



**MAKING MSME SECTOR A PROFITABLE BUSINESS PARTNER-
SOME STRATEGIES FOR BANKS**

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Abstract

MSME plays a key role in the development of the Indian economy by making most important contribution to GDP, generating employment in the country especially in the rural areas, developing entrepreneurial skill among its citizens and increasing foreign currency reserve of the country via exports. Even though MSME plays a major role in the development of Indian economy banks are reluctant to extent finance to this sector due to increasing number of sick unit that affects the banking performance due to the increase in NPA and corresponding provisioning. This paper tries to examine the problems faced by MSME sector and in particular accessing bank finance and perspective of banks towards it reluctance to extent finances to these sectors and discuss suggestive measure to make the MSME portfolio profitable business.

Index Terms – MSME, NPA, Sick Unit, Bank Financing

I. INTRODUCTION

In a world scenario, MSME density (No of MSME per 1000 population) in a developed economy is not only more than developing country but also employs higher percentage of work force. MSMEs employed at least 45 percent of the workforce, compared to only 27 percent in low income economies which indicates the importance of MSME contribution towards economic development of developed country. It clearly indicates that MSME are essential for the development of any growing economy. One of the highly spoken subjects in the recent past in India is about the importance attached to this sector and its role in development of Indian economy. MSME has emerged as a vibrant sector in Indian economy and plays a key role in generating employment at lower capital cost compared to large industries. Besides it helps in the development of the rural and backward area thus reducing regional imbalance by providing equitable distribution of national income and wealth. According to the Ministry of Micro, Small & Medium Enterprises, the sector consisting of 36 million units, as on January 2016, provides employment to over 80 million persons. The Sector through more than 6,000 products contributes about 8 percent of GDP, further it contribute about 45 percent of the total manufacturing output and 40 percent of the exports from the country. Moreover, the labour capital ratio in the MSME is high compared to large



industries and they are widely disbursed in their presence making them important for achieving the national objective of growth with equity and inclusion. The current 12th Five Year Plan (2012 to 2017) which aims for the faster, sustainable and more inclusive growth has provided lot of opportunity for this sector to develop and contribute to the economic development.

The MSME are enterprises engaged in manufacturing and rendering service as per the investments limit specified below as per the MSMED ACT, 2006.

TABLE1: Classification of MSME's in India

As per MSMED Act,2006			MSMED(Amendment) Bill, 2014(Proposed)		
Categories	Manufacturing*	Services #	Categories	Manufacturing*	Services #
Micro	<=25 lakh	<=10 lakh	Micro	<=50 lakh	<=20 lakh
Small	>25 lakh and <= 5 crore	>10 lakh and <= 2 crore	Small	>50 lakh and <= 10 crore	>20 lakh and <= 5 crore
Medium	>5 crore and <= 10 crore	>2 crore and <= 5 crore	Medium	>10 crore and <= 30 crore	>5 crore and <= 15 crore

Note: *Amount Invested in Plant and Machinery & # Amount Invested in Equipments

II. MSME's and Bank Financing in India

Banks are the financial intermediaries which accept funds from the public in the form of deposits and lend it to needy for margin which is usually the fees for under taking intermediation .Banks plays key role in financing MSME sector which is evident from the outstanding credit flow of the scheduled commercial bank to MSME sector. The public sector bank has huge share in financing MSME's followed by the private bank and the foreign banks. The following figure indicates the shares of public, private and foreign bank in financing MSME sector.

