

# *Recommendations of PM Task Force on Credit to MSEs: A Critical Analysis*

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## **<<< Abstract**

*The MSEs constitute over 90% of total enterprises in most of the economies and are credited with generating the highest rates of employment growth and account for a major share of industrial production and exports. In India also, the MSEs play a pivotal role in the overall industrial economy of the country. They are largest employment provider only after the agricultural sector. The MSE account for 13% of GDP of the nation, and their output constitute about 39 percent share of the value addition in manufacturing sector & about 33% of total export from India. Realizing the potential of this sector our Prime Minister has set up a task force under the chairmanship of principal Secretary to address the issues of MSE Sector. The Task Force covers the issues of Credit, Marketing, Labour, Exit Policy, Infrastructure/Technology/Skill Development, Taxation and Special Package for North East/Jammu & Kashmir. The Task Force submitted its report in the month of January 2010. For any unit to start & function smoothly, money is essential, as such, credit can be termed as lifeline of any unit in spite of its size, whether small or large. The issue of credit comprises of Availability of adequate credit in time, Cost of credit, Collateral requirement, Access to equity capital, Rehabilitation of sick units etc. The recommendations made by the task force, if accepted by the cabinet & implemented by the concerned implementing agencies are likely to have significant impact on the growth of this sector. In addition to this a great task ahead is of monitoring the implementation of the recommendations. The suggestions made by us in this paper, if implemented, will definitely make the task of implementing as well as monitoring agency very easy.*

## **1. INTRODUCTION**

The world is getting smarter everyday and it is becoming increasingly important for us to understand the importance of motivating Micro & Small Enterprises (MSEs) to be the foci of our economies in the times to come. This can either be done by encouraging them into production and marketing the produce, or by ushering them to the right amount and sources of finance, for them to be able to make the decisions of implementation and expansion.

Micro, Small & Medium Enterprises Act (MSME Act-2006) has categorized the units into Micro, Small & Medium categories based on the investment in plant & machinery used for manufacturing.

With majority of revenue generation coming off MSEs, the duty of government to provide the sector with sufficient resources has become more crucial. The purpose of this paper is to highlight the importance of finance for the Micro and Small enterprises and to usher the task force to better prospects of

Table-1

Industry	Enterprises engaged in the manufacture of productions of goods: (investment in plant and machinery)	Enterprises engaged in providing or rendering of services: (investment in equipment)
Micro	Not Exceeding Rs. 25 Lacs	Not Exceeding Rs. 10 Lacs
Small	Between Rs. 25 Lacs to Rs. 5 Crore Not	Between Rs. 10 Lacs to Rs. 2 Crore
Medium	Exceeding Rs. 10 Lacs Between Rs. 5 Crore to Rs. 10 Crores	Between Rs. 2 crore to Rs. 5 Crore

ensuring MSEs with resources.

## 2. ANALYSIS

Worldwide, the Micro & Small enterprises (MSE) have been playing the pivotal role in the overall growth of the economy. MSEs have also been regarded as the tool for promoting equitable development. So because, The MSEs constitute over 90% of total enterprises in most of the economies and are credited with generating the highest rates of employment growth and account for a major share of industrial production and exports. However, the definition of MSEs varies with countries. As far as India is concerned, investment in plant & machinery used in production is the sole criteria, whereas in the European Union (excluding United Kingdom), USA & Malaysia, the number of employees & sales turnover are the criterion in determining the status of MSEs. In UK & China MSEs are categorized based on number of employees, turnover & assets size of the enterprise.

In India too, the MSEs play a pivotal role in the overall industrial economy of the country. They are largest employment provider only after the agricultural sector. The MSE account for 13% of GDP of the nation, and their output constitute about 39 percent share of the value addition in manufacturing sector & about 33% of total export from India.

Further, in recent years the MSE sector has consistently registered higher growth rate compared

to the overall industrial sector. The major advantage of the sector is that it is employment potential even at low capital costs. As per the available statistics, this sector employs an estimated 59.7 million people spread over 26.1 million enterprises and the labour intensity in the MSE sector is estimated to be almost 4 times higher than the large enterprises.

Realizing the potential of this sector our Prime Minister has set up a task force under the chairmanship of principal Secretary to address the issues of MSE Sector. The Task Force in its first meeting held on 25.9.2009 decided to constitute seven sub-groups to cover the issues of Credit, Marketing, Labour, Exit Policy, Infrastructure/ Technology/Skill Development, Taxation and Special Package for North East/Jammu & Kashmir. The Task Force submitted its report in the month of January 2010.

In this paper we have tried to analyze the impact of the recommendations of the task force on Credit, critically, as they are likely to impact on the performance of this sector.

