

# Financing SMEs – An Industry Perspective

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Small and Medium Enterprises (SMEs) are critical to the nation's economy – they contribute approximately 40% of India's domestic production, almost 50% of total exports and 45% of industrial employment. More important, they are the second largest manpower employer overall after agriculture.

SMEs in India are mostly in the unorganised sector and are the source of livelihood for millions of people. The social contribution made by SMEs is even more significant than its economic contribution. Within the SME sector, the small sector serves as a seed-bed for nurturing entrepreneurial talent and originating units to grow eventually to medium and large enterprises. The promotion of SMEs, therefore, becomes a major area for policy focus. Regeneration of SMEs must receive public support particularly for the village, cottage and micro level enterprises.

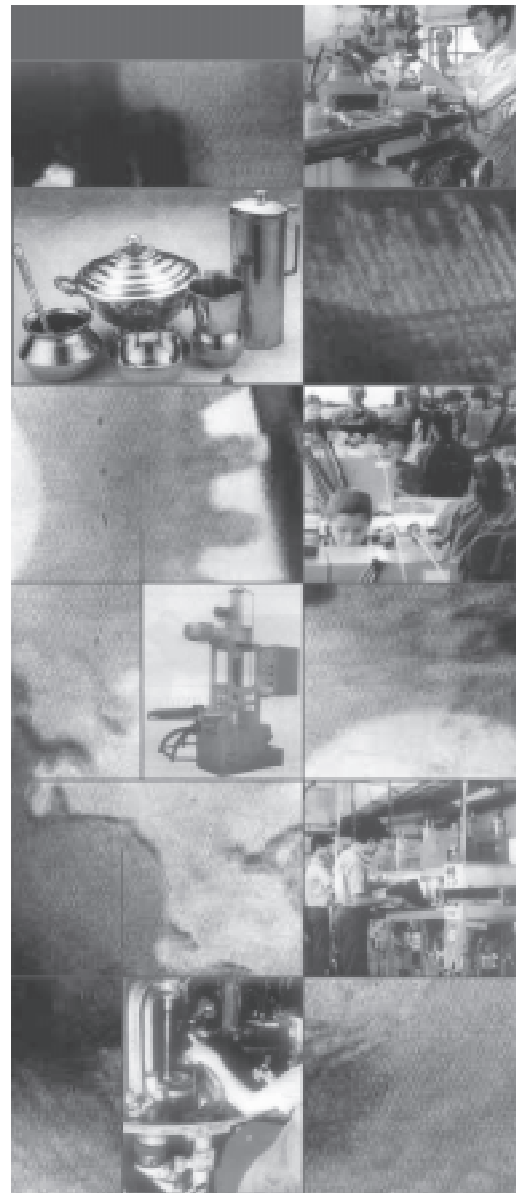
Despite their economic significance, SMEs face a number of bottlenecks that prevent them from achieving their full potential. Major obstacles for business development for SMEs relate to a wide range of issues:

**(i) Financing:** Lack of access to finance and timely credit as well as escalating cost are cited as primary reasons for under-utilisation of the manufacturing capabilities of SMEs.

**(ii) Infrastructure:** The infrastructural facilities in India have not reached to the desired level. This restricts private initiatives in this sector. Therefore, creation of better infrastructural facilities for SMEs must receive greater priority.

**(iii) Taxes and regulations:** A multiplicity of regulating agencies lead to harassment and inspections with greater impact on operations of SMEs than on larger units.

**(iv) Marketing:** With growing access to modern means of communication, particularly revolution in the information technology, the sheltered market for the SMEs product is no longer so. SMEs should join hands globally to create a global



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commodity chain. In this regard, SME mother units in marketing, similar to mother units in production, may be promoted.

**(v) Technology:** Cutting-edge technology becomes difficult to access for SMEs due to the high initial costs leaving them behind in the race for competitiveness.

A major obstacle in SME development is inability to access timely and adequate finance. There are several reasons for low SME credit penetration, key among them being insufficient credit information on SMEs, low market credibility of SMEs (despite their intrinsic strengths) and constraints in analysis. This leads to sub-optimal delivery of credit and services to the sector.

As the access of SMEs to capital markets is very limited, they largely depend on borrowed funds from banks and financial institutions. While investment credit to SMEs is provided by financial institutions, commercial banks extend working capital. In the recent past, with growing demand for universal banking services, term loans and working capital are becoming available from the same source. Besides the traditional needs of finance for asset creation and working capital, the changing global environment has generated demand for introduction of new financial and support services by SMEs.

There is an urgent need to regenerate SME financing. As the SMEs have been the greenfield for nurturing entrepreneurial talent, first generation entrepreneurs should be facilitated in access to the desired finance through creation of guarantee funds. Finance should not only be timely but also cost - effective.

### Instruments of SME Financing

SIBDI is the principal financial institution for the promotion, financing and development of industry in the SME sector in the country. SIDBI also provides appropriate support in the form of promotional and developmental services. In order to improve the credit flow to the SME sector, it has tied-up with eight public sector banks in the country. With these tie-ups, it has covered 150 SME clusters, out of the total 388 clusters identified across the country.