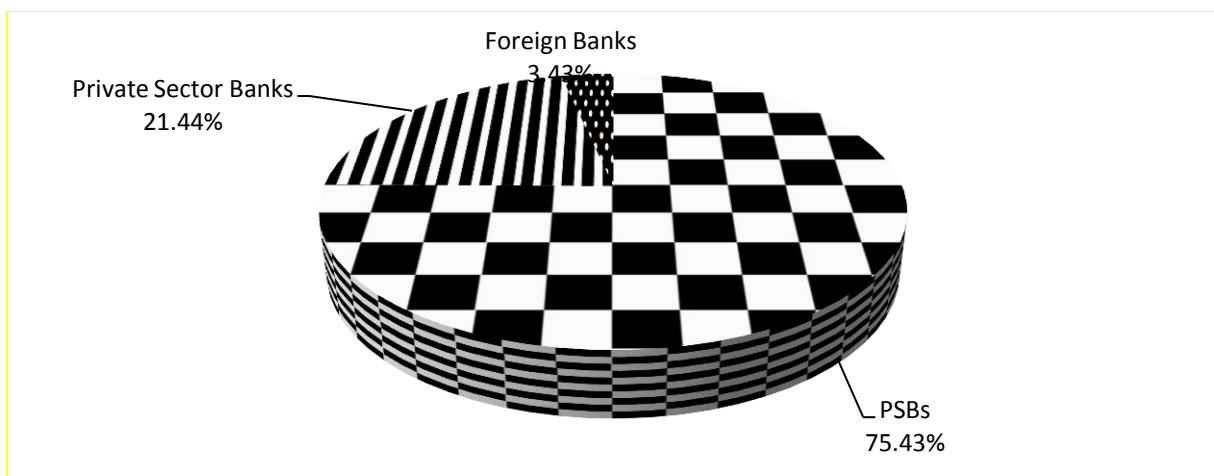


Fig.1 Bank Category wise sharing of outstanding credit to MSME sectors

Source: RBI data bank



Though MSME sector can source from many ways for meeting their short-term and long-term financial requirements, the commercial banks play an important role in credit distribution to MSME sector. The regulator also kept the MSME sector under priority sector so as to encourage the banking system to distribute credit without any constraint.

The following table provides the Scheduled Commercial Bank credit outstanding to Micro Small and Medium industries in India.

TABLE2: Scheduled Commercial Bank Credit Outstanding to MSME Sector (Rs in Billion)

Year	Gross Credit of SCB	Credit To MSME Sector	Credit to Priority sector	Credit To MSE under Priority sector	% of MSME credit to Gross Credit	% of MSME credit to Priority sector credit
2010-2011	37315	6396	12515	4550	17.14	36.36
2011-2012	43714	6234	14210	4986	14.26	35.09
2012-2013	49642	7458	15398	5623	15.02	36.52
2013-2014	56218	8330	18297	7078	14.82	38.68
2014-2015	61023	9268	20103	8003	15.19	39.81

Source: RBI data bank.

From the above table, on an average 15% of total bank's gross credit goes towards financing MSME sector, with in this priority sector credit on an average 37.29% of priority sector advance of banks goes to the micro and small enterprises. The gross credit of SCB's have experienced the increase from Rs.37315 billion to Rs 61202 billion accounting for the growth of 64 percentage between 2010 - 2011 to 2014-2015. During the same period the credit flow to MSME sector has increased from Rs 6396 billion to 9268 billion accounting for the growth of 44.90 percent. Even though the gross credit of bank has increased to the tune of 64.01 percent during the period 2010 - 2011 to 2014-2015, credit flow to MSME sector appeared at only 44.90 percent. This indicates that no corresponding growth in gross credit flow to MSME sector from the bank. In the same way the credit of SCB's to priority sector have experienced the increase from Rs. 12515 billion to Rs 20103 billion accounting for the growth of 60.66 percentage between 2010 - 2011 to 2014-2015, the credit flow to MSE under priority sector has increased from Rs 4550 billion to 8003 billion accounting for the growth of 75.89 percent, which is a good sign for the MSE enterprises.

Even though bank plays a key role in financing MSME, there was a growing dis-concern among the bankers towards financing MSME'S usually due to increase in the no of sick unit which has affected the bank's performance on a whole because of the corresponding increase in Non Performing Assets of bank. To understand it better the results of the study conducted by CRISIL regarding the funding pattern of micro, small, and medium enterprises



