

## **Winning Strategies in Small and Medium Enterprises Finance**

It is a matter of great pleasure for me to be present on this occasion for the inaugural address and share some of my thoughts and experiences on the development of this vital sector of economy. The IFC and FICCI need to be congratulated for the thoughtful theme selected for the symposium. The organisation of this symposium gains importance in the context of globalisation when the Small and Medium Enterprises (SME) face challenges and take advantage of opportunities created.

### **Importance of SSI Sector**

The development of Small Scale Sector has been an important plank of India's industrial policy. SSIs in India have been given a distinct identity and the Government has accorded high priority to this sector on account of the vital role it plays in balanced and sustainable economic growth. It plays crucial role in the process of economic development by value addition, employment generation, equitable distribution of national income, regional dispersal of industries, mobilisation of capital and entrepreneurial skills and contribution to export earnings.

At the end of March 2001 there were 3.37 million Small Scale Industrial units in the country. During 2000-01 the value of production by these units aggregated Rs. 6503320 million at current prices and they provided employment to 18.56 million persons. The Sector accounts for 95% of the industrial units in the country, 40% of the value added in the manufacturing sector, 34% of national export, 7% of Gross Domestic Product, production of over 7500 items in industrial sector and the product range varies from simple items produced with traditional technology to high-tech products produced with sophisticated state of the art technology.

### **Credit Flow to the Sector**

Credit is critical input for SSI Sector. Provision of timely and adequate finance to SSI Sector is central to the banking policy. Nationalisation of major banks in 1969 signaled the need for redefining lending priorities and it was mandated that 40% of loan should be for what is called priority sector which includes agriculture, SSI and individual service and business sectors. There has been a steady increase in the flow of credit to SSI Sector which has gone up considerably from Rs. 167830 million in March 1991 to Rs. 484450 million in March 2001 constituting 14.2% of the net bank credit.

The process of liberalisation of Indian economy since 1991 has created many opportunities for growth as well as has thrown many challenges to the SSI Sector. In the recent phase of globalisation each and every Sector of the Indian economy is in the process of being integrated in to the world market. SSI Sector also has been exposed to the challenges of opening of the economy. The Sector could achieve greater sustained growth by increasing technological capabilities and creating sustained competitive advantages in the environment of increased competition and rapid technological changes.

In 1991 Government of India announced a separate industrial policy, which had measures for development of small, tiny and village enterprises as a sequel to the financial sector reforms initiated in July 1991. In the subsequent years many measures have been taken for development of the sector viz. (i) Setting up of National renewal Fund to protect the workers affected by technology up-gradation and modernisation (ii) promulgation of the 'Interest on delayed payments to Small Scale and Ancillary Industrial undertakings Act, 1993 for mitigating the delayed payments problems of SSI, (iii) launching of Integrated Infrastructure Development Scheme and the Single Window Scheme of SIDBI, (iv) Setting up of Technology Development and Modernisation Fund in SIDBI and the

Entrepreneurship Development Institute in some States, (v) Investment limit for tiny sector has been raised to Rs. 2.5 million and to encourage the tiny sector, larger share i.e. 60% of the total advance to SSI Sector to these units has been stipulated, (vi) raising of the composite loan limit to Rs. 2.5 million, (vii) raising of collateral free loan limit to Rs. 0.5 million, launching of the Credit Guarantee Fund Trust Scheme which covers collateral free loans up to Rs. 2.5 million and setting up of a Technology Bureau for small enterprises in SIDBI and raising the investment limit to Rs. 50 million in certain selected sectors like garments, hosiery, hand tools etc. for enabling technology up-gradation to make the units in these sectors competitive to face the challenges in the international markets.

To provide more focused attention on the development of SSI, the Government of India created a new Ministry of Small Scale Industries and Agro & Rural Industries in October 1999. The Government came out with a comprehensive policy package for small scale and tiny sector and the Hon'ble Prime Minister announced the same at the first ever National Conference on Small Scale Industries organized by the Ministry of SSI & ARI in New Delhi on 30 August 2000. The policy package included support on policy, fiscal, credit, infrastructural, technological and quality improvement and marketing and measures for streamlining inspections/rules and regulations, entrepreneurs developments, facilitation of prompt payment, rehabilitation of sick SSI units, promotion of rural industries and improving data base.

