Financing of Small and Medium Enterprises in India

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Small and Medium Enterprises (SMEs) have played a significant role world over in the economic development of various countries. India, certainly, is no exception. Over a period of time, it has been proved that SMEs are dynamic, innovative and most importantly, the employer of first resort to millions of people in the country. SMEs in India have recorded a sustained growth during last five decades and today, SMEs have substantial share in industrial production, export and employment. The sector contributes 40 % of the gross value added in manufacturing, around 35 % to direct exports, provide employment to around 28 million people in the country and is a breeding ground for entrepreneurship. Keeping in view its importance, the promotion and development of SMEs has been an important plank in our policy for industrial development and a well-structured programme of support has been pursued in successive five-year plans for the promotion and development of SMEs in the country.

India embarked on the path of opening up its economy and integrating it with the global economy in 1991. The liberalization of economy, while offering tremendous opportunities for the growth and development of Indian industry including SMEs, has also thrown up new challenges in terms of fierce competition both in domestic and international markets. The very rules which provide increased access for our products in the global market, also put domestic industry under increased competition from other countries, not only in exports but also in the domestic market. In today's world, technology, competitive strength together with benchmarking with the best international standards and practices have become the drivers of change and accelerated growth. Access on a global basis to modern technology, capital resources and markets have become the most critical determinants of international competitiveness. This underscores the need for SMEs to be internationally competitive in terms of quality, delivery, after-sales service, price, etc.

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The need of the hour for Indian SMEs is to upgrade their technology, quality and adopt modern management techniques to keep pace with the changes that are taking place in the global market. Investment would be a prerequisite in these areas to bring about transformation. The availability of adequate credit at affordable cost, thus, becomes critical for Indian SMEs.

There exist a well-developed network of financial institutions at national and state level to channelise credit to SMEs. SIDBI is the national level principal financial institution for promotion, financing and development of SMEs. It provides direct assistance to the SSI sector through several schemes like direct discounting, project finance, assistance for technological

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upgradation and modernisation, marketing, finance, resource support to institutions engaged in developing SSIs, venture capital, factoring services, etc. It also provides indirect assistance comprising refinance, bills re-discounting (equipment) and against inland supply of bills through an organized network of 910 Primary Lending Institutions (PLIs) including banks and SFCs with more than 65,000 outlets throughout the country.

In order to enhance the flow of credit to the sector, various initiatives have been taken by the Government of India/Reserve Bank of India from time to time, viz. enhancement of loan limit under Composite Loan Scheme, increase in project cost limit under National Equity Fund (NEF) Scheme, launching of Credit Guarantee Fund Trust for Small Industries, extension of concessional assistance under Technology Development and Modernisation Fund Scheme, introduction of special schemes for modernization of units under Technology Upgradation Fund Scheme for textiles and jute industries, Tannery Modernisation Scheme and Credit Linked Capital Subsidy Scheme for Technology Upgradation. Further, to give focused attention to the needs of SSIs, public sector banks have so far opened 391 specialised SSI branches.

Last year, the Government of India has announced that the credit to SMEs would be doubled in the next five years. Various policy directives and schemes have been announced from time to time to help improve the credit flow to the sector. The credit rating system for SMEs has recently been introduced to ensure availability of adequate and timely credit at low cost. Dedicated agencies for credit rating to SSI sector have been created with a provision of subsidized credit rating charges. The concept and practice of cluster financing has been brought into practice. Besides, the RBI has recently allowed banks to appoint business correspondents for collecting deposits and delivering credits. This could be really helpful for micro financing.

However, the availability of adequate and timely credit to SMEs continues to be a major concern. The proportion of credit to SMEs among the total bank credit has shown a declining trend. The figure speaks for itself. The share of net bank lending to SSI sector has declined from 17.5 % in 1998 to 8.5 % in 2006. Lack of credit at reasonable rate has hindered the growth of SMEs in the past. According to the third All India Census of Small Scale Industries, there are around 11.85 million small scale units in India, out of which, only 1.63 million are registered and rest are unregistered. Only 14.26 % of the units in registered sector and 3.09 % in unregistered sector have access to institutional finance. The coverage of institutional finance, thus, is far from satisfactory. It is no wonder that according to a survey conducted by SSI Ministry in 2003-04, 48 % of the respondents cited shortage of working capital as at the key reason for sickness in the industry.

It is clear from the above, that despite the best intentions of the Government to expand the credit to SMEs, the results are far from satisfactory. It calls for an urgent need to have a relook on the policy measures for the promotion of SMEs and iron out the problems hindering the growth of credit to this sector.