(MSMEs) in the pharmaceutical, engineering, and auto-component sectors from 2010-11 to 2012-13 (refers to the financial year, April 1 to March 31) are analyzed. The analysis indicates that the share of bank and institutional funding for MSMEs in these sectors is dwindling, and such enterprises are increasingly relying on their own resources to fund business growth. The study shows that there was a decline by 6 per cent and 3 per cent respectively in the share of bank and institutional funding to MSMEs in the engineering and pharmaceutical sectors. For auto-component, it declined by 1 percent. This shows that there is a serious concern among the banker community in financing MSME sector. On the other hand improved access from bank for capital investment and working capital requirement is important for MSME sector given the key role they play in the country's economy. Some of the concerns for banks to finance MSME sector is asymmetry of information that exists between the bank and borrower, problems related to collateral and credit rating, Hence banks and MSME sectors should work together to find out the feasible solutions to increase their finance without compromising on the quality of the loan portfolio enabling win-win situation for both.

III. Sickness in MSME Sector

According to Companies (Second Amendment) Act, 2002, A industrial unit is regarded as potentially sick or weak unit if it has accumulated losses equal to or exceeding 50 per cent of its average net worth in the immediately preceding four financial years and has failed to repay debts to its creditor(s) in three consecutive quarters on demand made in writing for such repayment. The two basic factors which may result in sickness of an industrial unit are Internal and external factors. Generally internal factor that contributes to the failure of industrial unit are lack of management skill, unprofessional conduct in functions of the company, wrong decision in choosing the location of the unit, Poor management in relation to the inventory, over estimated demands, non modernization of machineries and poor labour management, where as power related issues, infrastructure related problem, credit squeeze are some of the external factor responsible for industrial sickness. Sick unit have adverse effect on the economy as well as on the banking sector, Its negative effects on economy is seen via loss in the revenue to government leading to increase in public expenditure, increase in unemployment, increases in industrial disputes. on the other side the banks have the obligation via its statutory requirement to finance Micro and small enterprises in its priority sector advances, so when there is increase in sick companies, it definitely affects the banking sector as necessary resources are locked in the sick unit, leading to the increase in nonperforming assets of bank. Some of the reason attributed to sickness in MSME sector is financial constraints, Managerial problems, Government delay, Marketing, Technology and Infrastructure related issues. The following figure shows Ministry of MSME report on reasons for sickness in MSME sector

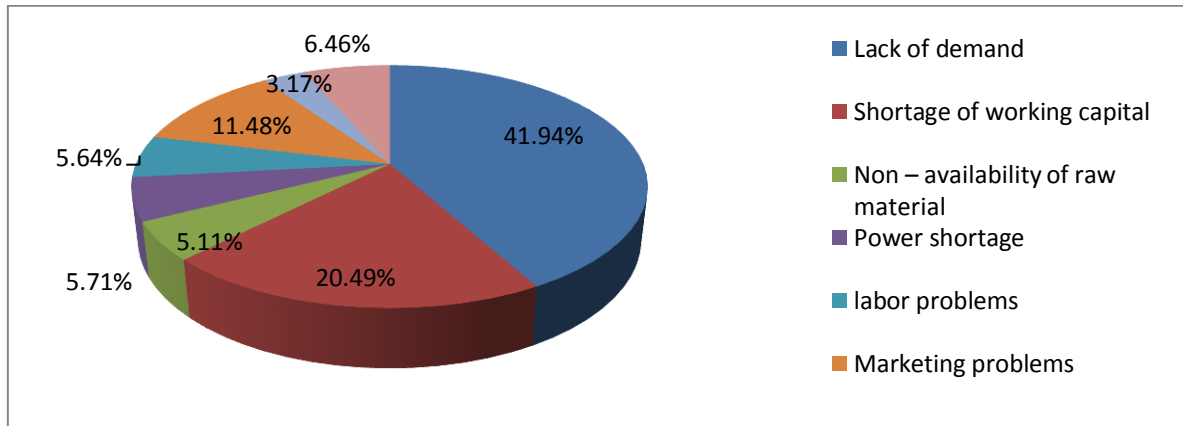


Fig 2 :Reasons for the Failure of MSME in Indi

Source: Fourth All India Census of MSME, Ministry of Micro, Small and Medium Enterprises, Government of India

IV.Sickness in MSME and Bank Loan Outstanding

Banks face huge problems in terms of Non Performing Assets (NPA) as it has direct impact on bank performance and its image in general public as well as indirect impact on it business as the banks has to increase their provision to NPA on the account of increase in the no of NPA accounts resulting in reduction of capital resource available with the bank to do business thus reducing the profitability of the banks. The following table shows no. of sick MSME unit and the corresponding bank finance for the period from 2011 to 2015.

