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ASSOCHAM
INDIA

Social Banking Excellence Awards 2017

THE ASSOCIATED CHAMBERS OF COMMERCE AND INDUSTRY OF INDIA

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February 2018

THE ASSOCIATED CHAMBERS OF COMMERCE AND INDUSTRY OF INDIA

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SECRETARY GENERAL MESSAGE

D S RAWAT
Secretary General
ASSOCHAM

ASSOCHAM over the years has been trying to understand, reward and celebrate Performance of banks in the social sector. Continuing the legacy, ASSOCHAM has called for nominations from banks to analyze, deliberate, compare and reward the best social bank and also the banks contributing significantly to the Agricultural Banking, priority sector lending and Participations in Government schemes.

This year again, ASSOCHAM has received overwhelming responses from the banks. Many banks have nominated in multiple categories of awards. A total of 108 nominations from 44 banks have been received across different categories.

APAS, the knowledge partners of this initiative have developed robust scoring models for the evaluation for shortlisting the winners and runners after applying prudent judgment by the jury.

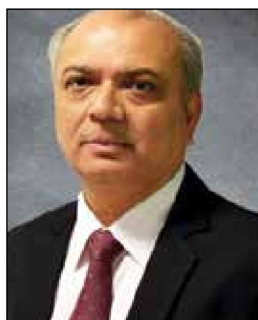
In this backdrop, ASSOCHAM is organizing 13th Annual Banking summit cum excellence awards to recognize to reward and celebrate models of inclusive growth and sustainable development as well as innovative approaches to creating value for society and business together.

ASSOCHAM-APAS is pleased to release a report at the 13th Annual Banking summit. I would like to express my sincere appreciation to ASSOCHAM-APAS team for sharing their thoughts, insights and experiences.

I am confident that the ASSOCHAM-APAS report will be insightful and useful to all stakeholders.

D S RAWAT

APAS PREFACE



Ashvin Parekh
Managing Partner
Ashvin Parekh Advisory Services LLP (APAS)

Ashvin Parekh Advisory Services is proud to present the Knowledge report for the 13thSocial Banking Excellence Award 2017. APAS has been associated with this initiative for the last 2 years and has been constantly striving to make it better.

The awards lay emphasis on recognizing the efforts of banks (all categories) to enhance their efforts in contributing to priority sector lending, to applaud and cherish the social banking models created and developed by banks over the years.

In the year 2017, SMEs and MSMEs stirred towards searching different avenues for their credit needs as banking industry withdrew small amount of support. As the exploration would see, SMEs and MSMEs will now find greater amount of reliance on the Bond markets to meet their credit needs.

The Indian Bond markets have received a greater push in light of alternative sources of funds. The regulator has been forthcoming, in terms of easing the regulations related to bond markets.

As the new dynamics of credit flow take shape, we understand that lenders are trying to ease pressures from Bank-based lending, by reducing it to almost 75% of the total credit flow to the industry and laying the responsibility for the rest 25% on avenues such as bond markets and alternative sources of funding.

Amidst the easing pressure, we can see an evolution of infrastructure for resolution of NPAs, through an active participation by the industry, private equity, investment funds, banks and other competitors. Almost 70% of NPAs are held-up by large-sized companies, and rest 30% by medium and small sized companies. As the resolution proceeds ahead, it paves way for freeing up capital in banks' books to be lent to more productive outfits. As initiatives like Make-in-India, proceed ahead, we can only think of this to be a brighter future for Indian MSME sector, with more capital availability and better prospects.

Along with the industry, the banking sector must also see an upgradation now, in terms of the lending infrastructure, credit analysis, credit flow and control mechanisms.

The discussions covered in the book are designed keeping in mind the fact that between the enabling environments and the business of small and medium sized borrowers, the latter should prevail. The enabling environments need to be examined and bespoke solutions be arrived at.

The event specifically focuses on creating a platform where the socially oriented banking is recognized and applauded. The problems in such kind of banking are discussed and solutions are arrived at.