In spite of various initiatives taken by the Government, banks and financial institutions, SMEs face certain challenges which are universal in nature. These problems relate to the issue of collaterals, cost of loans, delay in receivables, obsolete technology, marketing, etc. In order to address the above problems in the Indian context, some innovative instruments of financing have been introduced and institutional set up created. Some of the major initiatives include:

**Credit Guarantee Fund Trust for Small Industries:** Government of India, in association with SIDBI, has set up a Credit Guarantee Fund Trust for Small Industries (CGTSI) to implement the guarantee scheme.

**Risk Sharing Facility:** While the CGTSI extends guarantee cover for the loans upto Rs.2.5 million, there is a need for offering guarantees for loans extended by banks beyond the above limit. Under a World Bank led Project on Financing and Development of SMEs, a possibility of introducing a Risk Sharing Facility for the SME sector is being examined, wherein the risk in lending by banks to SMEs could be shared on pari passu basis between the originating banks and the suggested entity.

**Venture Capital Funding:** With regard to new sources of financing, many countries are considering liberalizing the rules regarding venture capital investments. In India also, various measures have been taken in this direction. SIDBI, along with some other institutions, has taken a lead in promoting venture capital funding in the country.

**Micro Credit:** Realising the potential of micro finance in stimulating economic growth, SIDBI has laid emphasis on increasing the capacity of the sector to handle credit and growth in the disbursements of micro finance. SIDBI Foundation for Micro Credit has been established.

### Small and Medium Enterprises Fund:

The most important amongst the sectoral initiatives taken by the GoI and SIDBI is an SME Fund, with a view to giving impetus to the fund flow to the SME sector. Under the Fund, assistance is being provided to SMEs at an interest rate of 200 basis points below the Bank's PLR. Direct assistance is being extended to SMEs through SIDBI's own offices at 9.5% rate of interest as also by way of providing refinance to the primary lending institutions. Refinance to SFCs is available in the interest rate band of 7.5% to 8%. The SME Fund provides for routing of assistance, besides SFCs, through commercial banks as well. The Fund, besides upscaling the flow of assistance to SMEs, addresses the issue of cross sector parity in the cost of loans.

### Setting up of a dedicated Credit Rating Agency for SMEs:

Rating agencies can play an important role in addressing some of these concerns. In this context, SMERA is wholly committed to facilitating the overall growth and development of Indian SMEs. The agency's primary objective is to provide SME ratings that are comprehensive, transparent and reliable.

All facilities to SMEs should be in the form of a level playing field. Boundary-less markets of today can sweep aside businesses which are not globally competitive. At the same time, businesses which enjoy comparative advantages, are forward looking and can attune themselves to the changing environment, will have tremendous opportunities. SMEs need to rediscover and regenerate themselves to integrate with the world markets. In the backdrop of emerging needs, new financial services need to address the challenges of technology upgradation and modernisation, marketing finance, infrastructural facilities, venture capital, micro finance and factoring assistance. In the non-financial services, information dissemination, technical assistance, early warning, human resources development, environment management and quality consciousness are required more urgently than ever before.

### Globalisation of SMEs

Competitiveness of SMEs in the global markets is a priority. Though Indian SMEs have achieved a measure of success, especially in sectors such as, garments, leather and leather products and gems and jewellery, among others, further heights can be achieved only through fostering international linkages between SME sectors of different countries. A concerted effort on the global scale is required to bring the SMEs to the mainstream from the periphery and integrate them with the organised sector. Under the WTO regime, new opportunities are being created for linkages between SMEs across the globe. It is critical for SMEs to be international in outlook, competitiveness and costs. Models for clusters are developed to help them integrate with global supply chain. Based on the strengths and diversity of the vibrant SME sector in India, there exists enormous potential for participation and partnership for further development.

### Crucial role of the Confederation

Confederation of Indian Industry (CII) has been involved with the promotion of SME sector since inception. CII strongly believes that employment will be best served by promotion of the small sector. Promotion of SME sector addresses other larger problems of regional equity, income distribution and strain on urban infrastructure. Thus, approximately 80% of CII's members are from the SME sector. CII has been deeply involved in their development and modernization, introducing concepts of quality management, energy conservation, globalization and technology upgradation to its member-companies. It also undertakes dedicated measures for marketing linkages and access to export markets for SME units.

This is done through the following initiatives:-

- An SME division analyses the challenges facing the sector and suggests interventions to the government for improving their efficiency. CII's inputs have been considered while drafting the SME Development Bill.
- A unique cluster activity of shared learning has been developed in consultation with leading Japanese experts for assisting units in quality management and globalization at affordable cost.
- CII sets up special exhibition platforms at all its leading high-profile trade fairs such as International Engineering and Technology Fair, DefExpo for defence industry, Auto Expo for the automobile and components industry and many others throughout the year.
- A conference on globalization of SMEs is held annually in partnership with the Ministry of Small Scale Industries, bringing to one venue ideas as well as networking opportunities for SME entrepreneurs.
- CII regularly conducts Enterprise India shows in many countries during the year, where overseas investors and markets are able to view the latest developments in SMEs.
- Realising the importance of credit ratings in getting finance, CII has partnered with ICRA, the premier credit rating institution, to provide ratings to small enterprises.
- CII has also set up the Subcontracting and Partnership Exchange with UNIDO to disseminate information about opportunities in these avenues.

CII's principle of partnerships and cooperation is especially relevant to small and medium enterprises and its activities, to sustain and grow the sector, are bound to increase as industry expands and funding becomes easier for these units.