TABLE3:Positions of Sick Unit Financed By Schedule Commercial Banks (Rs in Billion)

Year	No of Sick Units- MSE	Amount Financed By SCB
2011	90141	52.11
2012	85591	67.90
2013	220492#	124.42
2014	465492	263.11
2015*	528300	253.88

Source: RBI

*- Data for 2015 are provisional & #- The definition of sickness was revised with effect from November 01, 2012

It is clear from the above table that huge amount of bank money is locked in sick unit which has become the serious concern among the banker committee to finance MSME sector .There will be an increase of 387% in amount of bank money being locked in MSE enterprise over the period of 2011 to 2015 (if provisional data related to 2015 becomes true) necessitating banks to take step to make this MSME sector a profitable portfolio.



V. Strategies for the banks to make MSME portfolio profitable

1) Incentivise their large corporate client to procure product from the MSME's financed by the bank. Since most of the MSME companies fails because of lack of demand for the product, the banks being the capital provider for the large corporate can create a bridge between the MSME's and large corporate enabling ready markets for the MSME thus mitigating risk associated with MSME's finance, further the monitoring of account also become easy as analysis of resource flow between the MSME and large corporate become assessable from bank point of view.

2) The banks may introduce Customised Risk Rating Model for MSME's, in order to understand the risk better. Generally, the banks have their own rating software for analysing the credit worthiness of the borrower where more importance is given to other factors such as collateral compared to his primary information because of which many companies failed even though the possibility of survival was more. Hence, banks should use customised risk rating model giving more weight age to primary information about the borrower like personal net worth, track record of personal account of the borrower or key persons of company, dealing with their customer and supplier, technology used by company to understand the comparative advantage, the company possess over the other companies in the market space.

3) The banks may create a Common pool of Risk associated data with each set of cluster the bank deals with and make use of technology to develop IT enabled monitoring and appraisal system for each individual clusters. It is found that MSMEs fail due to lack of monitoring and appropriate intervention in terms of technology, training and development, funding etc.

4) The banks can develop customised loan product for MSME's, based on the data available with bank in relation to risk profile of MSME sector, market demand for the product it manufactures, and cash flow need of different life cycle of the product, the bank can develop a product with step up interest, where interest is low on a initial year and increases on the subsequent year when MSME's business grows. In addition, the bank can provide loan with concessional interest rate for marketing and branding purpose which can help the MSME's to have wider access to market leading to better revenue and profitability.

5) The banks shall introduce more delivery channel in order to help the MSMEs. Most of MSME's fails mainly because of non availability of timely credit particularly working capital credit. Hence, banks should make sure the timely availability of credit to this sector by opening braches especially to deal with cluster financing on particular clusters and to open satellite branches in areas where presence of MSME's are more.

6) A Forum to be formed in which representatives from bank, government and MSME sector should come together and meet at least once in quarter to discuss about the current problem related to MSME sector thus paving a way for possible solution to problems confronted by this sector.



7) Banks should adhere to Banking Codes and Standard Board of India (BCSBI) at all circumstance to improve the quality of relationship with the MSME sector that will help the banks to better the loan collection.

8) Bank should follow automation and standard process for sanctioning loan to MSME's, it should also avoid lengthy and complex paper works and it should also try to include simple documents in their loan proposal, process and distribution.

CONCLUSION

MSME plays a key role in the development of an economy by contributing a significant portion towards Gross Domestic Product of the country. Hence, to make this sector viable, constraints related to this sector should be identified and steps to overcome it should be framed. One such important problem is related to availability of finance from banks as banks are reluctant to finance MSME sectors because of increase in no of sick unit and the corresponding increases in NPA. Some of the strategies suggested above will help the bank to overcome such issues. More over banks should work together with government agencies and MSME enterprises to make the MSME's profitable partners.

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