

Credit to Small and Medium Enterprises - At Cross Roads

A.V. Sardesai*

The small scale industrial (SSI) sector has played a very crucial role in the industrial development of the country. With its ability to provide a larger employment per unit of capital employed, decentralised production, ancilliary support, development of entrepreneurship, it has not only contributed substantially to industrial production but also to exports. It was in late 70's that for the first time Government of India (GOI) announced a separate policy for SSI sector. Table I below traces the growth of the small scale industrial sector.



Table 1 - Growth of SSI

Year	No. of SSI Units (in lakh)	Production (Rs. in crore)		Employment (in lakh)	Export	
		1993-94 prices	Current prices		(Rs. In crore)	(US \$ mm)
1973-74	4.2	34200	7200	39.7	400	500
1980-81	8.7	72200	28100	71.0	1600	2078
1990-91	67.9	84728	78802	158.3	9664	5386
2000-01	101.1	184401	261297	239.1	69797	15278
2001-02	105.2	195613	282270	249.1	71244	14938
2002-03	109.5	210636	311993	260.1	86013	17773
2003-04	113.9	228730	357733	271.4	97644	NA
2004-05	118.9	251511	418263	282.9	NA	NA

(Sources - MOSSI & Economic Survey 2005-06)

There had been a spurt in the growth of number of SSI units in the 1980s and thereafter the number had grown steadily. By the end of 2004-05 there were 118.9 lakh units accounting for a production of Rs.418263 crore at current prices and employment of 282.9 lakh. For the year 2002-03 the export of SSI in US\$ terms were at 35.7% of total exports.

*Executive Director (Retd.), Reserve Bank of India.

Table 2 provides a comparison of growth rates of SSI sector vis-à-vis the manufacturing sector during 1990-2001.

Table 2
Annual growth rates of overall industry,
manufacturing sector and SSI

Year	Overall Industry(%)	Manufacturing sector (%)	SSI Sector(%)
1990-1991	8.2	9	9.1
1991-1992	0.6	(-) 0.8	3.1
1992-1993	2.3	2.2	5.6
1993-1994	6.0	6.1	7.1
1994-1995	9.1	9.1	10.1
1995-1996	3.0	14.1	11.4
1996-1997	6.1	7.3	11.3
1997-1998	6.7	6.7	8.4
1998-1999	4.1	4.4	7.7
1990-2000	6.7	7.1	8.2
2000-2001	5.0	5.3	8.1

The significant role played by SSI sector in industrial development is evident as it has consistently grown at a rate higher than the manufacturing sector except in 1995-96.

The development of SSI sector was not even across the states. An analysis made in SIDBI report on SSI sector, for the year 1999-2000, indicated that major concentration of SSI units was in UP (12.51%) followed by Tamil Nadu (11.34%), Madhya Pradesh (9.71%), Bihar (9.34%), Maharashtra (7.83%), Karnataka (7.3%) and Gujarat (5.76%). Tamil Nadu accounts for the largest share of employment (20%) followed by Maharashtra (10.28%), UP (9.73%), Delhi (7.8%) and Karnataka (7.39%). Maharashtra accounted for the largest share of investment at 33.3% followed by Tamil Nadu (12.03%), Gujarat (8.93%), Karnataka (6.65%), UP (5.47%) and Punjab (5.32%).

Credit to SSI Sector

Adequate and timely availability of credit is a *sin-qua-non* for development and growth of any sector of economy. Considering the importance of the SSI sector in generation of employment, it has been given the priority status in lending by banks. Under the present dispensation, the scheduled commercial banks are required to deploy 40% of their net bank credit in priority sector which includes agriculture, SSI and others. While there is a quota earmarked for agriculture, there has been none for SSI. Table 3 gives the growth of advances to SSI since 1991-1992

Table 3
Lending to SSIs by Public Sector Banks

(Rs. in crore)

Year (1)	Net Bank Credit (2)	Loan to SSI (3)	% of (3) to (2)
1991	105632	16783	15.9
1995	169038	25843	15.3
1998	218219	38109	17.5
2000	316427	46045	14.6
2001	341291	48400	14.2
2002	396954	49743	12.5
2003	477899	52988	11.1
2004	558849	58278	10.4
2005	718722	67634	9.4

The deployment of bank credit to SSI sector as a proportion of net bank credit has been declining since 1991-1992 when the reforms process in the banking sector was initiated. The regional distribution of advances deployed by the schedule commercial banks to SSI sector as on March 31, 2003 is given in Table 4

There has been a large regional disparity in the deployment of credit to SSIs. The Northern, Southern and Western Regions have a share of 81% of the bank credit whereas North Eastern, Eastern and Central Region account for 19% of the credit to SSI sector.