Non-availability of acceptable collateral is the major problem at the time of starting a venture. The problems get further compounded in case of young and women entrepreneurs. Even though the Government along with SIDBI has set up a Credit Guarantee Fund Trust for Small Industries (CGTSI), to encourage banks to extend financial assistance to SMEs without collateral, the banks still seem to be hesitant to extend credit to SMEs. Similarly, despite a scheme for technology and quality upgradation with a subsidy component, the disbursement under the scheme is certainly below expectations.

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- First, a very important issue to understand is the composition of Indian SMEs and their financing needs. As per third All India SSI Survey, out of 11.85 million SSI units in India, more than 99 % units falls in the category of tiny, i.e. investments in plant and machinery of these units is less than Rs. 25 lakh. Even in this tiny sector, majority of them would be very small and would include cottage industries and artisans. Only a few lakhs would actually form what can be termed here as modern SSI sector having investments in plant and machinery in the range of Rs. 25 lakh to Rs. 1 crore. The financing needs of these modern SSIs along with medium enterprises, say with an investment in plant and machinery less than Rs. 10 crore, are, most of the time, quite different than that of tiny enterprises. These big units among the SSI sector would often require funds mainly for diversification and expansion of the business and technology upgradation that needs to be dealt with separately. The schemes like credit ratings are most relevant to this sector. On the other hand, micro financing would be a very effective tool for financing smallest of small enterprises providing coverage to a large number of small units and also reducing the risk of banks. Further, there is a need of reorientation of government functionaries to this vast range of SMEs. It will be in the best interest of the sector if government officials are properly designated to take care of certain set of SSIs and the relevant schemes.

- Second, one will have to realistically assess the positions of banks and other financial institutions in this regard. They have the concerns about the NPAs and the growing incidences of sickness in SSIs. Obviously, financing of SMEs should be a profitable venture for banks so that they can extend credit to SMEs. As the large enterprises have access to alternative sources of financing, like capital markets and often the rate of interest is very low in case of large enterprises, banks have also started looking at SMEs as a potential thrust area. However, this needs to be further strengthened by the right mix of promotional policies reducing the risk of banks while financing the SMEs. Banks, on their part, would do well by providing adequate publicity to various promotional schemes so that a large number of units could get benefited.

- Third, it is often observed that there is a lack of understanding of the government policy directives and guidelines and schemes of the RBI and the SIDBI on the part of field level functionaries of financial institutions. The officials need to be sensitized regarding the needs of the SMEs through proper training.

- Fourth, a number of private banks are venturing in the field of SME financing with innovative schemes. Besides, cluster financing and innovative financing schemes like factoring are emerging as powerful tools for extending credit to SMEs. Credit rating is also gaining prominence. However, again there is a lack of understanding of these schemes on the part of banks and other financial institutions as well as SME entrepreneurs. It, therefore, becomes extremely important to engage SMEs and financial institutions and apex SME developmental agency in a constructive dialogue to ensure better understanding of policies and schemes. SME associations should come forward in this regard and organize programmes in which all the stakeholders could be invited and the schemes could be popularized.

- Fifth, the SME associations and NGOs should come forward and accept more responsibilities. Their role should not be limited to only lobbying for their members. The associations and NGOs can play a crucial role in micro financing. They could also provide specialized services to the SMEs in preparation of project documents and help in procedural aspects and could also help banks in assessing the risk for financing a venture.

- Sixth, a few changes and improvements in the policies could help infuse credit to this sector. Equity participation ceiling of large companies in small scale sector should be raised from 24 % to 49 %. It would certainly motivate large enterprises to invest in small enterprises and thereby expansion of these units. Similarly, technology upgradation fund of SIDBI needs to be strengthened. The scope of credit linked capital subsidy scheme should be enhanced to cover a wide spectrum of products, sub-sectors and technologies.

- Seventh, over the period, it has been observed that small units that are linked to large corporates as suppliers, service providers, etc. are usually successful. It is relatively easier for the banks and financial institutions to finance various requirements including working capital, technology upgradation, etc. of these units. Promotions of clusters linked to large units, thus, could help expansion of credits to small units.

Finally, it has been observed that one of the major reasons for delays in sanction and disbursal of loans is the lengthy documentation and legal procedures involved in the process. While the large industries can afford to hire specialists for the job, the small scale entrepreneurs are often ill-equipped to handle this job on their own. It will greatly help SMEs if facilitation services are provided by various promotional agencies like SISIs, DICs, SIDCs, industry associations, banks, etc. The evaluation of various applications should also take place in a time bound manner and a stand should be taken within a stipulated time period. In case the application is rejected, the bank must apprise the applicant of the reasons for not granting the loan. For the benefit of SMEs, which through improved efficiency have managed to reduce the stock, the banks should give consideration to other factors for computing the maximum permissible bank finance. ■