Report
of
The Working Group on Flow of Credit to SSI Sector

2004

RESERVE BANK OF INDIA
Central Office
Rural Planning and Credit Department
Mumbai

Table of Content

PREFACE

Small Scale Industries (SSIs) are a vibrant and important sector of the Indian economy. It makes significant contributions to the annual GDP, exports and employment. In an environment of sustained high economic growth, economic reforms and opening of the Indian economy, the role and importance of the SSI sector will be even more significant in the future. The growth of the service sector is particularly noteworthy in this regard.

As per the announcement made by the Governor, Reserve Bank of India, in the Mid-Term Review of the Monetary and Credit Policy 2003-2004, a "Working Group on Flow of Credit to SSI sector" was constituted with the terms of reference, given in the Chapter 1 of this report.

I would like to especially thank the members of the Working Group for their noteworthy and valuable contributions during the deliberations of the Working Group and in the preparation of the final report:

Padmashri (Smt.) Jaya Arunachalam, President, Working Women's Forum, Chennai.
Shri N. Vaghul, Chairman, ICICI Bank Ltd.
Shri K. P. Jhunjhunwala, Ex. President, Bihar Industries Association (Director, State Bank Board).
Dr. Ashok Jhunjhunwala, Faculty, IIT, Chennai.
Shri A. K. Purwar, Chairman, State Bank of India.
Shri S. S. Kohli, Chairman, Punjab National Bank.

The advice and encouragement of Deputy Governor, Smt. K.J.Udeshi is acknowledged with grateful thanks.

I also wish to express my deep appreciation and thanks to Shri V K Chopra, Chairman & Managing Director of SIDBI for participating in the deliberations of the Working Group and for his valuable contributions, as a special invitee.

I also wish to put on record the excellent support the Working Group has received from colleagues in the Reserve Bank of India, Shri A. V. Sardesai, Executive Director; Shri G.Srinivasan, Chief General Manager; Shri G. P. Borah, Deputy General Manager; Ms. V.G. Savithri, Assistant General Manager and Smt.Chitra Alai, Deputy General Manager from SIDBI.

The Working Group received valuable inputs from several individuals and SSI Associations and wish to acknowledge them with thanks:

Smt Chanda Kochhar, Executive Director, ICICI Bank Ltd.
Shri Nikhil Prasad Ojha, Monitor Group.
Shri Gurpal Singh, Deputy Director General, Confederation of Indian Industries.
Shri J.P.Saikia Chairman & Managing Director, North Eastern Development Finance Corporation Ltd. (NEDFi), Guwahati.
Shri Balwant Rai, President, Laghu Udyog Bharati, New Delhi.
Shri.Vijay Kalantri, President, All India Association of Industries, Mumbai.
Shri J.M. Pawar, Chairman, SSI Committee, Maharashtra Chamber of Commerce & Industry.
Shri Faiznur Ali, President, North Eastern Small Scale Industries Association (NESSIA), Jorhat , Assam..
Shri K.N.Nagaraju, President, Association of Borrowers of Karnataka.
Shri N.S.Sisodia, Secretary (Banking), Ministry of Finance, Govt. of India.
Shri B.S.Minhas, Secretary, Ministry of SSI, Govt. of India.
Shri Suresh Chandra, Development Commissioner, Ministry of SSI, Govt. of India.
Dr.C.S.Prasad, Additional Development Commissioner, Ministry of SSI, Govt. of India.

Dr.Kamal Taori, Adviser (VSI, VSA and State Plans), Planning Commission.

On behalf of the Working Group, I wish to place on record our grateful thanks to Dr. Y. V. Reddy, Governor, Reserve Bank of India, for giving us this unique opportunity to explore the important issue of the flow of credit to the SSI sector.

A. S. Ganguly
Chairman of the Working Group

Chapter 1

Terms of Reference

The "Terms of Reference" for the Working Group are as under:

1. To assess the progress made in implementation of Kapur Committee and Gupta Committee's recommendations.
2. To suggest ways to improve credit flow to the SSI sector, particularly tiny sector and examine the issues of linkages with large corporates/producers.
3. Evaluation of methods of utilization of deposits made by foreign banks with SIDBI for shortfall in their priority sector obligations.
4. To suggest appropriate institutional arrangement for enhancing the credit delivery to the sector on a timely basis and in adequate measures.
5. Further plans to extend micro finance coverage.

The committee may co-opt any other members if they so desire. The committee may call expert for consultation or constitute Sub-Group to deliberate on the issues in details. Secretariat to the Working Group will be provided by RBI.

The committee may submit its report within a period of 4 months from January 01, 2004.

The members of the Working Group are as under:

Dr.A.S.Ganguly, Director, Central Board of the Bank	-Chairman
Padmashri Jaya Arunachalam, Working Women's Forum, Chennai	-Member
Shri Kailash P.Jhunjhunwala,Ex. President, Bihar Industries Association (Director, State Bank Board)	-Member
Dr.Ashok Jhunjhunwala,Electrical Engineering Department.,IIT, Chennai	-Member
Shri A.K.Purwar, Chairman, State Bank of India	-Member
Shri N.Vaghul, Chairman, ICICI Bank	-Member
Shri S.S.Kohli, CMD, Punjab National Bank	-Member

Note: Comments made by the Governor in the first meeting of the Working Group held on January 22, 2004

- The Working Group is expected to propose ways of facilitating credit flow and availability of timely finance to the sector at the right price. Major focus to expedite support to assist the viable units.
- The focus should be on facilitating rather than subsidising finance. In order to make the SSI sector competitive and efficient, dependence on subsidy by the sector needs to be reduced.
- For healthy and sustainable growth of the SSI sector, strong linkage between large corporates and small-scale units is vital for the sector. The Working Group should examine how successful linkages work.
- Definition of SSI needs to be revisited. It could be based on capital/turnover. The term "medium" in SME needs to be defined in view of globalization/liberalization and WTO.
- A shift from the traditional credit delivery mechanism (based on preconceived ideas) to a system based on risk assessment mechanism may be looked in to. Pricing or quantum of assistance should not be subjective. Proper risk mitigation mechanism can be achieved, for example, by creation of hedge funds, sharing of risk etc. Similarly, Bank-funded Non Bank Finance Companies (NBFCs) (not collecting public deposit) may be considered for undertaking risk assessment and SSI financing.
- Tiny sector should be major focus for micro finance.

Chapter 2
Executive Summary

SMEs are major contributors to GDP, and an even larger contributor to exports and employment. Given this background, banks will find SME financing an attractive business opportunity rather than a compulsion, of lending to the priority sector. SIDBI and banks jointly have to play a pivotal and proactive role in financing the SMEs.

The present slow down in lending to the SME sector is principally due to the risk aversion arising out of a high proportion of the lending becoming non performing. This calls for reassessment of the strategy of lending to this sector and this reassessment has led us to three principle elements of our strategy. (1) One is directed at those units which have linkages with large corporate undertakings as vendors or suppliers. To these units, provision and flow of credit could be tied up with the large undertakings which would facilitate recovery but more important than finance our proposal is that the linkage will have to be strong enough to ensure a win win approach for both. This could be achieved by technology transfer of the large undertakings to the small units accompanied by a greater oversight and the quality of the products delivered; (2) the second leg of our strategy is aimed at developing a set of standard products for units belonging to the same cluster of industries; (3) the third leg of our strategy is to develop local financial intermediaries specifically aimed at financing units in the tiny and small sectors and more particularly to the former. These would be in the nature of the NBFCs but without any permission to accept deposits from the public. They would draw their resources from the banking system, by originating the loans and selling the same to the banks as a portfolio with appropriate arrangements for risk sharing.

This report, therefore, emphasizes the need for new vehicles and instruments viz. bank promoted (non-deposit taking) NBFCs, micro credit intermediaries dedicated to SME financing, etc. Such micro credit intermediaries (funded by individual or a group of banks) would be able to credit-rate and risk assess and serve as instruments for extending quick credit to SME clusters, accredited to them.

This report also reinforces the importance of SIDBI's **Technology Bank** for SME upgradation in order to facilitate technology transfer, provide services such as project evaluation, risk assessment and risk mitigation measures for the SMEs exploring and adopting new technologies. Such a service would significantly improve the credit accessibility of the SMEs as well.

A dedicated, National level SME Development Fund, promoted by SIDBI /banks, to fund export oriented, high technology SMEs and accredited clusters can play catalytic role in the advancement of the SME sector.

The role of SME rating agencies and CGTSI needs to be proactive in order to protect the bank advances and publicized widely.

Special plea for novel funding for SMEs, especially in North East and other backward regions/areas, in order to remove regional imbalances by promoting and developing SMEs, needs to be pursued actively.

Highly successful micro finance models working in southern states should be actively publicized and replicated, as best practices in other parts of the country. Given the potential opportunities, banks may consider adopting Micro Finance Intermediaries (MFIs) to extend their business.

Since many SFCs have good infrastructure, trained personnel, etc., revival of some of the more active SFCs as state level NBFCs needs to be explored.

The need to activate avenues to speed up credit to the SME sector is paramount, as it is an important sector contributing to the growth objectives of India’s economy.

Chapter 3

Response to Terms of Reference (ToR)

The recommendations of the Working Group on Flow of Credit to SSI Sector, constituted by the Reserve Bank of India are described below broadly as per 'Terms of Reference' of the Working Group. Since in the Indian context, SSI includes the SME sector, the term 'SME' has been used throughout the report as synonymous with SSI.

ToR No.1
To assess the progress made in implementation of Kapur Committee and Gupta Committee's recommendations

1.1 Out of 126 recommendations of the S.L. Kapur Committee, 88 have already been accepted and implemented by banks/other agencies which inter-alia includes important recommendations such as (a) delegation of more powers to branch managers to grant ad-hoc limits, (b) simplification of application forms, (c) freedom to banks to decide their own norms for assessment of credit requirements, (d) opening of more Specialised SSI branches, (e) enhancement in the limit for composite loans, (f) strengthening the recovery mechanism, (g) banks to pay more attention to the backward states, (h) special programmes for training branch managers for appraising small projects, (i) banks to make customers grievance machinery more transparent and simplify the procedures for handling complaints and monitoring thereof, etc. 17 recommendations have not been accepted. The remaining recommendations (21) are under examination by the Govt. of India (See details in **Annexure I**).

