

CHAPTER - 17

MSMES in India – Bridging the Gap of Credit Supply

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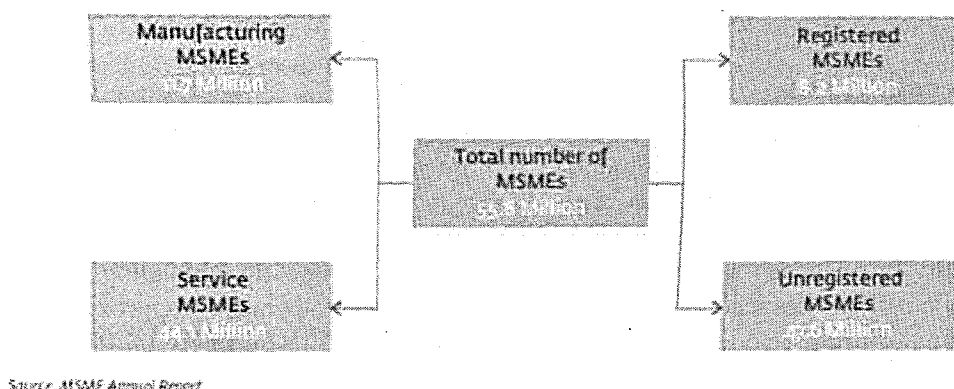
ABSTRACT: *In an economy, entrepreneurship has often recognized the economic demand and the required factors of production essential to meet that demand. Thus a substantial contribution of micro, small and medium enterprises leads towards creation of employment opportunities, enhancing the GDP growth along with improving the exports. The total number of MSMEs in India account to 55.8 ml with 47.6ml being unregistered and 44.1 ml being engaged into service enterprises. According to the MSME Annual Report 2017, MSME employment stands at 124 million with 31 percent contribution to GDP and 45 percent to the total Indian exports. The total finance demand stands at 87.7 in INR trillion as per the IFC Report 2018. WBG-Intellectap Analysis estimates the overall debt supply to the sector, through informal and formal sources at 69.3 in INR trillion. The current article attempts to study the credit growth at the aggregate level and the role of government, banks and NBFCs in extending the credit to the MSMEs thus providing them with an enabling environment. The study also reveals that the MSMEs registered annual growth rate of 4.35 percent during the period of 2006-15. There also arises a need for MSMEs to explore other avenues to fulfill the credit needs. The share of NBFCs in supply of credit shows an increasing trend since year 2015. For strengthening the financial position of MSMEs thus it becomes imperative to work collaborate towards bridging the gap of credit supply.*

INTRODUCTION

In the context of a developing economy, a remarkable importance has been attached to entrepreneurs and entrepreneurship. In an economy, entrepreneurship has often recognized the economic demand and the required factors of production essential to meet that demand which in turn leads to generation of profit.

Entrepreneurship has been one of the major aspects responsible for poverty alleviation. A slow economic growth combined with increasing level of poverty forces the people to move towards self employment. Thus a substantial contribution of micro, small and medium enterprises leads towards creation of employment opportunities, enhancing the GDP growth along with a positive contribution towards improving exports. The MSME initiates, promotes and continuously maintains the level of economic activities and secures equitable distribution of income and wealth. Micro and small enterprises in the developing countries has a major contribution towards the generation of employment. As put forth by Peter Drucker (1970) “entrepreneurship is about taking risk”. Though, a herculean task, the Indian entrepreneurs have been able to shoulder the responsibilities attached to the business because of their drive, ability and the tenacity. Their overall contribution towards the development of economy has been referred as “an economy is the effect for which entrepreneurship is the cause”(Khanka 2004). In India, entrepreneurship can be considered as necessity entrepreneurship (Chattopadhyaya 2005). The total number of MSMEs account to 55.8 ml with 47.6ml being unregistered and 44.1 ml being engaged into service enterprises. The share of unregistered enterprises remains on the higher side, presumably due to the cumbersome process of availing the registration benefits such as subsidies.

Figure 1: Broad Classification of the MSMEs in India



In order to facilitate flow of credit to the sector without the collaterals or the third party guarantees the Ministry of MSME, Government of India and SIDBI have developed the Credit Guarantee Fund Trust for Micro and Small Enterprises. Lending process by the banks to the MSME is considered eligible for priority sector advances only if the MSMEs are engaged in the manufacture or production of goods to any industry specified in the first schedule to the Industries Act, 1951 or if they are into rendering of services and work on the terms of investment in equipment under MSMED Act, 2006.