During the last decade various committees viz. Nayak Committee, 1991, Abid Husain Committee, 1997, S.L. Kapur Committee, 1998 and Dr. S.P. Gupta Committee, 1999 have looked in to the problem of SSI Sector. Majority of the recommendations of these Committees relating to opening of specialised SSI branches, simplification of loan application forms, computation of working capital on projected turnover method, launching of new credit Guarantee Scheme, delegation of adequate powers to branch managers for sanctioning ad hoc limits up to 20% of sanctioned loan limits, raising of composite loan, conducting of third census of SSI, etc. have been accepted and implemented.

Apart from SSI sector, credit is being extended by all banks to small business, which has been categorized under priority sector lending. This includes individuals and firms managing a business enterprise established mainly for providing any service other than professional service, whose original price of the equipment used for the purpose of business does not exceed Rs.1 million with working capital limits of Rs.0.5 million or less. The aggregate of term loan and working capital limit sanctioned to a small business unit should not exceed Rs.1 million. As at the end of March 2000, the credit to this sector from scheduled commercial banks amounted to Rs.55237 million on 2527 million accounts.

### **Major problems/challenges faced by the Sector**

The major problems faced by the SSI Sector relates to availability of loan without collaterals, delay in getting the loan, high cost of funds, delayed payments, marketing problems, WTO related issues, sickness etc.

The limit for collateral free loans to tiny sector is Rs. 0.05 million and that for other SSI units is Rs. 0.01 million. This limit has since been raised to Rs. 0.05 million for other SSI units also. Many small-scale entrepreneurs are facing difficulties in providing collateral security as per the requirements of the financing banks. The problem is addressed to a certain extent with the introduction of the Credit Guarantee Fund Trust Scheme under which collateral free loans up to a limit of Rs. 2.5 million are guaranteed.

The present guidelines provide for a time limit of a fortnight for disposal of loan applications upto Rs. 0025 million and 8 to 9 weeks for amounts beyond that. Further reduction in the time taken for disposal of application is under consideration.

The high cost of borrowings was a major constraint affecting the growth of the sector. The Bank Rate changes by the RBI combined with CRR and repo rate charges have emerged as signalling devices for interest rate changes. The reduction in Bank rate announced in the last Monetary and Credit Policy or outside the policy from time to time has resulted in a consequential reduction in the lending rates. Banks have now the flexibility to offer lending rates on a fixed rate or on a floating rate. The reduction in interest rates and the offer of floating rates will help the SSI units to procure funds at lower costs than what was prevailing in earlier years.

Considerable delay in settlement of dues/payment of bills by the large-scale buyers to the SSI units adversely affected the recycling of funds and business operation of SSI units. Though the Government has enacted the Delayed Payments Act, many of the SSI units are reluctant to pursue cases against major buyers. The Act since amended in 1998 has made it compulsory that the payment of SSI suppliers should be made within 120 days. Further the Department of Company Affairs have issued notification in February 1999 amending schedule VI of the Companies Act, 1956, to make it obligatory on companies to disclose in their Balance-Sheets the outstanding dues owed by them to SSIs for a sum of Rs. 0.01 million or more which are outstanding for more than 30 days. To improve the plight of SSI entrepreneurs due to delayed payments, steps for strengthening and popularizing factoring services, without recourse to the SSI suppliers may have to be thought of seriously.

The banks have also been advised about sub-allotting overall limits to the large borrowers specifically for meeting the payment obligations in respect of purchases from SSI. It is expected that these measures will improve the situation of delayed payments.

Marketing remains the most problematic area for the SSI Sector as some of the units are very small and so is their output individually. Adopting consortium approach could best solve the marketing problems of the SSI sector. Besides finance for marketing related activities, dissemination of requisite information on demand pattern, futuristic trend, etc. could be made available by the Development Institutions/SSI Associations, etc.