1.2 Out of 64 major recommendations of the S.P. Gupta Committee, 8 recommendations pertained to RBI which have been implemented such as (a) fixing of time frame for disposal of loan application forms, (b) softer interest rate for SSI entrepreneurs, (c) regular meeting of Standing Advisory Committee (SAC), (d) enhancement in the quantum of composite loan and collateral free loans, (d) fixing of self-set target to SSI sector by banks, etc. Six recommendations have not been accepted by the Ministry of SSI, Govt. of India (See details in **Annexure I)**

ToR No. 2
To suggest ways to improve credit flow to the SSI sector, particularly tiny sector and examine the issues of linkages with large corporates/producers

2.1 Definition of the SME Sector.
Though the definitions are not part of the terms of reference for the Working Group, a clearer definition of the SME sector vis-à-vis conventional SSI and Tiny sectors was felt necessary.

(a) At present small scale industry is defined as one having original investment in plant and machinery not exceeding Rs.1 crore. While recognizing need of larger investment in some of the more important segments of SSI, the Government of India has enhanced this to Rs.5 crore in respect of certain specified industries. A process of graduation of several SSIs into medium enterprises, having larger investment is a natural progression of successful units. Therefore, it was agreed that a separate category of medium enterprises (ME) needs to be recognized. While ME may not qualify for priority sector lending, it must be seen as contiguous with SSI.

(b) The SME definition, adopted by other countries is generally based on **number of employees, capital investment or turnover.** The existing definition of SSI adopted in India, based on investment in plant and machinery, excludes the rapidly growing **service sector.** The past decade has witnessed the services sector contributing almost half of the GDP. The Working Group strongly recommends the **adoption of turn over as a measure for defining the SME sector.** Based on **turn over,** Tiny, Small and Medium enterprises may be redefined as under:

Tiny: Turn over up to the financial limit of Rs.2 Crore,
Small: Turn over up to the financial limit of above Rs 2 Crore and Up to Rs.10 Crores,
Medium: Turn over above the financial limit Rs.10 Crores and up to Rs. 50 Crores.

Till the Government of India takes a view regarding turnover as suggested above, the Working Group recommends that a medium enterprise may be defined as a undertaking where the original investment in plant and machinery is more than Rs.1 crore but less than Rs.10 crore.

2.2 Priority Sector Lending Targets

In an environment of high economic growth, the priority sector lending is an attractive growth opportunity for banks and FIs. Slowing down of off-take of credit by the large corporates due to opening up of new sources for accessing finance by them and stagnation of credit demand by retail business, makes financing the priority sector an opportunity to expand banks' business profitably.

An uniform target in priority sector lending (including SSI) at 40% of Net Bank credit (NBC) for all domestic and foreign banks is recommended. This would provide a level playing field for all the banks and ensure active participation in the faster development of the priority sector.

2.3 Risk Assessment Mechanism

With growing opportunities for banks to extend credit to SMEs, it is essential for banks to put in place proper risk assessment mechanisms. This would facilitate objective and speedy decisions based on better client information. This will also help in improving quality of credit portfolio. In order to utilize risk assessment, the following methods may be adopted:

2.3.1 Lending to SME Clusters

A full-service approach to cater to the diverse needs of the SME sector may be achieved through **extending banking services to recognized SME clusters by adopting a 4-C approach** namely, **Customer** focus, **Cost** control, **Cross** sell and **Contain** risk. A cluster based approach to lending may be more beneficial:

(i) in dealing with well-defined and recognized groups;
(ii) availability of appropriate information for risk assessment and
(iii) monitoring by the lending institutions.

Clusters may be identified based on factors such as trade record, competitiveness and growth prospects and/or other cluster specific data

2.3.2 In order to enable the lending institutions to take more objective decisions, an appropriate **Rating mechanism for designated industrial clusters may be put in place**. Accordingly a scheme may be designed jointly by CRISIL, IBA, SIDBI and SSI Associations. This would enable institutional funding to be channelised through homogenous recognized clusters. Credit rating of clusters would aid not only the lenders but also the clusters themselves by providing information on wider market opportunities for their products, strengthen negotiability and adopt improved business practices and better quality control. Lenders, in turn, may be in a position to cross sell their financial products through better market penetration, monitoring and information sharing.

2.3.3 Formulating and institutionalizing **rating** for clusters or stand alone SMEs (through techniques such as balanced score card or appropriate software) is **a key to rapid deployment of cost effective credit**. It is important to **encourage SSI Associations to take initiatives which would enable their SSI members to be rated individually or as clusters, by banks or rating agencies.** SIDBI is in the process of consultation with number of banks for setting up an independent rating agency. This should be expedited and implemented.

2.3.4 Linking with Large Industry

There is strong evidence that SSIs which are linked as suppliers, service providers, etc. to successful large industries are usually successful ventures, in India as well as in many other countries. Such successful SSI/large industry linkages provide examples of best practices which can be aggressively extended. There are a number of corporates in India who adopt Corporate-linked SME cluster models to gain competitive advantage in local as well as global markets and derive mutual benefits. **Corporate-linked SME cluster models need to be actively promoted by banks and FIs**. Banks linked to large corporate houses can play a catalytic role in promoting this model.

2.3.5 Financing SMEs linked to large corporates, covering suppliers, ancillary units, dealers etc. would also enhance competitiveness of the corporates as well as the SME participants.

2.3.6 Though Government has enacted "Interest on Delayed Payment to Small Scale and Ancillary Industrial Undertakings Act" in order to ensure that the small scale units receive prompt and timely payment of their dues, **implementation of the provisions of the Act remains ineffective. The Government needs to take urgent steps to enforce the provisions of the Act especially in public sector enterprises**.

2.3.7 Adoption of "Best Practices Code" for large corporates dealing with the SME sector on the lines of "**Code for Payments for large industries/corporates**", formulated by CII, would greatly help the sector regarding timely payment to SMEs. This may also enable SMEs to access better technology as well as complying with quality and environmental standards (Annexure II). In this regard the RBI **"Guidelines on Fair Practices Code for Lenders"** is particularly noteworthy. The guidelines need to be reinforced for their use and application.

ToR No. 3
Evaluation of methods of utilization of deposits made by foreign banks with SIDBI for shortfall in their Priority Sector obligations

The foreign banks are currently permitted to deposit any shortfall in meeting the target for lending to the priority sector, with SIDBI. With liberalization, which enables foreign banks to open branches. Therefore, existing priority sector lending norms by foreign banks needs to be reviewed.

At present, the foreign banks' deposits with SIDBI, on account of priority sector lending shortfalls, have a tenure of one year. Therefore, deployment of these funds to the SME sector by SIDBI is difficult. Further, the interest rate paid on these deposits by SIDBI to foreign banks, does not encourage meeting the priority sector lending requirements.

The Working Group recommends that

3.1 the tenure of the deposits representing shortfall in lending to the priority sector by foreign banks with SIDBI, be increased to a period of three years in order to enable SIDBI to better manage disbursal to SME sector ;

3.2 risk sharing mechanisms between foreign banks and SIDBI needs to be worked out, on credit extended to the SME sector by SIDBI and

3.3 interest rate payable by SIDBI to foreign banks on priority sector lending shortfall deposits, may be pegged at a rate which does not act as an incentive for the foreign banks to keep the deposit with SIDBI, rather than directly meeting the credit needs of the SME sector.

ToR No. 4
To suggest appropriate institutional arrangement for enhancing the credit delivery to the sector on a timely basis and in adequate measures

4.1 Credit Information

Credit Information Bureau (India) Ltd(CIBIL) has been set up in January 2001 to serve as an effective mechanism for exchange information between banks and financial institutions for curbing growth of NPAs. This organization could be extremely effective in playing a proactive role for the SME sector as well.

4.2 Venture Financing

Recognizing the catalytic role of venture finance in the advancement of the SME sector, the Working Group strongly recommends that a dedicated National level SME Development Fund should be established. SIDBI may promote a NBFC (non–public deposit taking) exclusively for undertaking venture and other development financing activities for SMEs.

Banks could also contribute to the corpus created by SIDBI (on risk sharing basis) or alternatively, set up their own venture financing instruments

4.3 Technology Transfer through Technology Bank

In the current scenario, the growth and success of SMEs will be primarily determined by **market forces rather than by reservation, preferential treatment, etc.** The legacy SMEs have become identified with low-technology, poor quality and weak management. In the current scenario for the SME sector to achieve economic efficiency and international quality standards, there is imminent need in many instances to upgrade technology. This will help the sector to break away from the protected environment of the past and to adapt and innovate in tune with changing market forces. Liberalization and globalisation requires technological upgradation, improved marketing and better infrastructure in SMEs. In order to facilitate technology access, transfer and absorption, the Technology Bureau of Small Enterprises (TBSE) was established in 1995 as a collaborative initiative between SIDBI and United Nations-Asia and Pacific Center for Transfer of Technology. This was meant to help SSI units to attain international competitiveness through transfer of latest technology both from within and outside the country. **Conversion of TBSE into an independent Technology Bank for the SMEs to facilitate technology transfer may be considered. The proposed Technology Bank may also provide services such as project evaluation, risk assessment and risk mitigation measures to the SMEs adopting new technologies. Such a service would improve the credit accessibility of the SMEs as well.** Such a Technology Bank would facilitate building stronger linkage between R&D institutions and the SME sector for enhancing their productivity and competitiveness. **Besides SIDBI, banks may also contribute to the corpus of the proposed Technology Bank to ensure its commercial viability and play an active role in enhancing the capabilities and credit worthiness of the SME sector.** The cost involved in providing technology support should be recoverable over a period of time from the successful ventures.