The policy in this regard makes the banks follow certain targets as specified for lending to the MSE sector. They need to achieve a 20 percent annual growth in credit to MSE, a 10 percent annual increase in the number of micro enterprise accounts and 60 percent of total sanctions to MSE sector with due emphasis on support to the Micro enterprises. Globally, India ranks third as the biggest start-up hub in the world with around 7,200 start-ups, out of which 1,200 start-ups were floated in 2018, with 108 percent growth in total funding during 2017-18. This has led to a creation of 40,000 new jobs. City based start-ups connect to local SMEs and also try to address the problems of MSMEs relating to product standardisation and access to the market. According to the MSME Annual Report 2017, MSME employment stands at 124 million with 31 percent contribution to GDP and 45 percent to the total Indian exports. However, 85 percent of the businesses remain unregistered with a meagre 15 percent being registered enterprises. This sector comprises of almost 95 percent micro enterprises. According to the MSME Census 2007, 46 percent of the units were into retail followed by food, apparel, repair and textiles resp. According to a recent CII survey, MSMEs are the second-largest employment generator after agriculture. There are 6.34 crore units contributing around 24 percent to the services GDP. The total finance demand stands at 87.7 in INR trillion as per the IFC Report

2018. WBG-Intellect Analysis estimates the overall debt supply to the sector, through informal and formal sources at INR 69.3 in INR trillion.

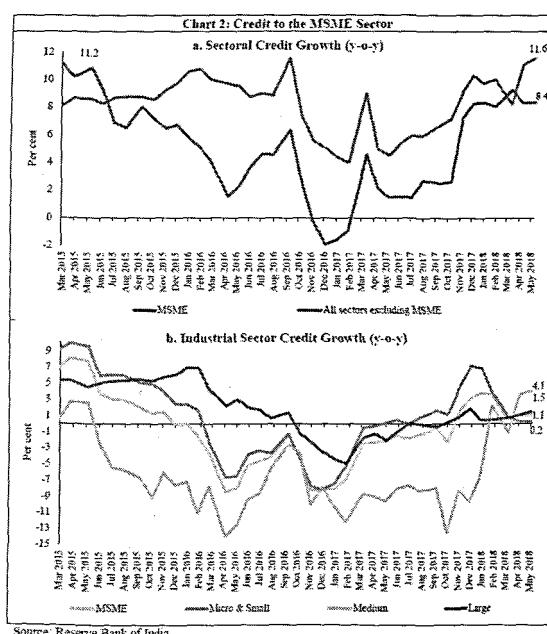
The SCB debt supply to the MSME Sector in the year 2017 stood at 5.4 in INR trillion by the Public Sector, with 3.1 by the Private Sector and 4.5 by the Foreign Banks. Debt supply from NBFCs to the MSME is estimated to be INR 1.5 trillion or 14 percent of the overall supply to the MSME sector. The micro enterprise segment accounts for 31 percent of the total credit gap in the MSME sector. However, they prefer the informal sector for their financing because of hassle-free process, personal contacts and reasonable turnaround time. As reported by the World Bank in 2014, nearly 47 percent of Indians are excluded from the formal financial system as they depend on informal credit support.

At aggregate level, it has been observed that credit growth plunged to 5.1 percent in the year 2017, the lowest in last six decades. The common phenomenon which has been witnessed shows that the bank credit remains diverted towards large enterprises. However, one-fourth of bank credit which is Rs 14.8 lakh crore out of the total Rs 62.3 lakh crore goes to the MSME sector. This highlights the potential of the MSME sector as it receives one-fifth of bank credit. Moreover, the contribution of public sector banks in lending to the MSME sector has shown a decline by 19 percent during the period from 2013-18, implying a need for MSMEs to explore other avenues to fulfil the credit needs. As per the IFC report 2018, the entry of 'new to credit' (NTC) borrowers in the formal credit sector have accelerated from 2.7 lakh in the year 2016 to 5.2 lakh approximately in 2018.

Need for the credit growth

Indian MSMEs are the backbone of the economy and has acted unremittingly as a defensive wall to avert the global economic shocks. With millions of units operating throughout the geographical spread of the country, MSMEs contribute around 6.11 percent of the manufacturing GDP and 24.63 percent of the GDP from service activities. The need for credit growth arises because the major obstacle before this sector is lack of access to finance along with the low scale, technology, competition, branding , etc. Between the manufacturing and the service sector, service sector has offered an employment of approximately 50 million, whereas the manufacturing sector could provide only half that number. Interestingly, most of the employment comes from unregistered enterprises. The saying "small things make the largest impact" holds true for Indian MSMEs where small enterprises account for a fixed asset value of over two trillion Indian rupees. With more infrastructural input and a simplified process of registration and receiving benefits from the government, MSMEs in the country are destined to go a long way.