As on March 31, 2003, there were 109.5 lakh units in existence whereas the scheduled commercial banks had 18.16 lakh accounts in their portfolio. If the number of accounts is taken a proxy for number of units, then the coverage worked out to 16.6% only or in other words, nearly 83% of the SSI units were outside the formal financial system. The third census of SSI for 2001-02 had come to the conclusion that only 7.39% of units have outstanding loans, of which 4.55% had outstanding loans from institutional sources. The ratio of production at current prices to credit outstanding ranged between 5.08% and 6.14% during the period 2000 - 2004. The deployment of credit by banks as a proportion to net bank credit is declining and that there are regional disparities in deployment of credit by bank to the sector. Thus, there is a very large financial exclusion of SSI units. These issues need to be addressed appropriately.

Table 4
Schedule Commercial Banks Advances to SSI
as on March 31, 2003

(Rs. in crore)

Region	No. of accounts	Amount outstanding	% of 2 to total	% of 3 to total
1	2	3	4	5
Northern	299741	15178	16.5	23.5
North Eastern	39914	378	2.2	0.6
Eastern	507337	5600	27.9	8.6
Central	283136	6542	15.6	10.1
Western	174272	18959	9.6	29.3
Southern	512443	18050	28.2	27.9
Total	1816843	64707	100.0	100.0

(Source - RBI)

Recent Policy Initiatives for Promoting Small Enterprises

From time to time GOI has been initiating policy measures for promoting small and medium enterprises (SMEs). One of the contentious issues has been dereservation. Reservation, per se a protectionist measure, breeds inefficiency. If the challenges of globalisation, reduction of tariffs, external competition are to be faced, then efficiencies are to be brought in and the process of dereservation has to set in. The GOI has, therefore, brought down the number of items reserved for SSI to 506 and more items are under consideration for dereservation. Fiscal relief are also provided to smaller SMEs by increasing the turnover limit under general SSI exemption limits upto Rs.4.00 crore. In order to remove the inspection raj, the MSMED Act has been enacted, limits under credit linked capital subsidy scheme has been raised from Rs.40 lakh to Rs.1.00 crore, Small Enterprises Financial Centres (SEFC) have been constituted by SIDBI for better coordination between the banks and SIDBI, a new package of promotion of Micro & Small Enterprises is under consideration.

Policies on Lending to SSI Sector

The process of liberalisation had created many opportunities and challenges for the sector. In 1991, GOI announced a separate industrial policy which had measures for development of small, tiny and village enterprises. Subsequently, many measures were initiated for development of the sector. These measures were, among others, setting up of National Renewal Fund, promulgation of Interest on Delayed Payment Act, launching of Integrated Infrastructure Development Fund and single window scheme of SIDBI, Technology Development and Modernisation Fund at SIDBI, etc.

Various committees, viz. Nayak Committee, Abid Hussain Committee, S.C.Kapur Committee, Dr.S.P.Gupta Committee, Ganguly Committee have examined the problems faced by the sector and made some significant recommendations which, in a way, changed the banks' approach to SSI lending. Thus, banks were required to follow a simplified approach to assessment of working capital requirements, providing finance to small unit by way of composite limit comprising of investment and working capital, providing collateral free loans to small units upto a limit of Rs.5.00 lakh, making credit guarantee available to SSI units covering collateral free loans up to Rs.25.00 lakh, etc. Banks were also advised to open a number of specialised SSI branches. GOI created a new ministry of SSI and Agro & Rural industries for providing a focused attention towards development of the sector. In 2000, the GOI had announced a comprehensive policy package which included policies relating to fiscal incentives, infrastructure, technology and quality improvement, credit marketing, etc. A number of measures have been implemented including venture capital availability so that the financial needs of this vital and vibrant sector are met effectively. In August 2005, the GOI announced a policy for stepping up credit to SMEs. The policy had the following dimensions:-

(i) units with investments in plant and machinery in excess of the SSI limit and upto Rs.10.00 crore to be treated as medium enterprises but only SSI units financed would be included in priority sector (ii) public sector banks to fix their own targets for funding SMEs in

order to achieve a minimum 20% year-on-year growth in credit to SME sector, (iii) banks to follow a transparent rating system with an appropriate linkage with cost of credit, (iv) banks to make efforts to provide credit to at least 5 new SMEs at each of their semi urban and urban branches each year, (v) RBI to issue detail guidelines on debt restructuring of SMEs, (vi) introduction of an OTS scheme, (vii) banks to formulate a comprehensive and more liberal policy relating to advances to SME sector, (viii) special dispensation under the credit guarantee scheme for all loans upto Rs.2.00 lakh, to eligible women entrepreneur and borrowers located in NER & J&K, (ix) cluster based approach to lending and banks to ensure presence of specialized SME branches in those clusters, (x) periodical review of the progress state-wise, (xi) bank boards to review progress of self set targets, and (xii) periodical review of progress state wise. Thus, a number of measures have been implemented including venture capital availability so that the financial needs of this vital and vibrant sector are met effectively

