



NPA Conundrum of Small Scale Industries and Tiny Units

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Think globally and act locally it has been said. Jean Tardif in his article "The Hidden Dimensions of Globalization: What is at Stake Geo-culturally?" says that "Since the 1648 Treaty of Westphalia, national territories have been the foundation of international relations, based on relationships between sovereign states". Today's global dynamics transcend this interstate model more and more, however. The globalization of knowledge never meant general acceptance of neo-liberalism by any definition we know of. We use the word "neo-liberalism" in its original sense. John Williamson, Senior Fellow, Institute for International Economics, Washington, USA and a renowned economist of the World Bank refers to the doctrines espoused by the Mont Pelerin Society (a classical liberal society, founded by Friedrich Hayek and other scholars in 1947). According to him, a set of ideas that had long been accepted as appropriate within the OECD countries was sweeping aside policies of the 50's in Latin America. Arguably one of the most discussed term, known as the

Washington Consensus, was, thus, espoused by him broadly outlining fiscal discipline, reordering public expenditure priorities, tax reform, liberalising interest rates, a competitive exchange rate, trade liberalization of inward foreign direct investment, privatization and deregulation of property rights, as the issues aimed specifically at Latin America.

He had emphasized that this was done at a particular moment of history and not as a text for all countries at all times and rued that he would have added the need for policies designed to crisis-proof economies and stabilize them against the business cycle (the sort of measures that Ricardo French-Davis has advocated under the heading of "reforming the reforms"). Hardly he would have thought that his consensus would be regarded as a comprehensive blueprint for policy practitioners which would be blindly aped and followed as a text for all countries at all times. Creating capital for the poorest of the poor to enable him to work his way out of poverty and such other issues of income distribution should ideally be addressed in a manner with a sure goal that it should matter profoundly who gains or loses income. All these profound thoughts and more have all been lucidly illustrated very apologetically by him in a paper in September 2004.

Globalization does, nonetheless, constitute the structuring process for key sectors of contemporary activity, constraining us to rethink the relationships between territory and security – its geopolitical stakes – and between territories and economies – its geo-economics stakes. Quite as important, it is changing relationships between territory, cultures and the representations of them that we have. Thus macro policies could be formulated along these broad contours

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but microeconomic policies should involve an active role for the state as the Korean, Taiwanese and Chinese experiences, not to speak of the Japanese experience, which all were far from pursuing laissez-faire blindly as an end in itself to bolster their economic growth and with particular reference to financial stability of their banks. These material facts have been highlighted here for the simple reason that what arose out of the said Washington Consensus as structural reforms, inter alia, as financial sector reforms, came to be carried under the aegis of the Bank of International Settlements (BIS) by the Basel Committee on Banking Supervision (BCBS).

In 1988, the Committee decided to introduce a capital measurement system commonly referred to as the Basel Capital Accord. This system provided for the implementation of a credit risk measurement framework with a minimum capital standard of 8% by end-1992. Since 1988, this framework has been progressively introduced not only in member countries but also in virtually all other countries with active international banks. It is interesting to note that this has been done in spite of the fact that the Committee candidly says that it does not possess any formal supranational supervisory authority and its conclusions do not and were never intended to have legal force. Rather, it formulates broad supervisory standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them through detailed arrangements - statutory or otherwise - which are best suited to their own national systems. In this way, the BCBS encourages convergence towards common approaches and common standards without attempting detailed harmonisation of member countries' supervisory techniques.

It is a well known fact that the capital adequacy norms of the BCBS was in response to protect the banks from financial crises so common in the 80's in the developed world as such. But what had happened in the Indian context was that these norms have been

introduced more vehemently and across the board uniformly wherein our banks are not active international banks in the strictest sense both in terms of size and volume of business. These norms have been applied as a one size fits all model, not having been deeply rooted into the ground realities of our own strengths and weaknesses. Most importantly, the pace mode and sequencing of such drastic reforms should have been calibrated and fine tuned to sub serve the cause of development and redistributive justice.

The clarion call of our Prime Minister that emphasis should be on achieving a high rate of growth coupled with redistributive justice and balanced development and the recent exposition of our Finance Minister on the "Dharma" of the banks to lend should not be mere cries in the wilderness and should not be sacrificed on the altar of an over emphasis on financial stability of our own commercial banks, arising out following any international best practices. That the complex structure of administered interest rates guided by the social concerns resulted in cross-subsidization, which not only distorted the interest rate mechanism but also adversely affected the viability and profitability of banks, was an overhang problem more to do with the bad quality of appraisal and lending by the banks, which factor has been conveniently obfuscated.