4.4 Credit Guarantee Scheme for Small Industries

The Working Group strongly feels that the banks should have the freedom to decide the terms of lending (with or without collaterals) depending on the risk perception of any proposal. However, till such time the policy relating to collateral-free lending is reviewed, as a prudent measure the **existing credit guarantee scheme (CGTSI) may continue. The Credit Guarantee Scheme for Small Industries (CGTSI), however, must play a more proactive role to assist SSI entrepreneurs. The scheme needs to be revisited to make it more affordable for the intended users. SSI Associations, banks and the CGTSI should actively encourage SSI entrepreneurs to cover their loans under the Scheme.**

ToR No.5
Further plans to extend micro finance coverage

5.1 The traditional sources of credit flow to the SME sectors (through public sector banks, Specialised SSI Branches, etc.) are unlikely to improve their services, at least, in the short and medium term. While public sector banks have inherent problems in extending credit to many SMEs, due to historical reasons, it is necessary to explore ways to overcome such traditional problems, **by the banks, promoting and financing Special Purpose Vehicles (SPVs) in the form of micro credit agencies dedicated to servicing SME clusters.** Banks should extend wholesale financial assistance to NGOs/MFI and work out innovative models for securitisation of the MFI receivable portfolio on the pattern of models in vogue in USA and other countries. Such SPVs may be extended necessary support through various fiscal/taxation measures by the Government.

5.2 Such micro credit intermediaries, say, in the form of NBFCs (funded by individual or a group of banks but not permitted to accept public deposits) could credit-rate and

risk assess and serve as instruments for extending quick credit to SME clusters, accredited to them.

5.3 Finally, in the scheme envisaged by the Working Group, **large banks can directly extend credit and banking services to (i) SMEs linked to large corporates and (ii) to identified SME clusters which are credit rated.** The **micro credit intermediary** (SME-specific **NBFC**) funded by banks (individually or in groups) could be an alternate source to speed up credit access to stand alone clusters of product/service specific SMEs. The Working Group recognizes the acute problems faced by SMEs, tiny and village industry sectors, particularly in the North East region of the country. Special instruments, besides NBFCs, etc., need to be tailored, dedicated and funded for these regions in order to generate economic activity and employment (See ToR No.6).

5.4 There are 25-30 very active and successful NGOs in South India and some other states, who have an outstanding record of successful micro credit management. They provide ideal role models for training and development of groups and individuals in other parts of the country. Besides NGOs, there are other successful micro-credit institutions who service small, tiny and individual entrepreneurs in Tamilnadu, Andhra Pradesh and Karnataka. **SIDBI and Lead Banks should make use of these successful models to encourage the adoption of their work practices in other states, by sponsoring specific projects as well widely publicizing the successful working models.**

ToR No. 6
Other issues related to the brief

6.1 Special Dispensation for N.E. Region and other Backward Regions/Areas

Regional imbalances exist on account of geographical locations, lack of infrastructure, political environment and other historical/ social factors, etc. This has led to inadequate response from the banking system to the needs of SMEs in this region. Special dispensation is required for promotion and development of SMEs in the North East Region as well as other backward regions/areas in the country. Some of the ways of approaching this problem are as follows:

6.1.1 The North East entrepreneurs have a major problem in providing collaterals. **The Model of Mutual Credit Guarantee may be able to address the problem of collateral**. **There is a need for private initiative to provide mutual credit guarantee**. In the states of North Eastern Region, due to peculiar land tenure system, (in most of states, the land is owned by the community, thereby making it difficult to provide individual collateral for availing credit), **the issue of alternative to land mortgage for availing bank loan could be addressed if Deputy Commissioners can provide guarantee for the loans in their capacity as Chairman of Village Development Boards (e.g. Nagaland).**

6.1.2 As the number of SSI units are widely dispersed in these regions/areas, **all SSI units without a ceiling (of Rs.25 lakh) may be covered under the CGTSI scheme**. **The guarantee cover may also be extended to the extent of 90% of the credit.**

6.1.3 Farm sector projects and tiny sector projects where Village Council guarantee is available, should also be covered under CGTSI scheme.

6.1.4 Hilly terrain and frequent flood causes hindrance in the transportation system in these areas, and as a result supply chain gets frequently disrupted. Because of this the **SMEs have to maintain high levels of inventory requiring high working capital. Higher working capital limits need to be taken into account while extending credit to such units.**

6.1.5 Growth of rural industry would be the key to significant growth in GDP as well as in creating employment over time. While the traditional means of financing rural sector has been on decline, banks have not reached adequately in rural areas. Micro-finance partially addresses this issue, but not adequately. New instruments need to be explored for promoting rural industry and to improve the flow of credit to rural artisans, industries and rural entrepreneurs.

6.2 Revival of SFCs

Historically, SFCs have played a pivotal role in the overall promotion and development of small-scale industry in the States. They have contributed to decentralization of economic development, dispersal of industrial activities, created employment opportunities, narrowed regional imbalances, promoted first generation entrepreneurs and also strengthened the economy of some States. SFCs helped generate substantial revenue for some States by way of sales tax, local duties etc by promoting activities of the SSI units, assisted by them. Their major contribution has been to provide long term credit to SSIs where bank credit was not readily forthcoming. SFC's assisted wide variety of activities ranging from artisans to units engaged in sophisticated lines of manufacture. It will not be out of place to mention that some of the large enterprises in the country commenced their journey as SSIs with the support from SFCs.

In the 'seventies', there was rapid increase in SFC's activities due to the increasing emphasis laid by the Govt. of India on promotion of small scale industries and development of economically backward areas. These continued through the 'eighties'. However, during the 'nineties', there was a decline in the activity of SFCs, due to a number of factors. The downturn coincided with the SFCs' inability to raise resources on competitive terms and deterioration of their functioning on commercial lines. The poor financial health of SFCs were exacerbated by poor recoveries, rising NPAs and growing provisions, due to tightening of provisioning norms. As a result, the share capital of several SFCs has eroded over the last few years.

It may be emphasized that unless the SFCs that are performing poorly, improve their working and become entrepreneurial in their business transaction, they will be unable to provide appropriate financial assistance and guidance to SMEs and the tiny sector.

Furthermore since many SFCs already have good infrastructure, trained personnel, etc., they could be encouraged to play a more proactive role with the help of the following measures:

6.2.1 SFCs Act needs be repealed in order to enable them to become effective vehicles for the promotion of SMEs and tiny sector;

6.2.2 Commercially viable SFCs may be restructured which could become effective vehicles for banks/financial institutions to fund the SME and tiny sector;

6.2.3 Restructuring of SFCs could be facilitated by their NPAs being transferred to appropriate Asset Reconstruction Companies;

6.2.4 State Government stake in SFCs may be taken over by SIDBI or individual banks as may be appropriate;

6.2.5 Individual SFCs or groups of SFCs may be reconstituted under the Companies Act in order to enhance their functioning;

6.2.6 SIDBI and banks either individually or jointly would be ideally placed to initiate the privatization of SFCs.

ANNEXURE-I

High Level Committee on Credit to SSI-S. L. Kapur Committee Recommendations- Accepted / Implemented

Recommendation	Action taken
6.01Crash training programmes for staff members of Regional Rural banks as also permission to them for opening specialised branches.	Commended to banks for implementation.
6.05 SIDBI should be accorded the same role and status as the nodal/coordinating agency for financing small industries as available to NABARD.	Accepted.
6.06 The Mahila Nidhi Scheme of SIDBI should be reviewed in consultation with Govt. and at least twenty five thousand rural women should be covered under the scheme.	Accepted
6.08 SIDBI should launch industry specific venture funds by setting up few software venture capital funds.	Accepted
6.09 SIDBI should give big push to the Market Development Assistance Fund Scheme in order to give proper impact by offering the scheme through banks also and private sector intermediaries.	Accepted.
6.10(i)& (ii) Measures like extensive publicity, buying software packages should be taken for utilization of Technology Development and modernization fund.	Accepted.
6.13 Branch Managers should be delegated powers to grant ad-hoc facilities to the extent of 20% of the limits sanctioned.	Commended to banks for implementation.
6.14 SIDBI should open more branches vending most modern banking services in North –East, Bihar, and Jammu & Kashmir where the SFCs are weak.	Accepted.
6.15 The linkages of SIDBI with IDBI to be snapped and it linked to Ministry of SSI & ARI.	Accepted.
6.16 SIDBI should review its programmes with a view to weed out the schemes which have not created any viable impact.	Accepted
6.17 All the states may be covered by Rural Industries programme of SIDBI.	Accepted.
6.19 At least 40% of the resources of SIDBI should be earmarked for tiny sector enterprises having investment in plant and machinery up to Rs.5 lakh.	Accepted
6.20 Reserve Bank of India may take the initiative to hold an All India conference of Urban Co-operative Banks and take some policy decisions regarding upgradation of skills of their staff, improvement in the training programmes and linking and integrating them with the country's banking system generally.	Accepted and Implemented.
6.21 RBI should encourage setting up of more urban co-operative banks which could function as local area banks.	Accepted
6.23 A study of the Rural Co-operative structure be undertaken by NABARD to ensure that 20% of the co-operative credit goes to Artisans, Village industries and rural SSI sector.	Accepted.
6.24 SIDBI may make arrangements for training the staff of SFC and also take up the expenditure on this account.	Accepted
6.26 NABARD may take up more districts under its District Rural Industries Project (DRIP) May be extended to 100 districts in the next 5 years.	Accepted.
6.27 NABARD could prepare schemes similar to handloom and handicrafts for assisting leather based industries, vegetable and	Accepted

fruits and food processing industries, milk product units, village level oil units and rural transport and services in rural areas. NABARD should also set up a fund similar to National Equity Fund .	
6.28 The margin money scheme of KVIC needs a lot of publicity and pushing for take off.	Accepted.
6.29 Meticulous compliance of the instructions already issued in implementation of Nayak Committee recommendations need to followed up by carrying out special studies periodically.	Commended to banks for implementation
6.30 While carrying out inspections, the officials of the banks as well as RBI should insist and ensure that only the prescribed loan application forms are used.	Commended to banks for implementation.
6.31 The filled application forms should be examined by a bank official having adequate experience and also maintain a check list for calling additional information.	Commended to banks for implementation
6.32 Controlling offices of banks should reiterate their instructions to their branches for rendering necessary assistance to applicants. Adequate number of copies of instructions and schemes etc. should be made available at each branch.	Commended to banks for implementation
6.33 The loan application forms should be tri-lingual i.e. in Hindi, English and local language.	Commended to banks for implementation.
6.34 IBA should get copies of software packages designed by CII and WASME and make available to each branch especially specialsed SSI branches.	Commended to banks for implementation.
6.35 RBI should review the application forms and ensure that superfluous items, if any, are deleted.	Accepted by IBA and implemented.
6.36 Proforma of application forms up to Rs.2 lakh be used for up to Rs.10 lakh and that up to Rs.15 lakh be used for up to Rs 50 lakh and that used for limits up to Rs 1. crore can be considered for loans beyond Rs 50 lakh and up to Rs. 2 crore. The fourth category can be for loans beyond Rs.2 crore.	Commended to banks for recommendation.
6.37 For the purpose of working out bank finance, in the case of an existing unit, the bank officials and entrepreneur should work out an agreed growth rate and projected turnover based on the past performance, the likely prospects and few other factors. For those sectors which are recording positive rate of growth and when the individual unit has also recorded positive rate of growth during the last 2-3 years, it may be permitted growth rate of a minimum of 15 per cent over the current year's turnover to arrive at the projected turnover and the working capital limits from banks be fixed accordingly. In case of new units, the projections accepted by the term lending institutions, for the first year of operation should normally be accepted unless there are specific reasons for not doing so.	Commended to banks for implementation.
6.38 The banks should, with the approval of their Boards, lay down some clear guidelines for computing the working capital limits for various sub sectors granted to SSI borrowers, particularly those units where fund based working capital requirements exceed Rs.4 crore.	Commended to banks for implementation
6.39 Where the banks have a first charge over fixed assets, they should not ask for cash margins from SSI borrowers on non-fund based facilities, provided there is adequate surplus of security to cover their exposure.	Accepted.
6.40 Banks should open more specialised SSI branches or shift/ restructure some of their existing branches and convert them into	Commended to banks for implementation.