## 3. RECOMMENDATIONS ON CREDIT

For any unit to start & function smoothly, money is essential, as such, credit can be termed as lifeline of any unit in spite of its size, whether small or large. The task force had made various recommendations requiring immediate action well as medium term institutional action. The issue of credit comprises of following:-

- Availability of adequate credit in time.
- Cost of credit
- Collateral requirement
- Access to equity capital
- Rehabilitation of sick units.

**a) Recommendation on Growth Rate:** The Task force had recommended that all Schedule Commercial Banks should achieve a CAGR of 20% on Micro & Small Enterprises businesses and out of this 60% should go to the Micro Enterprises. From 1<sup>st</sup> May 2010, any shortfall of this 60% on Micro Enterprises should go to a separate fund with Small Industrial Development Bank of India (SIDBI).

**Comments & Suggestions:** The poor growth is in spite of the fact that over the year the maximum

**Table-2**  
Presently the sector is facing a problem of poor growth as reflected in the Table

	As on the end of March							Rs. in Crores		
	2000	2001	2002	2003	2004	2005	2006	2007	*2008(P)	*2009(P)
Net Bank Credit (NBC)	316427	341291	396954	477899	558849	718722	1017614	1317705	1364268	1693437
Credit to MSEs	46045	48400	49763	52988	58278	67634	82492	104703	148651	185207
MSEs credit as % of NBC	14.6	14.2	12.5	11.1	10.4	9.4	8.1	8.0	10.9	10.9
Credit to Micro Entp.	24742	26019	27030	26937	30826	34315	33314	44311	66702	83945
Micro Entp. Credit as % of NBC	7.8	7.6	6.8	5.6	5.5	4.8	3.3	3.4	4.9	4.9
(P) – Provisional										

\* As per revised definition

limit for investment in plant & machinery for categorizing any unit as Micro or Small has

Investment in Plant & machinery	% of Credit out of the MSE credit
Upto Rs.5 Lacs	40%
Above Rs. 5 lacs & upto Rs.25 lacs	20%
Above Rs. 25 lacs for other Small Enterprises	60%

increased from ₹One Crore to 5 Crore i.e. five fold increase leading to more & more units coming under the category of Small Enterprises. Till now banks were supposed to lend 40% of total lending towards Priority Sector Lending, out of above 40%, an amount of 25% was marked for MSEs. It was further subdivided as under:-

It is matter of facts that banks had never achieved the targeted figure. In order to avoid higher lending risks & operational cost in financing MSEs, banks may prefer alternate route of parking their funds in the Designated Fund with SIDBI & will earn risk free return in shape of interest. In case the investment in the fund is given the status of Priority Sector Lending the banks will be able to achieve the lending targets for Micro Enterprises with zero-risk & this action may defeat the very purpose of the recommendation. In order to avoid such situation taking place it is suggested that the fund should have zero interest rate & investment in the fund be treated as Non-Priority Sector lending.

**b) Recommendation on the Growth Target:** The Task force had recommended 15% growth in number of Micro Enterprises.

Comments & Suggestions : This action may lead to snatching of good accounts from other banks. The

growth target of 30% will lead to coverage of 30 lac additional units in the next five years. At present more than 55% of MSEs are concentrated in 6 states namely, Uttar Pradesh, Andhra Pradesh, Maharashtra, Tamilnadu, West Bengal & Karnataka. The flat 15% increase will further increase the disparity among various parts of the country.

In our opinion banks be asked to increase the lending to Micro Enterprises by increasing number of units financed by each of the branch by say 4 units per year & every branch must achieve this targeted figure. If this target is achieved, the backward states will also get their due weightage & it will create employment opportunity across the length & breadth of the country.

**c) Recommendation on Interest Subvention:** The Task force had recommended Interest Subvention on Micro Enterprises Loan considering the Ministry of MSE thus formulating a scheme for the same.

Comments & Suggestions : Presently big corporate groups are getting Sub BPLR loans (Sub Benchmark Prime Lending Rate) & MSEs are getting loans at BPLR plus a spread of 3% above BPLR based on credit rating of the MSEs, which is again subject to various factors like past performance and availability of resources. It, at the end of all the process makes the credit very costly for MSEs which is already lagging behind the Large Industries resulting discrepancies in the 'Economies of Scale'. Presently in our country agriculture sector is being given interest subvention of 3% by the government. If similar amount of subvention is considered by the government for the new Micro Enterprises coming under the banking arrangement, it will lead to a subsidy amount of about ₹9000 crores over a period of 5 year, as the task force is expecting lending of 3 Lac crores to Micro Enterprises.

Banks as we know are free to fix their respective BPLR depending the credit worthiness of their client companies. Fixing any relaxation hereby on the MSEs will help them having more disposable liquid resources up hand so as to further promote activities like integrated marketing solutions and research and development.