Chart 1: Credit to the MSME Sector



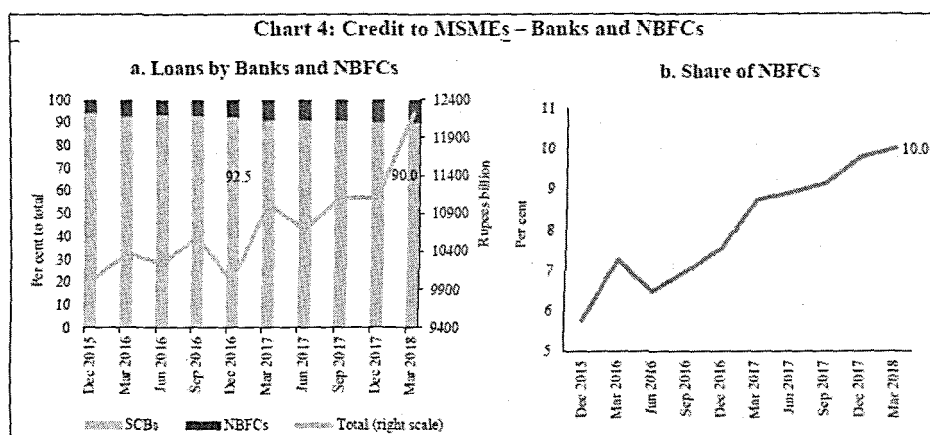
The above chart depicts the sectoral credit growth reflecting 8.4 percent of the credit being offered to MSME sector by May 2018. The credit extended to micro and small enterprises displays a much lesser share of 0.2 percent whereas the medium enterprises have secured the highest credit upto 4.1 percent by the month of May 2018. MSMEs registered annual growth rate of 4.35 percent during 2006-15 (from 3.618 crore in 2006-07 to 5.105 crore in 2014-15).

Role of Banks and NBFCs

Public sector banks have been advised to open at least one specialized branch in each district. They have been permitted to categorize their MSME general banking branches by making a provision of 60 percent or more of their advances to MSME sector thus providing better service to this sector as a whole. They are made to identify the areas with preponderance of small enterprises thus enabling the entrepreneurs to have easy access to the credit and to equip the bank personnel with needed expertise.

Banks are mandated not to accept collateral security in the case of loans sanctioned upto Rs 10 lacs to units in the MSE sector. Further, considering the good track record of entrepreneurs and stable financial position of MSE units, banks are allowed to increase the limit of collateral requirement for loans up to Rs.25 lakh after taking approval from the appropriate authority. In tune with their existing lending policies, they are made to incorporate the provisions for extending the credit facility in case of term loans, provision for additional working capital and timely review of the regular working capital limits so as to provide adequate credit to viable MSE during unforeseen circumstances. MSE entrepreneurs are also provided the training at Rural Self Employment Training Institutes along with financial literacy and consultancy support. As far as NBFCs are concerned, they do not enjoy that inherent competitive advantage unlike banks. Thus, there arises a need to provide NBFCs an access to lower cost funds with a regulatory impetus so that they can effectively assist in bridging the credit gap. They have outgrown the banking sector as their average credit disbursal growth rate stood at 24.3 percent as compared to 21.4 percent for banks. The share of NBFCs has been constantly on the rise since year 2015.

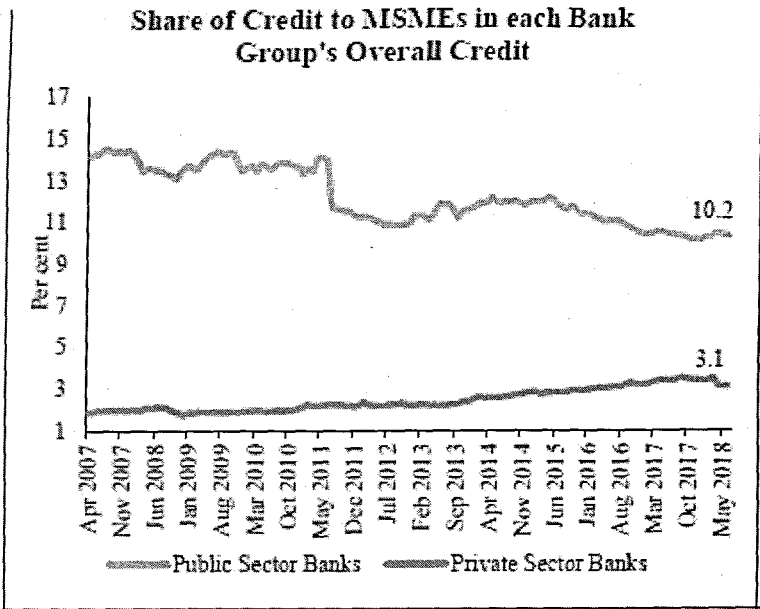
Chart 2: Credit to the MSMEs-Banks and NBFCs