specialised branches for financing the small scale sector. The banking sector within the next two years should ensure collectively that at least one such branch is opened in every district of the country, particularly at those centres where the number of small units is at least 100. These branches should be opened by strong banks only. The Committee is confident that the number of specialised and profit making branches can easily increase by 1,000 within the next three years.	
6.41 The banks should ensure that specialised SSI branches entertain loan proposals from the tiny sector and village industries units unhesitatingly. Each such branch may look after upto 200 units, out of which a minimum of 150 should be from the tiny sector with loans less than Rs.10.00 lake. This ratio should preferably be maintained in case the number of such units at a branch is less than 200.	Commended to banks for implementation.
6.42 Selective specialised branches should be encouraged to innovate and experiment with new products such as factoring services and business credit cards.	Commended to banks for implementation.
6.43 National Equity Fund should be disbursed through specialised SSI branches. SIDBI may provide direct credit lines to these branches.	Accepted.
6.45 The Committee was informed that one field officer in a specialised branch is able to handle about 50 SSI units. The number of field officers should be sufficient to take care of number of accounts entertained by a branch. Properly trained and preferably technically oriented direct recruits in adequate number should be posted in specialised SSI branches.	Accepted.
6.46 Banks should undertake research activities on credit related policies in relation to specific sectors of SSI for a consistent medium term policy formulation purposes.	Accepted.
6.47 Further delegation of sanctioning powers should be made in respect of specialised SSI branches in particular and other branches in general for prompt disposal of applications.	Commended to banks for implementation.
6.49 Banks and financial institutions are hesitant to deal with SSI enterprises requiring loans of less than Rs.5 lakh. The Public Sector Banks, with resources and expertise available at their disposal, should sanction loans to SSI enterprises requiring loans upto Rs.5.00 lakh in a big way and SIDBI should refinance these on attractive terms.	Commended to banks for implementation.
6.50 The limit of composite loans should be enhanced from Rs. 2 lakh to Rs.5.00 lakh so that the entire requirement of such units is met by single documentation and security and charge creation process. This facility should also be extended to all SSI units requiring loans upto Rs.5.00 lakh irrespective of their location.	Commended to banks for implementation.

6.51 Only banks should entertain projects both for term loans and working capital of borrowers with loan requirement, up to and inclusive of Rs.5.00 lakh. Only one organisation, either SFC or a bank may sanction both the term loan and working capital for projects requiring institutional credit for more than Rs.5.00 lakh and upto and inclusive of Rs.25.00 lakh. For Projects having loan requirement in excess of Rs.25 lakh, arrangements should be made by SIDBI with the Public Sector Banks to have an MOU signed between the SFC and selected Public Sector Banks active in different regions of the country for joint financing, whereby both the term loan as well as working capital should be shared alongwith sharing of securities on pari passu basis. However, the borrowers in this category who want to avail such facilities from a single agency i.e. bank or SFC, should be allowed to exercise their option.	Commended to banks for implementation.
6.52 The scope of leasing, hire-purchase and equipment finance should be expanded and obstacles removed including legal hurdles. Financing institutions should be advised to have a flexible approach in fixing margins for financing of DG sets, modernisation or technology upgradation or equipment required for pollution control or obtaining quality markings under International Standards Organisation (ISO) programmes. Banks/SFCs may consider utilising the funds available from the National Equity Fund to be treated as margin.	Accepted.
6.53 There is need to provide for NEF line (in addition to presently available for project outlay upto Rs.10 lakh) for purchase of equipment for modernisation/technology upgradation or DG set purchase upto Rs.10 lakh. Wherever amount from NEF is provided, no additional margin should be obtained.	Accepted.
6.56 For ensuring competitiveness of SSI units, it is necessary to set up units with optimum size of operations and capital. There are a number of agencies in public sector engaged in preparing project profiles on economic sized units. Project Profile work can be undertaken by them also for SSIs. We can also depend on technical consultants in respect of hi-tech or new technology projects. The ultimate decision, however, shall have to be taken by the controlling offices of banks which should periodically advise their branch managers accordingly.	Commended to banks for implementation.
6.58 Banks should consider providing `SWIFT' services in specialised SSI branches catering to big clusters of SSI units engaged in export of goods.	Commended to banks for action.
6.59 It is very essential that the loan applications are sanctioned promptly and normally within one month. Banks should be advised to adopt committee approach for sanction of the applications.	Commended to banks for implementation.
6.60 There should be at least one Debt Recovery Tribunal (DRT) in each State and their functioning be smoothened by providing adequate support staff for expediting recovery of bank loans above Rs.10 lakh.	Accepted
6.61 Regarding loans below Rs.10 lakh, the State Government should provide all facilities and assistance for the recovery of these loans. Special revenue courts should be set up in each state to deal with SSI cases. The State Government should also get in touch with the respective High Courts and get a few Civil Courts (one at every district headquarters with proper infrastructure) designated as Recovery of Bank Dues Courts. These courts should deal with loan recovery matters in a summary manner. Government can also	Commended to banks.

examine treating such loans on the pattern of agricultural loans upto Rs.10 lakh as Government dues and recover these as arrears of land revenue. The banks should take advantage of the Lok Adalats and arbitration to settle dues up to Rs.10 lakh. The banks should appoint special officers or designate existing officers having aptitude for work relating to recovery, who should exclusively deal with recovery.	
6.66 Banks should be directed to report separately the figures of those sick SSI units which are neither defunct nor closed (other than temporary closure) nor have been set up under Government sponsored schemes. RBI should also take suitable measures to ensure that the statistics relating to sick SSI units are collected and reported correctly. Banks should motivate specialised SSI branches to take up innovative products and new schemes. They could be given some autonomy and freedom to take up such innovative products.	Commended to banks.
6.68 The overall interest payable by SSI should remain within the existing parameters fixed by RBI i.e. maximum of PLR plus four per cent. The PLR should take care of the cost of funds incurred by the banks. Additional spreads over the PLR will be used as premium for guaranteeing the repayment of the loan. Naturally, SSI units, with good track record will have to pay lower premium and can derive some advantage out of lower spreads.	Commended to banks.
6.69 The existing Credit Guarantee Scheme being operated by DICGC should be scrapped and be replaced by a more objective and suitable scheme to be operated by a new Guarantee Corporation. Reserve Bank of India should take the initiative for setting it up in SIDBI. The proposed corporation should cover only those loans which are sanctioned by Public Sector Banks/financial institutions and where principal amount sanctioned does not exceed Rs.10.00 lakh. The coverage for the purpose of guarantee will be limited to 80% of the amount in default. Depending upon the experience gained over a period of time, the scheme can be extended to loans with higher credit limits.	Accepted.
6.70 The proposed Credit Guarantee Corporation should have a strong corpus of at least Rs.500 crore which can be contributed by SIDBI, NABARD, Government of India, State Governments and banks. The proposed Corporation may appoint either selected bankers as their agents or the Corporation can set up its own offices in different States for extending such guarantees. The premium under the Scheme would also be decided by the agents subject to a maximum of 4 per cent points depending upon the risk perception.	Accepted.
6.71 Unlike DICGC, option to have guarantee cover or not in individual accounts should rest with the banks. On a reciprocal basis, acceptance or not of a borrower for extending guarantee cover shall be at the discretion of the Guarantee Corporation. Simultaneously or as an alternative, the banks can set up special funds for meeting losses arising on account of defaults of repayments in SSI loan accounts. RBI should take up the matter suitably with the Government of India to ensure that necessary amendments are carried out in related Tax Laws to enable the banks to set up such funds and provide effective in-house guarantee for loans granted by them.	Accepted.