To face the challenges emanating from the WTO agreement, SSI units irrespective of their size need technology up-gradation and modernisation. An awareness about the implications of WTO agreement has to be created and SSI entrepreneurs to be educated in this regard. Technology is the key element contributing to productivity quality, competitiveness and market acceptability of products. The preparation for competitiveness needs to be done by the Government as well as entrepreneurs and the corporate. The Government should provide good infrastructure and create level playing field for the industry that, in turn, should respond by determination to succeed through upgrading technology, skills, etc. The skills and competence upgradation can be successfully done through training of the workers, supervisors/managers and the entrepreneurs themselves. Considering the fund constraints with SSI Sector Government has introduced the credit linked capital subsidy scheme for Technology up gradation of Small Scale Industries under which 12% back ended capital subsidy would be admissible on the loans advanced to the SSIs by the scheduled commercial banks/designated SFCs for technology up gradation in certain select sectors. The Study Group on development of Small Scale Enterprises made a number of recommendations like setting up of a Technology Bank, providing of finance to units for entering into collaboration for technical know-how and technology upgradation with a view to enhance the marketability of their products concessional rate of customs duty for importing

equipment for technology up gradation, programme to modernise export oriented industrial clusters, establishment of technology mission, quality assurance and Testing Laboratories, etc. for improving the present scenario.

Growing incidence of sickness of SSIs is yet another area of concern. When the sickness prolongs it leads to the closure of units and unemployment. Lately mortality of the SSI units has been showing increasing trend. This has wider implications including locking of funds of the lending institutions, loss of scarce material resources and loss of employment. The number of sick SSI units as a percentage to the total number of SSI units is around 10. The number of units identified as potentially viable as a percentage to total sick SSI units is around 8. The causes of sickness are both internal and external. The major causes are limited financial resources, lack of organisational, financial and management skills and expertise, diversion of funds, diversification/expansion before stabilisation, non-availability of power supply shortage of raw materials, marketing difficulties, delayed and inadequate credit, globalisation and liberalisation of the economy, obsolete technology, inadequate infrastructure, etc. With a view to ensuring that potentially viable sick SSI units are provided with the timely and adequate assistance by all agencies concerned, there are State Level Inter Institutional Committees (SLIIC) constituted in each state involving State Government, Financial institutions, commercial banks and SIDBI. SSI Associations are also invited to the meetings of this committee. A sub-committee of SLIIC has also been set up in each state to examine the individual cases referred to it for rehabilitation.

To address the incidence of growing sickness in the sector RBI has recently issued a complete set of revised guidelines drawn up on the basis of the recommendations of a Working Group constituted by it for the purpose. The major change from the earlier guidelines relates to revision in the definition of a sick SSI unit. In the revised definition a borrowers account which remained sub-standard for more than 6 months or erosion in its net worth due to accumulated cash losses to the extent of 50% during the previous accounting year and where the unit is in commercial production for last two years is categorised as a sick unit. The guidelines also covers aspects relating to monitoring, viability, incipient sickness, relief and concessions that can be extended by banks to units under nursing, time limit for implementing rehabilitation package etc. These revised guidelines will help in identifying the sick units in the early stages of their sickness and the appropriate measure of rehabilitation dose is expected to bring the units back on healthy tracks.

In conclusion a number of steps have been initiated to promote the healthy growth of SSI Sector. However, to ensure the prospects of these enterprises in the coming years, they will have to gear up to face the challenges of liberalisation. I am confident that given the inherent strength, the sector will develop a global vision, respond to more demanding standards of the customers and adopt key strategies that could take them ahead in competition. Credit should not be a constraint for viable projects.

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\* Inaugural address delivered by Shri Vepa Kamesam, Deputy Governor, Reserve Bank of India at Mumbai on February 11, 2002 at a Symposium on “Winning Strategies in SME Finance” organised by International Finance Corporation and FICCI.