Financial Inclusion of Micro Enterprises

Agency model for rural credit and micro finance, with the existing large rural branch network of commercial banks, have covered only about 17 to 18% of rural population through deposit and loan accounts. The cooperative credit structure suffers from many infirmities. The RRBs are yet to fill the gaps. To meet the gaps, many innovative ideas have been put forth. There are many micro finance institutions (MFIs) operating for many years. The MFI system, through bank - SHG linkage, made tremendous stride with strong official support. However, there is a lopsided development, in as much as it has made rapid progress only in southern states and it is yet to take roots in other states. Besides, the SHGs are mainly women participative and the credit outlay per capita is low. There issues are multidimensional and need to be addressed. Two other models i.e. Business Facilitator and Business Correspondent are now proposed. Whereas the former provides support services for delivery of financial services the later functions as a pass through agency. The two models are of a very recent origin.

Sector's Perspective

There is a need for a comprehensive study to address the various issues/factors which constrains the coverage. Interactions with the sector suggest that the small enterprises expect a simplified application form and appraisal systems and early decisions. A transparency in processing fees, raising the limit of collateral free loans to Rs.50.00 lakh, reduction in guarantee fee are some of the issues mentioned often. But more importantly, the inability of the banking system to comprehensively meet the credit requirement is a major issue.

The Bankers' Perspective

The SSIs have characteristically low capital base and financial infirmities in meeting the shocks they face. The banking system has no customised product for meeting these temporary problems and have only *ad hoc* as an instrument which is a tedious process. This may lead entrepreneurs to move over to informal sources for meeting these shocks which could be detrimental to the interest of the formal financial system.

A major critical issue is the risk perception of the banks in lending to the sector. The level of NPAs of scheduled commercial banks in SSI advances is given below:

(Rs. in crore)

		NPAs	
		2004	2005
1.	SSI	10101	8799
2.	Non Priority Sector	33494	30417
3.	Total	60501	56496
4.	% of 1 to 3	16.69	15.57
5.	% of 2 to 3	55.36	53.8

The proportion of NPAs in SSI lending to outstanding loans to SSI sector is given below:-

(Rs. in crore)

		Years	
		2004	2005
6.	Loans to SSI	65901	76302
7.	NPAs	10101	8799
8.	% of 1 to 2	15.3	11.5

(Source - : RBI's Report on the Trend and Progress in Banking- 2004-05)

At the gross level the ratio of gross NPAs to gross advances was 7.2% and 5.2% for 2004 and 2005 respectively. Thus, the banks' perception is that there is larger risk involved while providing financial services to the SMEs. A number of measures have been suggested to deal with these risks which include, mechanism such as, OTS, CDR, rehabilitation of sick SSI. The risk of default could be addressed by increased recourse to credit guarantee provided by the CGTSI. The request of the sector to raise the limit is pertinent in this context. Rating may also be used as a tool for risk management.

Another major issue is the information asymmetry that exists. A lot of improvement is required in the presentation of accounts, projections, etc. by SSI units to the bankers. SSIs need to be more accurate and fair to enable the bank to arrive at an appropriate financial decision.

The Road Ahead

A greater stress on lending to clusters is necessary. There are new opportunities being created on account of WTO provisions and these need to be exploited through

formation and development of clusters. The recent policy provides for this approach. Large scale outsourcing of production activities provides opportunities of ancillarisation and many clusters are coming up. But settlement of bills is becoming an issue. There is a tendency amongst large units to delay the payment of suppliers bills. Attempts to regulate this problem through legislation have not proved to be successful. A coordinated approach by the bankers, the large units and the suppliers needs to be explored.

Services sector is coming into prominence and has ability to generate considerable employment. It has been included in the SSI sector for priority lending in a limited way. It may be explored whether definition similar to SSI can be made applicable to services sector.

In conclusion, it may be mentioned that very useful and pragmatic policy initiatives have been introduced in relation to credit to SME sector which has resulted in growth of credit to the sector but still there is a large scale financial exclusion, particularly in the tiny sector. This has to be addressed fittingly. At the same time, a study/survey needs to be undertaken to examine the causes of exclusion and to address them suitably so that the SME sector comes under financial mainstream and it becomes more vibrant and contributes more to the development of the nation.