6.72 In order to promote some guarantee service associations on the lines being operated in Italy, it is necessary to provide incentives to some of the banks to take up a kind of service-cum-guarantee arrangement in respect of few clusters. Reserve Bank of India should give them or get from the Government of India some small corpus fund of say Rs.10.00 crore which could be made use of in a few such clusters like bicycle component manufacturers in Ludhiana.	Accepted.
6.73 With a view to reduce the cost of funds to the promoters, ensure availability of liquidity, improve debt equity ratio, and pave the way for setting up of more viable projects and provide an incentive to the banks/financial institutions to take up cases of tiny units with credit limits upto Rs. 10 lakh, these institutions should be permitted to utilize the national equity fund of SIDBI in addition to the normal margin to be contributed by the entrepreneurs. The restriction on applicability of NEF in the metropolitan areas should be removed. Additionally, NEF should be permitted to provide margin required for undertaking nursing programmes in respect of the sick SSIs. To cope with increased fund requirement, the corpus of NEF should be expanded. However, NEF facility should not be available to those units which are getting margin money from KVIC or any grant/subsidy under any scheme of Central/State Government or their undertakings.	Accepted.
6.74 Reserve Bank of India should initiate appropriate policy measures for phasing out the system of collateral securities. Greater emphasis may be laid on the viability of the project and the management of the enterprises rather than on collateral security.	Accepted.
6.75 A revised floor level of Rs.2.00 lakh for exemption of borrowal accounts from obtention of collateral securities is recommended as against the existing level of Rs.25,000/-. In respect of other accounts, the collateral security including third party guarantee should be in relation to the risk undertaken. The Committee also suggests that for loans upto Rs.10.00 lakh, the value of collateral security or the net means of third party guarantee should not be more than 50% of the fund and non-fund based exposure of the bank/financing institution. Beyond loans of Rs.10.00 lakh, the banks may exercise their commercial judgement in determining the level of collateral or third party guarantee. However, in no case a bank should obtain a collateral security or third party guarantee which is in excess of the loan amount. Reserve Bank of India may also prescribe that at least 10% of the SSI loans sanctioned by a bank branch should be without collateral guarantees.	Accepted.
6.80 It would be appropriate to assess the flow of credit to SSI by using data on disbursement rather than `outstanding balances'. The Committee feels that it is possible for banks to achieve a growth rate of 30% p.a. in disbursement terms and accordingly, the banks should be advised to fix their disbursement targets along with outstanding balances. Reserve Bank may also advise the banks to pay more attention to the backward states such as Bihar, J&K, M.P. and North Eastern States while fixing the lending targets and seek progress in this behalf separately.	Commended to banks for action.

6.83 There are certain doubts whether RIDF set up in NABARD can be used for supporting infrastructure for rural industries as well. Reserve Bank of India should examine the matter and permit this fund to be used for such purposes as also for provision of alternate power sources.	Accepted.
6.85 The banks have been directed to ensure that not less than 25 per cent of total credit purchases are through the bills drawn by the seller so as to develop bills culture. RBI may examine the possibility of increasing this percentage to 50 per cent in the next year depending on the experience gained during the current year.	Accepted.
6.86 Government of India may be requested to make amendments in the Companies Act to provide that the company accounts and reports should contain a separate section indicating period-wise delays in the payment of SSI dues.	Accepted.
6.88 The Union Finance Minister has recently announced in his Budget speech that steps would be taken to amend the `Delayed Payments Act' to make it more effective. The new legislation may provide for the setting up of a statutory authority on the lines of MRTP Commission which should be empowered to impose deterrent penalties.	Accepted.
6.90 The mechanism of `Factoring' should be got studied afresh by an expert Committee with a view to expand the scope and reach of these services. This could be followed by enacting a new law, if necessary, so as to remove legal impediments relating to stamp duty, registration fee, assignment of contracts etc.	Accepted.
6.93 It was decided by RBI that SFCs should act as principal financing agency for small sector industry under the Single Window Scheme of SIDBI in 23 districts having a concentration of SSI units. The SFCs may not be able to do much in this regard. It is possible that these districts would have been reallocated to the commercial banks. However, if this has not been done so far, this should be done now.	Accepted.
6.95 Bankers should publish that it is borrowers' right to get loans from the bank in case these are merited. The SSI entrepreneurs should also bear in mind that they can get loans only if their projects are viable and they are found to be creditworthy by the banks. Borrowers have also to be clearly told that while it is their right to get the loans, they also have a corresponding duty to earnestly implement their projects and repay the dues of the bank as per the terms agreed to at the time of sanction.	Commended to banks for action.
6.96 Banks should develop a set of written loan policies. Such policies should, inter-alia, specify explicitly customer and group exposure limits, standards for documentation, sectoral exposure limits and delegation of powers. The smallest customer should expect and receive the courtesy and service reserved today for the biggest company. The prescribed comprehensive code of Banking Practices should be drawn up expeditiously outlining standards for disclosure of information about the bank's services and available products and the rights and obligations of its customers.	Accepted.

6.98 The banks should upgrade their systems to be able to access the latest information about technology even from international sources including Internet. The Public Sector Banks should select one or two Regional Centres where they can get all the technological information inputs. The same could then be shared with the branches as per their requirement. The banks could also keep a panel of technology consultants who could be addressed specific problems relating to technology. The fee payable to these consultants should be predetermined which may be borne by the entrepreneurs.	Accepted.
6.99 Some special training courses have been designed by Entrepreneurship Development Institute (EDI), Ahmedabad to help bank managers and trainers of bank staff requiring the requisite skills for appraising small projects and the entrepreneurs behind them. RBI may like to advise banks to make use of such training programmes and incorporate the same in the training courses provided by Bankers Training Institutes.	Commended to banks for implementation.
6.100 RBI should update its instructions relating to the software industry which were issued during 1988.	Accepted.
6.101 There has been a hefty escalation in fee, commission and charges levied by the banks on various facilities. While no concessions should be given, yet excessive charges which are not directly related to the costs should be suitably rolled back to make such services cost effective for the banks.	Accepted and implemented.
6.105 The Committee also supports the recommendation of Expert Committee for setting up of a special fund for taking care of the equity support and interest rate concessions for expansion of SSIs, technology upgradation, modernisation and training. This fund should be of 5 annual tranches of Rs. 500 crore each for technology upgradation etc. of those SSI units which are facing problems on account of liberalisation (including deregulation) and increasing competition. These funds could be used to provide refinance to SIDBI, banks and other SFCs for low cost funding.	Accepted.
6.106 The scope of lending of micro credit should be increased considerably.	Accepted.
6.107 Every bank should be asked to earmark a part of its credit for assisting SSI units established by women entrepreneurs. Separate schemes could also be framed to promote women enterprises by the banks in consultation with Government Ministries and departments engaged in developing programmes and enterprises for women.	Accepted.
6.109 SSI branches should help their customers in the designing of their bank products and thereby offer a new kind of customised and personalised banking service	Commended to banks for implementation.
6.110 RBI should ask the Public Sector Banks to upgrade skills and ning programmes of the bank staff to enable them to deal freely with appraisal of diverse SSI projects and their credit related needs.	Commended to banks for implementation.
6.111 The aspect of training for the bankers particularly those posted in new SSI branches has to be adequately focussed at the highest level in the bank. The training programmes should attempt to prepare the managers for meeting the challenges involved in dealing with this vital and demanding sector.	Commended to banks for necessary action.
6.114 While fixing accountability a line should be drawn to separate malafide decisions from normal bonafide credit decisions in order to keep the morale of the staff high.	Accepted.

6.115 To instill confidence in the staff and encourage them to make decisions including some bonafide mistakes, there is a need to evolve in Public Sector Bank a system of maintaining a Balanced Score Card for assessing of performance of each officer in taking credit decisions.	Accepted.
6.117 Computerised information and monitoring system should be developed by banks for SSI units. There should also be a provision for inputs from the individual industrial units themselves either directly or through the SSI associations. SIDBI should be the nodal institution for this task of furnishing client input for inclusion in the information system.	Accepted
6.118 Public and Private Sector Banks should take up schemes in respect of professionals needing financial assistance for meeting their professional requirements including their needs of finance to bankroll their own businesses. One such area where there is requirement for such funds is the computer software business set up by professionals.	Commended to banks for implementation.
6.120 With a view to redress customer grievances, time limits and systems prevalent in banks should be made as transparent as possible and well publicised.	Commended to banks for implementation.
6.121 The procedures for making complaints should be simple and as informal as possible.	Commended to banks for action.
6.123 There should be machinery at all Controlling Offices of banks to entertain complaints from the borrowers if the branches do not follow the prescribed guidelines. Regional Offices/Controlling Offices could periodically verify that these guidelines are implemented by branches in actual practice.	Commended to banks for implementation.
6.124 RBI should consolidate all the guidelines relating to grievances redressal and reiterate their implementation by the bank branches.	Accepted.
6.125 Instructions issued by RBI do not percolate to bank branches and these are not meticulously followed by them. For instance, the borrowers availing of credit facilities from a bank find it extremely difficult to shift to another bank. RBI should look into this aspect and ensure compliance by the branches of various instructions/guidelines issued by it in this regard.	Commended to banks for necessary action.
6.126 It is recommended that the Small Scale Companies who wish to have overseas presence should be allowed to invest up to US$ Twenty thousand based on a simple procedure and the banks should assist them for this purpose. This will help SSI units to increase exports and upgrade technology.	Commended to banks for necessary action.

High Level Committee on Credit to SSI -
S. L. Kapur Committee Recommendations -
Examined by RBI but not found feasible for acceptance

6.07The Mahila Udyam Nidhi Scheme being operated by SIDBI should be merged with NEF and the funds placed at the disposal of the Public Sector Bank. Other things being equal, entrepreneurs belonging to weaker sections, SC, ST, backward classes and women should be given preference in the matter of disbursal of NEF. Government bodies taking up schemes for helping entrepreneurs belonging to weaker sections should follow the pattern suggested for NEF and place the funds with banks to be used as equity or margin money.	Assistance under NEF and MUN is provided by SIDBI to new/existing entrepreneurs for meeting gap in equity while setting up projects costing up to Rs.10 lakh. Both the schemes are operated through PLIs and norms under MUN are prescribed on the lines of NEF. While the corpus of NEF fund is jointly shared by GOI and SIDBI, MUN fund is created by SIDBI out of its own resources. Thus the merger of these two schemes may not be necessary. The NEF is operated by PLIs for assisting all class of entrepreneurs including SC, ST and backward classes. Any advance placement of NEF with the public sector banks need not necessarily enhance the flow of assistance under the scheme. Moreover this would lead to problems of monitoring the projects assisted there under. SIDBI does not subscribe to the idea of placing NEF with banks to be used as equity or margin money.
6.10 In order to give a big push to the utilisation of the Technology Development and Modernisation Fund, the following measures should be taken : (iii) Loans under this Scheme should be routed through banks and adequate spread; say 4 per cent could be given to them to make the scheme attractive for them. (iv) Some amount, say 10 per cent could also be provided out of this fund for matching the entrepreneurs' contribution towards margin and thus making it easy for the banks to lend under the Scheme.	SIDBI is already providing assistance through refinance route for modernisation and technological upgradation of SSIs so that SSIs get assistance on same terms and conditions as available directly from SIDBI under TDMFS. Refinance for the purpose is provided at 2% below PLR of SIDBI. Given the existing cost of funds for SIDBI, any further downward revision in refinance rate may not be possible. The promoters' contribution under the Scheme is already kept very low at 20% as against the usual requirement of 33% under other schemes. Provision for contributing to equity under TDMFS is already available since assistance under the Scheme is provided by way of term loan or equity or both. In view of the above comments given by SIDBI, we may treat the recommendation as not accepted.
6.11 Reserve Bank should convene a meeting of SIDBI and Public Sector Banks and decide what should be the margins (spreads) normally available to the banks if the risk is shared by SIDBI or not so shared.	Relates to utilisation of Technology Development and Modernisation Fund with SIDBI and the issue relating to margin available to banks on refinance availments from SIDBI with and without risk sharing. SIDBI is already providing assistance through refinance route for modernisation and technological upgradation of SSIs. Refinance for the purpose is provided @ 2% below PLR of SIDBI. Any further downward revision in refinance rate may not be possible unless Government of India / RBI provides low cost funds to SIDBI or Government of India bears the interest rate differential. Convening of the meeting as recommended may not be purposeful in the above circumstances.
6.24 SFCs (ii) Funds for lending under Single Window Scheme by SFCs should be placed by SIDBI with the SFCs in adequate measures. Alternatively, SIDBI	Placing of any funds with SFCs for Single Window operation is not considered necessary as SIDBI is extending 100% automatic refinance to all PLIs for assistance under Single Window Scheme (SWS) which is presently provided for