This came about over a long period of time, more importantly, due to ownership and regulatory overlap of the Governments of the day and all other important factors have been brushed under the carpet. Not only the pressure of directed lending, not necessarily only the priority sector as has been bandied about, but also lending to large industry, the PSU's under the development finance mode are all socio economic issues which have exerted pressure on the banks. Commercial banks should definitely have suitable risk management framework, oriented towards their requirements dictated by the size and complexity of business, risk philosophy, market perceptions and the expected level of capital and not as a one size fits all code and standard as done for all the banks and for all sectors of the economy.

Therefore, one of the Basel codes and standards - 90-day norm for a loan account to be treated as NPA - should be relaxed for small and tiny enterprises because of the fact that the payments to the SSI's are delayed beyond 180 days as a norm, sometimes even to 210 to 270 days, notwithstanding the existing Delayed Payment Act. The 90-day norm is counter-productive because, for instance, if a particular bill is not honoured on the 90th day, not only the drawing power of the borrower gets reduced setting off a chain reaction but as a result of the account also slips into as an NPA.

The mere fact that there has been a marked improvement in the asset quality with the percentage of gross non-performing assets (NPAs) to gross advances for the banking system getting reduced from 14.4 per cent in 1998 to 7.2 per cent in 2004 is only one part of the story. The perceived notion of a drop in the NPAs of the PSB's, after the implementation of the BASEL 1 norm, actually conceals more than it reveals. This can be seen in the context of a drastic drop in terms of financing to the SSI's and tiny sector both quantitatively as a percentage of credit and in absolute terms in reduced numbers. Viewed in the context of the excessive appetite of the banks to hold risk free Government

paper far in excess of the statutory liquidity requirements (SLR), thereby reaping gains in their treasury operations and making wind fall profits, the PSB's have thus reaped a double whammy of carrying on narrow banking and at the same time made profits. This of course has helped a majority of them to liberally provision their NPA's, if not anything else.

The casualty has been reduced finance to the SSI's and the tiny sector, who have taken a very fatal hit. This has driven a majority of them to sickness, incipient and in various other stages and many of them to mortality. Moreover the high cost of funds, which even this reduced financing has entailed, has robbed them of what little incentive was left for them to upgrade technologically and to

modernize, leaving them to the wolves and also rendering them uncompetitive. In this context, the structural rigidities emanating from the availability of liquidity in the system - but as a paradox the liquidity not flowing to the needed and producing SSI and tiny sector - needs to be addressed surgically and radically and on a war footing.

The initiative of the of the Finance Minister last year directing the commercial banks to double the credit to the small and tiny enterprises in 5 years, on the lines mandated to the agriculture sector, though, is a welcome step and needs to be fast tracked to be doubled in 3 years. This would greatly help the small and tiny enterprise to modernize thereby increasing their competitiveness. This would further encourage the dispersal of industries, increasing their employment generation capacity and to continue its silent and strong contributions to exports and most importantly to enable them to play their due role in the market, as a necessary appendage of the economy, bringing true meaning and contributing positively to the recent slogan of the Government and the Planning Commission of a more faster and Inclusive Growth, a reality. ■

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National Venture Fund for Software and Information Technology (NFSIT)

- The National Venture Fund for Software and Information Technology Industry (NFSIT) has been set up by Small Industries Development Bank of India in association with Ministry of Information Technology (MIT), Govt. of India
- It is a close ended 10 year fund with an initial corpus of Rs. 1000 million/ US\$ 22.22 million. (1 US\$ = Rs. 45.00 approx)
- SIDBI, Ministry of Information Technology (MIT), Govt. Of India and IDBI are the initial contributors to the fund
- The main objective of the fund is to meet the total fund requirements of the software and IT companies, particularly small enterprises, to enable them to achieve rapid growth rates and maintain their competitive edge in domestic and international markets

- The fund would endeavour to develop international networking and enable assisted units to attract co-investment from international venture capitalists in subsequent rounds of financing
- The fund may also consider funding innovative incubation projects and development of products in the IT sector.

SME Growth Fund (SGF)

- The SME Growth Fund (SGF) has been set up by SIDBI in association with other leading commercial banks such as, Punjab National Bank, State Bank of India, Bank of Baroda, Bank of India, Central Bank of India, Union Bank of India, Oriental Bank of Commerce and Corporation Bank.
- It is a close ended 8 year fund dedicated to SME sector with an initial corpus of Rs. 5000 million/ US\$ 111.10 million.
- SME Growth Fund focuses at wide range of growth sectors such as, life sciences, retailing, light engineering, food processing, information technology, infrastructure related services, healthcare, logistics and distribution.
- The main objective of the fund is to invest in companies at early stage as well as in second round financing for those with a track record of proven technology or business model and opportunities for growth and earnings.
- The fund would endeavour to develop international networking and enable assisted units to attract co-investment from international venture capitalists in subsequent rounds of financing

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