Programme, Invest EU and Horizon Europe.

Hong Kong - It is quite interesting to study how this country has progressed by capitalising on digital technology.

Chapter 10 - gives final recommendations for the study.

A snapshot of recommendations is as under:

On loan procedure

Pursuant to the simplified system of lending to the MSMEs, banks and financial institutions have devised the loan application forms and check list. Generally, common application form as per the Indian Banks Association format is used for loans up to Rs.2 crore. It is expected that the terms and conditions regarding margin and security should be provided on the reverse of the application form itself. Similarly, there should be standard loan appraisal forms for new units, enhancement, renewal and review of loans prescribed by the banks and financial institutions. Banks have prescribed the time norms for disposal of MSME applications to ensure all loan applications from all categories of potential customers are disposed of expeditiously. Generally, these time norms are two weeks to four weeks from the date of receipt of the loan application. As per the feedback of the customers, some banks have reduced the time norms for processing by the credit officer in the range of six days to 22 days if all such applications are complete in all respects and accompanied by the required certificates, documents. As per RBI guidelines, it is mandatory to acknowledge all applications submitted by MSME borrowers through manual or online mode.

For transparency, it is expected that a running serial number is recorded on the application form and as well on the acknowledgement. It is conveniently followed on case-to-case basis. If the borrower insists for the acknowledgement, initially, it is avoided. In case of compulsion, it is with a disclaimer remark that application is incomplete.

On Margin

The normal margin requirement for the loan is in the range of 10% to 25%. Where subsidy/margin money assistance is available from the agency, then it should be considered while sanctioning the loans and, no additional margin should be insisted. In reality, it is demanded by the credit officers.

On CGTMSE Scheme

All loans to Medium and Small Enterprises up to Rs.2 crore which are otherwise eligible to be covered under have to be sanctioned collateral free due to guarantee cover of CGTMSE. This important provision is known to borrowers and bank officials. There are misconceptions about this scheme. Generally, it is perceived as costly scheme with lot of terms and conditions, so not suitable for the borrowers. Credit officers do get comfort from collateral by the borrower.

Expectation of Good track record of the borrower

Sanctioning authority needs good track record and financials for the credit decision. The criterion for determining the good track record and strong financials is unknown to the entrepreneurs. Their consultants/advisors should take due care to sustain this illiteracy level. Bankers' expectations for good track record are as under

- Satisfactory conduct of cash credit/working capital account.
- Loan instalments and interest have to be serviced regularly.
- Timely submission of stock statements, final accounts, review / renewal data.
- Continuous profit earning.
- Credit rating, Total outside liability to Tangible Net worth ratio, Debt Service coverage ratio at acceptable levels.

Borrowers should submit the stock statements in time. If they have genuine difficulty, borrowers should approach the bank and get the necessary permission for submission of stock statements at longer intervals. Generally, there is penalty for non-submission of stock statement in time. If the borrower fails to submit the stock statements, then the bank can appoint a chartered accountant for the stock audit. It adds cost to the borrowers. Due to ignorance, it is very difficult for the units to fulfil these expectations. Then, they make up their mind to avail unsecured loans from the private lenders at higher rates.

Working Capital assessment

The working capital requirements of the units shall be assessed on the basis of say, 25% to 37.5% of the projected turnover or on the basis of operating cycle or processing cycle of the unit. In this regard, the entrepreneur has to infuse minimum 7.5% own margin so that, effectively, the unit can get working capital limit of 30% of the projected turnover. Higher of the two limits can be sanctioned. The disbursement on the basis of actual level of operations can be possible.

Loan application form as a major source of information about the entrepreneur

Loan application contains more than 77 items of information about the entrepreneur and their business.

Loan Appraisal

The loan needs to be appraised according to the check list provided by the bank. All items need to be discussed with the borrowers and guarantors. This exercise is necessary for credit appraisal as per the banks' policy. Liberalised scheme needs to be put into practice wherein the quantum of loan is not linked to the security or collateral offered by the unit. It duly considers the genuine requirements of the unit for carrying on its activity with profit. The application and the appraisal forms should be different to avoid confusion in the minds of the borrower and the lender. Schemes for technically qualified entrepreneurs which provide financial assistance to entrepreneurs for setting up new viable industrial projects should be promoted by the bank.