should receive proposals from SFCs to do the lending itself directly in such cases till the health, particularly of weak SFCs, is restored.	venture outlay of Rs.1 crore. Effective October 1, 1998, SWS outlay has been increased to Rs.2 crore per ultimate beneficiary borrowing unit.
6.25 The number of units assisted by NEDFI is insignificant. Further, the State Financial Corporations in the North-East are almost defunct. SIDBI should set up an office in each of the States of the North-East and fill in the gap by taking up direct lending in a big way. Good Public Sector Banks should be persuaded to open more specialised SSI branches in this Region. The State Governments should help by providing assistance to recover bank loans and to improve infrastructure to upgrade performance of SSIs.	SIDBI is already having its branches in all the seven states in the Region and operating both direct and indirect assistance schemes. SIDBI is, however, not interested in competing with existing state level institutions in north-eastern region. It is interested in strengthening their activities so as to enable increased flow of assistance by these PLIs to SSI in the region. In fact, as directed by Government, refinance to SFCs and twin-function IDCs would be taken care of by NEDFI instead of IDBI / SIDBI. SIDBI would intensify its developmental activities in each of the north – eastern states for enabling entrepreneurial entry and growth of SSI and continue to refinance banks in the Region. In view of the comments given by SIDBI as above, we may not pursue the recommendation further and treat it as not accepted.
6.44 Steps should be taken to open new SSI branches for servicing particular industry in a big cluster. These specialised branches should be managed by competent staff and should be properly equipped with computer and communication lines. A beginning should be made by opening such branches for electronics and software industries.	Further compartmentalisation of specialised branches (either by opening new branches or converting the existing branches) may not be advisable. This would reduce the flexibility available to banks in their planning and operations. Moreover, where there is a cluster of a particular industry (like software, electronics, and vehicle parts. Hosiery, etc.), the staff of the specilaised SSI branch/es in that area automatically develop competence and expertise in handling loan proposals of such industrial units. We may not accept the recommendation.
6.57 RBI may set up a task force consisting of SIDBI, bankers, experts and export oriented SSIs to outline new credit policies and procedures for SSI exporters.	**The All India Export Advisory Committee consisting of representatives of RBI, export organizations, export promotion councils and banks is presently functioning to look in to the credit and exchange control issues of exporters, including SSI exporters. This committee is periodically meeting and bringing the exporters' problems to the notice of the policy-making authorities for taking remedial measures. We have not received any complaints / suggestions from the SSI entrepreneurs or their Associations regarding export finance. The Kapur Committee also has not enumerated any problems being faced by SSI exporters. In view of the above, task force suggested is not found to be necessary. We may not accept the recommendation.**

6.62 The definition of sick SSI unit may be changed to read as under: **(a) If anyone of the borrowal accounts of the unit remains sub-standard for six months i.e. principal or interest in respect of any of its borrowal accounts has remained overdue for a period exceeding one year,** **(b) There is erosion in the net worth due to accumulated losses to the extent of minimum 50% of peak net worth during1he previous accounting year, and** (c) The unit has been in, commercial production for at least three years.	Since the new definition in terms of Nayak committee recommendation has been introduced recently, no change has been considered necessary.
6.65 To encourage banks to take up rehabilitation of potentially viable sick SSIs some relaxation in Income Recognition and Asset Classification norms should be provided. A period of one year both for the additional exposure as well as old outstanding advances, to such SSI units should be permitted and these facilities treated as standard advanced for a period of one year where after the classification should be changed depending upon the record of recovery.	The exemption from prudential norms of income recognition and provisioning is not available for existing facility. The suggestions to classify both the additional credit facilities and the old outstanding accounts as standard assets for a period of one year would amount to further relaxation of the existing norms which is not considered feasible in view of the recommendation on the report of the Committee on banking sector Reforms, that not only the suggestion made from time to time for a relaxation of the definition of NPAs and the norms in this regard should be resisted but also the existing norms should be brought in line with more stringent international standards in a phased manner.
6.67 SSI should get a special treatment in the matter of interest rates. In view of their contribution to the economy, they should normally get credit at PLR.	Whether a SSI will get credit a PLR or at PLR + depends on the internal credit rating by the lending bank. Under the existing interest rate policy interest rates are linked to the quantum of loan and purpose-wise linkage has been done away with. It has been our view not to have separate interest rate policy for SSI sector. If we change the position, similar demands may come from other segments, which will lead to multiple, and complex interest rate structure again. Secondly, granting concessions, in the interest rate will also adversely affect profitability of banks. We may, therefore, not accept the recommendation.

6.77 Consequent upon revision in the definition of SSI the 40% allocation of SSI credit for units having investment in plant and machinery upto Rs. 5.00 lakh may continue. However, the allocation of 20% for units having investment between Rs. 5.00 lakh and Rs. 25 lakh should be raised to 30%. The balance 30% may be given to the units with investment in plant and machinery between Rs. 25-60/75 lakh.	Under the existing instructions, units with investment in plant and machinery up to Rs.5 lakh will get 40% of credit to all SSIs; units with investment in plant and machinery between Rs.5 lakh and Rs.25 lakh allocated 20% of the SSI credit by banks and the balance 40% to units with investment in plant and machinery between Rs.25 lakh and Rs.3 crore. This stipulation was made in the Credit Policy for the first half of 1997-98 and brought into force from February 1998. We may, therefore, not accept this recommendation. The Committee has further recommended that the balance 30% may be given to the units with investment in plant and machinery between Rs. 25 lakh and Rs.60 lakh (Rs.75 lakh in the case of ancillary or export-oriented units). This would mean that credit given by banks to the SSI units with investment in plant and machinery above Rs.60/75 lakh should not be reckoned as priority sector lending. This is not a desirable feature because bigger units in SSI sector should not completely be ignored as regards preferentiality and some kind of protectionism while safeguarding the interest of tiny and smaller SSI units. Further Govt. of India is likely to bring down the investment limit from Rs. 3 crore to Rs.1 crore. We may not, therefore, accept this part of the recommendation also.
6.78 The commercial banks should not be permitted to utilise funds earmarked for direct priority sector lending for : (i) Subscription 10 bonds issued by NABARD with the object of financing exclusively agriculture/ allied activities as well as non-farm sector. (ii) Subscription to bonds floated by SIDBI, SFCs/SIDCs and NSIC exclusively for financing SSI units. (iii) Subscription to bonds issued by NHB & HUDCO.	**These suggestions have been examined while discussing the draft report of sub- group II constituted to examine financial and fiscal measures for promotion and growth of SSEs. Under the Study Group on the Development of Small Enterprises. Such restrictions are not considered necessary since subscriptions to the bonds are also utilized for the development of the sector. We may not accept the suggestion.**
6.79 The banks should neither be permitted to exercise soft options nor rewarded for not meeting their targets of priority lending by payment of high interest on funds placed with SIDBI/NABARD. Rates of interest available to recalcitrant banks which continue to default in meeting the targets for lending to priority sector may be reduced to 5-6 per cent and over 3 years' time, the banks which still continue to default should be allowed a nominal return of only 1-2 per cent.	**This recommendation also was examined while finalizing the report of the Sub- Group II. We have taken the view to retain the rates of interest being offered as they are in tune with the rates offered by banks on term deposits. The matter was also referred to MPD and MPD in turn advised us with the approval of DG (R) that the interest on deposits maintained by foreign banks with SIDBI may be continued at 8 percent. We may not accept the suggestion.**
6.91 Some Lead Banks due to their weak financials are not able to lead in lending. Reserve Bank of India should review the performance of such banks with regard to their lending to priority sector and reallocate the responsibility of lead banks to stronger banks, which are able to take a	**The recommendation was examined in LBS section and decided not to reallocate the responsibility of Lead Banks as suggested because the performance of the lead banks which are financially weak is not as bad as would warrant change in their lead responsibility. The performance of all the banks present in the district is primarily significant for good**