The interest subvention will make the lending to Micro Enterprises appear attractive for the banks & the interest burden for Micro Units will reduce drastically. This will make their 'product cost' effective leading to an increase in their viability. In our opinion the subvention shall be given in two stages – first as interest subsidy & second as incentive for timely payment to the bank. If a subvention of 3% is considered 75% may be given to the bank on claims & remaining 25% shall be reimbursed by the party through banks in only those accounts categorized that are considered as Standard Asset on the date of closure of financial year. This step may improve banking culture amongst the Micro Enterprises & will reward the entrepreneurs in making timely payment of their dues to their lenders.

**d) Recommendation on the SME Exchange:**

The Task force had recommended setting up of SME Exchange presently SEBI is examining the proposal to set up exchange for SMEs.

Comments & Suggestions : This step is likely to help MSEs in raising equity capital from market. While the exchanges could serve as platforms for the MSEs to perform, those could also assist keeping check on the overall performance and effectiveness of the MSEs across the industry and service segments.

It is well known fact that investment in equity carries inherent risk for investors. Investment in equities floated by MSEs will carry comparatively higher risk when compared with larger corporate. This may make investment in equity of MSEs less lucrative for the investors. In order to improve equity participation in MSE Exchange, it is suggested that the investment in equity of MSEs by the institutional investors like banks be considered as Priority Sector

lending, so that the banks can invest in the equity in order to achieve the stipulated target of lending of 40% under priority sector. Retail investors and HNIs may be granted some tax benefits in their investment in addition to their limit under section 80-C. These steps may improve the acceptability of MSE equity floats in the market.

**e) Recommendation on Uniform Loan**

**Procedures:** The Task force has also recommended to device a uniform loan application form for loans upto Rs.25 lacs, acceptable by all banks.

Comments & Suggestions : It is a well known fact that a MSE Entrepreneurs play more so like "Uno" and generally do all the work like arrangements of funds, procurement of raw materials, supervising production, marketing & completing statutory formalities.

While the uniform loan procedures could prove fruitful to banks in improving results such loans could have multiple advantages to MSEs. With sufficient liquidity in hand and enough resources available for further projects, these loans could also help in expansion and exploration. We may consider the fact that banks have certain performance parameters and that only the MSEs qualifying the criterion shall be given consideration for further loan approvals, and again, the decision of approving off the loans shall be the sole discretion of the banks.

With this step the MSEs can approach a number of banks without worrying for paper formalities of different kinds with different banks. The entrepreneurs will thus save lot of time & energy required while filling forms for different kinds of loans with different banks. In the opinion of the Nayak Committee, the form should be made compulsory for all the banks for the loan amount calculated. Presently most of the PSBs are calculating working capital requirement of MSEs as per Nayak Committee recommendations upto WC Limit of Rs.5 Crores. If the form is considered up to lending of WC of Rs.5 Crores, it is going to save lot of time & energy of the units.

**f) Recommendations on Statutory Changes:**

The Task force had recommended that mandatory coverage under CGTMSE be increased from Rs. 5



lacs to Rs.10 lacs & banks to absorb the Annual Service fee & upfront charges payable to CGTMSE. Comments & Suggestions : This recommendation, if implemented by the banks is going to reduce the cost of credit to MSEs. Presently the CGTMSE is charging Annual Service fee upto 0.75 % & one time upfront charges of 1.5 % for the units covered under the scheme. Presently is observed that banks are reluctant to lend even Rs.5 Lacs under the scheme, so increasing it to Rs.10 lacs will need strict monitoring by the competent authority.

**g) Special Packages:** The Task force had recommended continuance of Stimulus package till 31/3/2011 including special refinance facility of Rs. 7000 Crore to SIDBI.

Comments & Suggestions : It is a welcome step & units will get benefitted from this in fighting from Global Slowdown.

As far as the fund for refinance is considered, presently the banks are flushed with funds & are looking for good opportunity for investment. As such, the fund is likely to remain unutilized.

**h) Miscellaneous Recommendations:** Recommendations of the task force on Angle Fund, Review of Lead bank Scheme, Bank code for

MSEs, participation of banks in Programme of Entrepreneurship, higher moratorium period for loans, electronic tracking system for loan approval/rejection, preparation of project profiles by banks with DICs, adoption of one cluster by Lead bank, specialized training for bank officials, MSME help line etc. are also there.

Comments & Suggestions : These recommendations are steps which will help in changing the mindset of the bankers. The steps will not have their immediate impact on the working or growth of MSEs.

#### 4. CONCLUSION

It is a well known fact that the Micro & Small Enterprises plays a vital role in development of any nation. Our government has also recognised the importance of this sector in our economy. The Task Force has highlighted the achievements of this sector in its report. The recommendations made by the task force, if accepted by the cabinet & implemented by the concerned implementing agencies are likely to have significant impact on the growth of this sector. In addition to this a great task ahead is of monitoring the implementation of the recommendations. The suggestions made by us in this paper, if implemented, will definitely made the task of implementing as well as monitoring agency very easy.

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