IFC report accounts the credit gap at Rs 16.66 lakh crore. Micro and small enterprise together account for 95 percent of the viable debt gap. It is thus important to have a proper blend of various tools and methods to plug that huge credit gap. Commercial banks, however, continue to play a very important role. Of the 16 percent financing which happens through the formal sector, about 80 percent is known to be from commercial banks. However, NBFCs and fintech are emerging as supporting centres in recent times.

Overall Credit Supply to MSMEs in India stands at INR 69.3 trillion. The debt supply of other banks and institutions as on 2018 stands as follows: Scheduled Commercial Banks INR 8.8 trillion, NBFCs INR 1.5 trillion, Other Banks INR 0.56 trillion, Government Institutions INR 0.04 trillion, Public Sector Banks INR 10.2 trillion, Private Sector Banks INR 3.1 trillion, Foreign Banks INR 0.3 trillion, RRBs INR 0.11 trillion, UCBs INR 0.45 trillion, SIDBI INR 0.01 trillion, SFCs INR 0.03 trillion. The public sector banks

Chart 3: MSME Credit by Scheduled Commercial Banks



Source: Reserve Bank of India

along with commercial banks play a pivotal role in bridging the credit supply gap. The share of public sector banks in offering credit to MSME with regard to the overall group credit stands at 14.6 percent.

Enabling Environment for MSMEs

In terms of their contribution to the economy and generation of employment in the country, the existence of MSMEs becomes indeed vital. The regulatory council of India along with central and state level government departments as well representatives from the industry and various experts work for maintaining that competitiveness among Indian MSMEs and works towards productivity enhancement through adoption of best practices and usage of appropriate technologies. It also monitors the financing and credit needs of MSMEs, and explores the possibilities for attracting global investors to the sector. In addition, it plays a pivotal role in strengthening India's bilateral trade with developed and developing economies. Even with those enormous challenges from accessing credit to marketing in this sector, India aims at increasing the GDP share from 30 percent to 50 percent in near future. However, reducing the credit gap still remains a challenge. The cluster development initiatives are mostly funded by public sector agencies whereas private sector contribution is expected to be enhanced through debt instruments like bonds, CDs, etc, with tax incentives offered through SIDB. Recommendations are also in support of strengthening the MSME Export Promotion Council which can pave way towards the crowd funding of MSMEs. The VC/PE firms expect a support from government-sponsored Fund of Funds (FoF). Assistance to MSMEs in mediation, debt counseling, financial education, etc also becomes vital. For strengthening the financial position of MSMEs, provision of insurance coverage to MSME employees by the government under Ayushman Bharat and PMJAY to in the advent of natural calamities can also be of much benefit.

If all the credit guarantee schemes are brought under the purview of RBI, due accountability and efficiency in the lending process can be aimed at. MSME loan proposals can be appraised through collection of online data from Credit Bureaus , Income Tax, Fraud Registry etc. RBI has rightly recommended for 25 percent mandatory procurement by PSUs from MSMEs and creating a unique enterprise identifier (UEI) for facilitating procurement, availing benefits, etc. At present, MSMEs have to do multiple registrations at Udyog Aadhaar portal, GSTN, NSIC, etc .which consumes much of the time and money which needs to be given a serious thought.

CONCLUSION

The government should assist in collaboration between MSME clusters and companies or universities

which can facilitate in areas such as technology, product development and marketing techniques for creating an enabling environment for MSMEs. The programs like Digital India, Start-Up India and Smart Cities, have created a conducive climate for financial technology. Thus, an effective environment for MSMEs would be the one where the policies and regulations encourage the entrepreneurs to establish their own ventures and also helps existing entrepreneurs to enhance the scale of their operations by bridging the credit gap.

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