lead in lending to SSIs.	**<u>performance in the district as a whole and not the financial position of the bank. The recommendation may be treated as not accepted.</u>**
6.94 Credit rating for SSI units can help in augmenting the flow of credit to SSI. The existing agencies are not equipped to cater to the credit rating requirement of a large sector like SSI. SIDBI should assist the formation of new credit rating agencies, which can be set up by professionals having experience SSI financing. While rating SSI units all relevant factors may be taken into consideration. While lending the banks should take into consideration the rating provided by such agencies.	SIDBI commented that introducing credit rating agency exclusively for SSI does not appear to be feasible at this point of time.
6.112 Banks may be advised to improve their system of promotion and reward to calibrate the same to the individual performance, not only in matters of deposits and house keeping but also in respect of granting loans, particularly to SSI. If required, the Annual Confidential Report Forms and procedures should be modified to provide for the above. Banks should give due importance to loaning activities for assessing the performance of individual manager. While judging the performance of a Manager Officer in case of specialised SSI branches this should rank as the most important criteria. A Balanced Score Card can be introduced in our banking system.	Bank Officials particularly those of branch levels are required to attend multifarious functions simultaneously. Emphasis on and time taken by the official/s for each type of function may vary from official to official and from branch to branch depending upon the size of the branch, area in which it is located and the nature and volume of each kind of activity handled by the branch. Therefore the suggestion to include the aspect of SSI financing in the Annual Confidential Report Form is not practicable.
6.113 Some ad hoc rewarding system could be introduced and encouraged. The banks may take up grant of some non-monetary rewards to recognise and promote good performance. These managers could be deputed to some specialised training programmes outside the banking system both within and outside the country. Outstanding performance can even be considered as a qualification for attractive postings abroad, wherever feasible.	**<u>The system of Human Resources Development exist in all banks. The non-monetary rewards cannot be extended depending on the performance in SSI area alone. It may depend on several parameters and the suggestion is not practicable. We may not accept.</u>**
6.116 Cases involving amounts up to Rs. 25 lakh should be dealt with by the Chief Vigilance Officer of the bank instead of referring it to the Central Vigilance Commission.	The dealing of cases by the Chief Vigilance Officer of the banks are as per CVC guidelines.
6.119 The work done by State Financial Corporations in 22 districts where they have been advised to take the lead role in financing SSIs should be evaluated. SIDBI should be asked to open its branches in	SIDBI would not be in a position to commit to open its branches in the said districts. However, it had agreed to add new branches to its network based on business potential, promotional and developmental initiatives required at the centre as also keeping in view the potential for resource

those districts, out of these 23, where term lending services are not being provided; it may also have to act as primary lender in these 22 districts. Similarly, SIDBI should be requested to act as a primary lender in those states where the SFCs are either moribund or are not functioning.	raising, etc.
6.122 Each Public Sector Bank should appoint an Ombudsman who should be a person of high integrity and inclined to do public service. He can look after the credit related grievances of the borrowers, which are outside the scope of Banking Ombudsman Scheme. In. addition to having only one Ombudsman, banks can have a Commissioner of Grievances, one in each zone, who should look after the complaints arising from 500 branches. Eminent retired citizens having adequate background of banking/industry/business may be appointed as Commissioners. The Governor, RBI may appoint each such Ombudsman or Commissioner on the recommendations of the bank concerned.	**<u>The scheme of Banking Ombudsman is under revision. The revised scheme under finalisation includes arbitration of inter bank disputes and also that between the customer and bank for amounts up to Rs 10 lakh. In view of this we may not accept the suggestion.</u>**

High Level Committee on Credit to SSI- Recommendations- pending for Views of/ action by Ministry of SSI/ MOF

1) 6.02 Issue regarding mortgage of land needs to be deliberated with the various State Governments for evolving a well coordinated national strategy for providing credit to SSIs in rural areas and legal and procedural difficulties in the path of such advances should be removed. Equitable mortgages should be permitted and if registered mortgages have to be done, these should be permitted without any stamp duty or registration fee as in the case of agricultural loans. Recovery of such loans could be made through attachment and sale of property as in the case of agricultural loans. No taxes should be imposed by any State Government on equitable mortgages. (Para 2.04.02)

2) 6.03 In the post liberalisation era SIDBI finds it difficult to cross subsidise its credit to SSI sector. Primary Lending Institutions seek refinance from SIDBI at a rate which is below the average cost of funds of SIDBI. This calls for SIDBI managing resources at low cost such as through increase in its equity capital, flotation of tax free bonds by it, placement by Government with it of special dispensation funds, increased allocation of NIC (LTO) Fund of RBI and Government providing exchange risk cover for SIDBI against its external commercial borrowing. (Para 2.07.01)

3) 6.04 LIC/GIC and Pension Funds should lend a portion of their funds to SIDBI for on lending to SSI. (Para 2.07.02)

4) 6.12 A new fund called the `Reconstruction Fund' may be set up in SIDBI and initiative thereof be taken by Government/RBI. Initial corpus should also be provided by Government/RBI. This should be linked with all the Public Sector Banks through appropriate lines of credit. (Para 2.14.01)

5) 6.18 While reconstituting the Board of Directors of SIDBI in the future, six to eight members should be drawn from SSI sector - SSI entrepreneurs or SSI experts or SSI representatives. (Para 2.15.07)

6) 6.22 Government may expedite enactment of a new Company Law incorporating a Chapter on co-operative companies which could be looked after by the Registrar of Companies. Government may also explore to promote Urban Co-operative Banks under the Central Multi State Co-operative Societies Act which could be suitably amended to provide for more self regulation and autonomy. (Para 2.17.02)

7) 6.55 Reserve Bank of India should have dialogue with the State Governments and the Central Government regarding delays in providing subsidies for financing the projects of SSI units. The State Governments may be well advised to discontinue schemes of subsidies if their financial strength do not warrant bearing this burden. However, where there are temporary financial problems, RBI should advise banks to consider providing bridge loans to cover the amount of subsidy. The State Governments should agree to bear the interest cost on such bridge loans. (Para 3.22)

8) 6.63 SLIICs should be converted into Statutory Bodies under a special Statue and given adequate statutory and administrative powers to enforce their decisions on bankers and financial institutions and other agencies concerned with the rehabilitation of potentially viable SSI units. (Para 3.28)

9) 6.64 Branches/benches of SLIICs could be established in districts having large concentration of SSIs. Besides potentially viable sick units should be dealt with by separate specialised branches as far as possible for the purpose of rehabilitation. (Para 3.28.01 & 3.28.02)

10) 6.76 The Committee proposes the setting up of a collateral Reserve Fund with an initial corpus of Rs. 100 crore to be contributed by Government of India, SIDBI, NABARD, State Governments and banks with a view to providing support to first generation entrepreneurs who find it very difficult to furnish collateral securities or 3rd party guarantees. The support from this fund will be limited to projects costing upto Rs. 10.00 lakh. However, they, i.e. entrepreneurs will have to contribute to this fund by paying some token amount of interest in addition to the PLR to avail of this assistance. (Para 4.05.04)

11) 6.81 The existing systems of technical assistance and consultation available to SSIs is very eager. The Government may provide some advisory structures which could help the industry generate new project profiles and provide technical and financial consultancy. The banks could have easy access to it. (Para 4.07.01)

12) 6.82 The District Industry Centres should be rejuvenated and rechristened as Micro Enterprise Development Centres. These should be set up by Business Chambers, NGOs, Technical Universities and Management Institutes. State Government agencies/KVICs/KVIBs and entrepreneurs can also join hands in strengthening these centres. The existing staff and budget of DIC could be transferred to these MED Centres which could be restructured as a non-profit making company under Companies Act with the share holding progressively being shifted to its beneficiaries. These centres should preferably be headed by successful businessmen or professionals and should provide advice on various matters. These centres may charge appropriate fee for their services. (Para 4.07.02)

13) 6.84 Reserve Bank of India may consider, in consultation with Government of India, the need to set up a small Industries Infrastructure Fund for developing industrial areas in/around metropolitan cities, urban and semi urban areas which are not covered by RIDF of NABARD. To start with, a corpus of such fund say Rs.1000 crore be kept with SIDBI for lending to the State Governments. (Para 4.09.03)

14) 6.87 Public Sector bodies/corporates/individuals/firms which delay payments to SSI beyond 90 days should not be allowed to deduct any expenditure relating to such supplies made by SSI units and adjust it against income. Section 43(b) of the Income Tax Act, 1961 should be amended accordingly. (Para 4.09.04)

15) 6.89 Venture Capital funding has not been successful in India. The Committee is of the view that the policy framework should encourage Venture Capital particularly for SSI sector. The policy measures required for popularising this concept should be got examined and decided. A separate legislation be enacted to promote the growth of venture capital in the country. (Para 4.10.02)

16) 6.92 Considering the importance of SSI, the Committee suggests that all the banks, including RBI, SBI and Foreign Banks should have at least one representative from this sector on their respective Boards. Care should be taken to ensure that the best representative of this sector is taken. Similarly, SIDBI should have a number of representatives of SSI sector on its Board and NABARD also should have one such member representing the small scale industries. The Public Sector Banks also should have Regional Advisory Boards and SSI should also be represented on these boards suitably. (Para 4.13.01)

17) 6.97 Government should set up a national research institute for SSI and ensure that reliable information about SSIs is not only circulated, but discussed and regularly published in the leading Economic Dailies/TV network, which should be made available to the branches of the banks. (Para 5.02.02)

18) 6.102 A limited company running an SSI is considered to be more suitable by the banks than either a partnership or proprietorship firm. However, taxation laws are not

designed to encourage such transformations. RBI should take up with the Central Government for a review of this policy in order to encourage SSIs to convert themselves into limited companies. (Para 5.06).

19) 6.103 The Committee endorses the recommendation of the Expert Committee that a separate law for small enterprises should be framed as a basic law. This law should also contain a chapter on provision of credit to the SSIs which should, inter alia, provide for sanction of loans, recovery of dues and settlement of claims of the banks, etc. (Para 5.07.01)

20) 6.104 The Committee also endorses the following recommendations made by the Expert Committee:

(i) Setting up of a marketing development assistance fund for helping targeted exporting units,
(ii) restructuring and corporatisation of DICs, SISIs and other development agencies,
(iii) restructuring State Financial Corporations and
(iv) promotion of SSI cluster level activities and facilities.

21) 6.108 Funds available under the existing schemes for promoting employment in the Government and Semi-Government agencies for persons belonging to Scheduled Castes, Scheduled Tribes and Backward Classes should be profitably and gainfully employed in taking up risk positions in new ventures set up by weaker sections, particularly those belonging to the scheduled castes and scheduled tribes. SIDBI could examine the possibility of setting up a separate Venture Capital Fund for promoting such enterprises. States also could be advised to set up such venture capital funds in one of their existing corporations for promoting these categories of entrepreneurs.

Annexure II

Confederation of Indian Industry (CII)
Code for Prompt Payment

CII is of the view that to delay payments beyond the due date, when goods and services have been received or services provided to satisfactory standards, is not only a breach of contract, it is plain bad business as it can jeopardise the viability of valued suppliers. CII, hence proposes code for payment to be universally applicable to all industry sectors irrespective of whether they are small, large or medium or belong to the private or the public sector.