Provision of Sustenance Money

There is provision by some banks to provide financial assistance to the entrepreneurs to maintain themselves during the gestation period of the first year of establishment. This money can be provided by clean term loan and the amount can be included in the pre-operative expenses of the project.

Restructuring or Rehabilitation of sick MSMEs

While identifying and implementing the restructuring package, the credit officer has to observe the unit's operations closely. There is provision of 'holding on operations' which allows MSMEs to draw funds from their working capital account to the extent of their deposits of sale proceeds during the period of holding operation. While restructuring of the loan account 'viability' criteria is important. Credit officer has to work out the operating and cash break even points. Promoters' sacrifice and additional infusion of funds is necessary. The existing prudential norms for restructured accounts make the standard account on restructuring as substandard account which attracts additional provision. The Non - Performing Assets, upon restructuring, would continue to have the same asset classification as prior to restructuring and slip into further lower asset classification categories as per extant asset classification norms with reference to the pre-restructuring repayment schedule. The rehabilitation package consists of restructuring of present dues to the bank and sanction of additional credit facilities as per the need. Such additional finance carries risk of lower asset classification, in case, it does not qualify for upgradation at the end of the specified period. The restructuring norms should be revised with improved relaxation in asset classification and provisioning for the deserving cases (businesses having potential to generate profits).

The standard accounts classified as Non - Performing Assets retained in the same category on restructuring should be upgraded only when all the outstanding credit facilities of the unit perform satisfactorily during the specified period. Loan restructuring is a process in which borrowers facing financial distress renegotiate and modify the terms of the loan with the lender to avoid default. It helps to maintain continuity in servicing the debt and gives borrowers a certain degree of flexibility to restore financial stability.

About Entrepreneurship

Financial planning for entrepreneurs is important to establish the financial goals of the unit. Banks are doing feasibility study without financial plan. Banks and entrepreneurs work on projected balance sheet for further 3 to 5 years. They assume that business will be successful. After commencement of actual production or service, entrepreneurs realise the success can be illusive. Creation of business plan along with financial plan is real feasibility study of what it takes to be successful.

Conversion of Deposits to other Financial Products

The factual position is that with the emergence of cross-selling now banks are trying to convert their deposits into other financial products to earn profit out of commission. Banks deposits are being converted to other financial products which is eroding away the deposit corpus leading to reduction in lendable resources of the banks. For instance, if a bank has deposits worth Rs.20,000 crores and if Rs.10,000 crores is converted into other financial products it reduces the deposit base which also helps banks to improve their Credit Deposit Ratio (CDR) without any loan disbursement.

This trend will restrict the lending capacity of the banks in due course of time and the victims will be MSMEs. MSMEs will at some point encounter difficulties repaying their monthly instalments due to investment in such products. The growth of deposits in banking system can boost the capacity to use these deposits for the production and services. The trust of the depositors in the prudence and viability of the local banking system and strong regulatory system to ensure safety of deposits is a must. At the same time, the banks should tap the opportunities to increase their deposits to increase their capacity to lend.

SHGs for MSMEs

Self-Help Groups (SHGs) are currently for individuals, and they are widely successful. This model can be replicated for MSMEs from unorganized sector to support their non - schematic financial needs. It will also ensure timely and adequate financial assistance to the entrepreneurs at reasonable rate.

No Recognition of achievements of officers serving MSMEs.

At present, there are no incentives, recognition or motivation for business achievement in MSMEs. Whereas there are incentives for cross selling. Banks should recognize the achievement by officers in MSMEs

Relationship banking is necessary

MSMEs are not comfortable with the present compartmentalization of their loan processing. They need handholding at several times. They need guidance and support. This requires trust and relationship. Single point contact is necessary for fulfilment of their banking requirements.

Special Purpose Vehicles (SPVs)

There is a need to provide facility of SPVs to make MSMEs competitive in the global market

Open term loan facility

This facility enables the customer to identify and purchase the machinery of choice as per the requirement. Within overall term loan limit customer can purchase machinery, equipments in suitable stage safety and restrict finance in those sectors without understanding the business potential of that sector.