The guidelines mentioned below would aim to help companies improve their credit management system, build long term relations with their suppliers and judge whether a company would be a good customer. These guidelines are expected to ensure a healthy, efficient and competitive economy. The companies agreeing to this code are expected to fulfil their payment obligations as per their contract.

Any company agreeing in principle to this concept should

- Have a clear, consistent and transparent payment policy.
- Ensure that the payment controls are strictly followed.
- Ensure that the finance and purchasing departments are aware of the policy and adhere to it.
- Agree on the payment terms at the outset of a deal and stick to it.
- Not alter or extend payment terms without prior agreement.
- Ensure that there is a system for dealing quickly with complaints and disputes.
  The monitoring of this code could be possible through the active involvement of the Government, which should introduce new measures to encourage firms to pay their bills promptly. The Government should
- Require public companies to set up their payment policies.
- Set a commercial debt ombudsman with power to receive and investigate complaints of companies not adhering to their payment policies.
- Make court procedures for debt recovery easier.
- Popularise the concept of factoring.

Annexure III

Details of meetings held

1. First Meeting of the Working Group

The first meeting of the Working Group was held on January 22, 2004 in Mumbai under the chairmanship of Dr.A.S.Ganguly. The Working Group was addressed by Dr. Y.V. Reddy, Governor, Reserve Bank India. Apart from the members of the Working Group, the meeting was attended by Smt. K.J.Udeshi, Deputy Governor and Shri A.V.Sardesai, Executive Director. In the address by the Governor he had emphasized following aspects which gave broad roadmap to the Working Group.

- The Working Group is expected to propose ways of facilitating credit flow and availability of timely finance to the sector at the right price. Major focus to expedite support to assist the viable units.
- The focus should be on facilitating rather than subsidise finance. In order to make the SSI sector competitive and efficient, dependence on subsidy by the sector needs to be reduced.
- For healthy and sustainable growth of the SSI sector, strong linkage between large corporates and small scale units is vital for the sector. The Working Group should examine how successful linkages work.
- A shift from the traditional credit delivery mechanism (based on preconceived ideas) to a system based on risk assessment mechanism may be looked in to. Pricing or quantum of assistance should not be subjective. Proper risk mitigation mechanism can be achieved, for example, by creation of hedge funds, sharing of risk etc. Similarly, Bank-funded NBFCs (not collecting public deposit) may be considered for undertaking risk assessment and SSI financing.

2. Meeting of Working Group with SSI Associations/Key individuals/Experts

The captioned meeting was held on February 25, 2004 in Mumbai under the chairmanship of Dr.A.S.Ganguly. Shri Balwant Rai, President, Laghu Udyog Bharati, New Delhi; Shri.Vijay Kalantri, President, All India Association of Industries, Mumbai; Shri J.M.Pawar,Chairman, SSI Committee, Maharashtra Chamber of Commerce & Industry, Mumbai; Shri Faiznur Ali, President, North Eastern Small Scale Industries Association (NESSIA), Jorhat , Assam presented their views and valuable suggestions to the Working Group. Besides above invitees, Shri Gurpal Singh, Deputy Director General, SSI Cell, Confederation of Indian Industry (CII), New Delhi; Shri V.K.Chopra, Chairman & Managing Director, SIDBI, Lucknow; Shri J.P.Saikia, Chairman & Managing Director, North Eastern Development Finance Corporation Ltd (NEDFi), Guwahati shared their rich experience with the members of the Working Group and also offered valuable suggestions.

3. Second Meeting of the Working Group

The second meeting of the Working Group was held on March 15, 2004 in Mumbai. A presentation on ‘SME Banking-International Analogs in India Context’ was made by Shri Nikhil Prasad Ojha, Monitor Group. In his presentation he drew examples of SME financing undertaken by Industrial Bank of Korea (IBK) and Wells Fargo (WF) of USA and also adoption of superior credit scoring models, behavioural scoring chart for risk assessment, use of technology to reduce transaction cost.

Another presentation was made by Smt. Chanda Kochhar, Executive Director, ICICI Bank Ltd. on “Scaling up SME financing- An Approach”, adopted by ICICI Bank. She had shared the experience of adoption of 4-C approach to SME financing by ICICI Bank namely, Customer focus, Cost control, Cross sell and Contain risk.

Shri K.N.Nagaraju, President of Association of Borrowers of Karnataka had made a written submission before the members of the Working Group suggesting certain measures for improving credit flow to the SME sector.

After completion of presentations by the invitees, they left the meeting venue. Thereafter, the members of the Working Group deliberated upon the issues relating to the terms of reference of the Working Group. Shri V.K.Chopra, CMD, SIDBI has also participated in the discussion as ‘Special Invitee” and offered his valuable suggestions regarding setting up of Technology Bank and National Level Credit Rating Agency for provide cluster based credit rating.

After deliberations the members of the Working Group arrived at a consensus that he draft recommendations may highlight following aspects in SME financing.

- Linkage between large corporates and ancillary /SSI suppliers.
- Emphasis on cluster approach form of lending to SME segment.
- Need for strong micro finance institutions (MFIs). Banks to extend finance to MFIs which are credit rated.
- Adoption of “Best Practices Code” for SME sector.
- Adoption of sound risk rating model.
- Special credit dispensation measures for promotion and development of SME in the North East Region.

4. Meeting of Working Group with Senior Govt. of India Officials from Ministry of Finance, Ministry of SSI and Planning Commission

The captioned meeting was held on April 12, 2004 in New Delhi under the chairmanship of Dr.A.S.Ganguly. Shri N.S.Sisodia, Secretary (Banking), Ministry of Finance, Govt. of India; Shri B.S.Minhas, Secretary, Ministry of SSI, Govt. of India; Shri Suresh Chandra, Development Commissioner, Ministry of SSI, Govt. of India; Dr.C.S.Prasad, Additional Development Commissioner, Ministry of SSI, Govt. of India and Dr. Kamal Taori, Adviser (VSI, VSA and State Plans), Planning Commission participated in the discussions and presented their views/suggestions to the Working Group. Shri Sisodia emphasized on following aspects relating to the SME sector:

- Need for taking a holistic perspective and also reforms in the real sector,
- Labour reforms, initiatives for improvement of infrastructural facilities,
- Focus on clusters by 2-3 banks,
- Rating of SSIs by banks or other agencies and incentives/interest concessions by banks to better rated units,
- Need for development of special appraisal skills, application of IT for appraisal.

Dr. Kamal Taori, Adviser (VSI, VSA and State Plans), Planning Commission emphasized on concerted efforts by Ministry of SSI alongwith Ministry of Finance and Planning Commission for overall development of the SME sector.

Shri Minhas made a power point presentation before the members of the Working Group. He emphasized on following aspects relating to the SME sector :

- Need for reduction in transaction cost,
- Development of rating system in consultation with IBA and Rating agencies.

He offered to share a part of the expenditure for development of an appropriate rating model for SME sector and also requested banks to share part of the expenses for this purpose.

5. Third Meeting of the Working Group

The third meeting of the Working Group was held on April 12, 2004 (afternoon) in New Delhi. The members of the Working Group discussed, in details, on the draft recommendations firmed up so far. The Working Group decided to hold the final meeting on April 30, 2004 in Mumbai to present the report to the Governor, Reserve Bank of India.

6. Fourth Meeting of the Working Group

The fourth (& final) meeting of the Working Group was held on April 30, 2004 in Mumbai. The members met at 2.30 P.M. to have a preliminary discussion on the Report of the Working Group, formed up after receipt of feedback and suggestions from them. The Governor joined the members of the Working Group for discussion at 3.30 P.M. He also addressed the members and thanked them for their valuable contributions.

Annexure IV

Details of suggestions received

1. **Suggestions from Dr. Amit Mitra, Secretary General, Federation of Indian Chambers and Industry (FICCI)**

    - Information relating to credit appraisal done by the bank should be shared with the applicants. It would be helpful if the banks inform the SSI units where their performance has fallen below the rating parameters and counsel the units to perform better.
    - Banks should revert to quarterly compounding of interest rate on working capital loan where it is presently being done on a monthly basis.
    - For the benefit of those SSI units which through improved inventory management have reduced their stock, banks must give considerations to other factors for computing maximum permissible bank finance.
    - The period of collection and credit of cheques should not exceed 3 days. In case, it takes longer for the cheque to be cleared, bank should compensate by paying penal interest for the inconvenience caused.

2. **Suggestions from Dr. B.Yerram Raju, Managing Director, Sandilya Consultants Pvt. Ltd., Hyderabad**
    - Handhold the enterprise till they break even. For this purpose Entrepreneurship Development Institutes (EDIs), local SSI Associations, acamdemic institutions having specific courses of entrepreneurship development may be involved.
    - Relative cost for at least one year should be treated as part of project cost in the beginning itself.
    - State Government earmark a market development for SMEs on the lines of Singapore Trade Development Board. These incentives would prevent use of short term working capital for long term purposes.
    - The financing institutions should take recourse to well founded SSI Associations for carrying out due diligence exercise as part of the appraisal mechanism.
    - Bank should do risk based pricing.
    - All delayed payments for the bills routed through the bank should be taken out of purview of 'default' category so that the unit does not qualify for being an NPA.

3. **Suggestions from Shri M. Viswanath, Additional Director (SSI), Industries & Commerce Department, Government of Karnataka, Bangalore**

    - Introduce MIS on credit flow to SSI sector to dispel the apprehensions of SSI Associations on lesser credit flow to SSI sector.
    - Branch having 400-500 SSI accounts should be converted automatically to Specialised SSI branch.
    - Greater thrust on building interface SSIs and R& D organizations for speedy and smooth technology transfer.

4. **Suggestions from the Boston Consulting Group**
    - Improving information availability-rating of SMEs.
    - Providing assistance in marketing, especially exports.
    - Providing professional services like legal, accounting, tax, etc.

Sd/
(**Dr.A.S.Ganguly)**

Sd/
(**Jaya Arunachalam)**

Sd/
(A.K.Purwar)

Sd/
(Kailash P. Jhunjhunwala)

Sd/
(N.Vaghul)

Sd/
(Dr.Ashok Jhunjhunwala)

Sd/
(S.S.Kohli)