As the knowledge partner, APAS is committed to highlight these requirements from both the sides namely bankers and borrowers. In order to fulfill this in an effective way, both APAS and ASSOCHAM are eager to have your feedback and suggestions.

As always, it has been an enjoying experience in developing this report. I would like to thank the team from ASSOCHAM led by Mr. Chandan Kumar for their continued support, and my colleagues – Sujana Hari, Ankita Narnaware, Kalpesh Mantri and Harsh Mirpuri and for assisting me in developing this report.

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Agriculture Banking in India

Economic perspective on Agriculture funding

Post-independence, Indian economy has progressed greatly from being dependent on agriculture to becoming a consistent food exporter. The gradual reforms in the agricultural sector (following the broader macro-reforms of the early 1990s) spurred some unprecedented innovations and changes in the food sector driven by private investment. These achievements must be understood and captured in light of policy, investment and growth perspectives, in a futuristic frame. Agricultural growth rate has improved in recent years (averaging about 3.5 percent since 2004/05), but at a long-term trend rate of growth of 3 percent, agriculture has underperformed relative to its potential. The effects of reformistic agenda have not been sufficiently scaled up to influence sector's long-term growth rate.

The importance of investment for productivity and growth cannot be understated. Capital formation from agriculture and agriculture growth, labor productivity is well connected. Public investments have effectively increased after 2003-04. Whereas earlier, 1980s and 90s had witnessed a negative rate of growth of flow of funds to agriculture. This was the outcome of concerted efforts through major programs in the 11th 5-year plan. Post 2004-capital diversion to the sector, the trend has emerged towards a flat curve. Private sector has also increased since mid-1990s, occupying almost 20 percent of agricultural GDP, which now extends to almost 80 percent of the total investment in the sector. Despite the positive development, agriculture as a sector remains highly dependent on both private and public sector investments.

When we consider the contribution of agriculture to the total economy, we can see the trend continues to decline for both public and private investments. In order to encourage investments through private sector, emphasis should be made on encouraging returns, policy reforms and adequate environment for investment in agriculture. In case of public investment, perhaps the policy announcement could be backed up by adequate funds. The trend of public and private sector investments and gross capital formation as contributed by agriculture sector has been captured in the figure below:

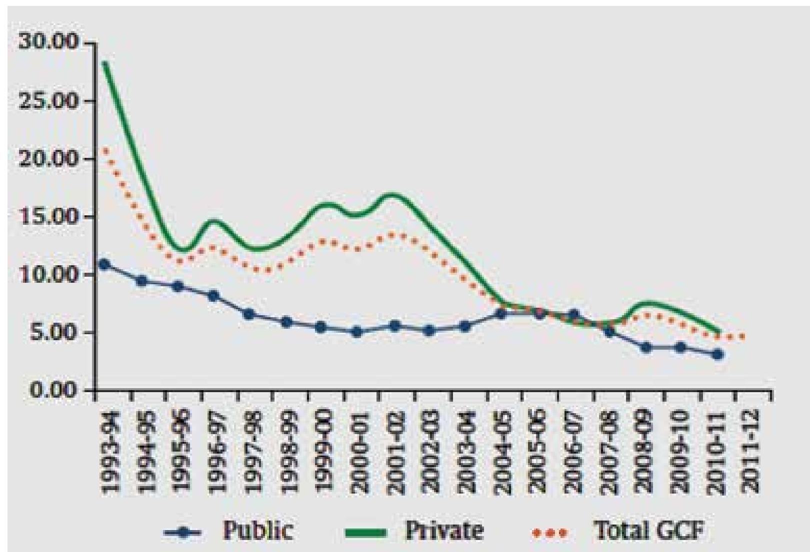


Fig 1.1: Share of agriculture in gross capital formation

Growth of agriculture sector:

Since the beginning of economic reforms in 1991, growth in agricultural GDP has shown high volatility. It has fluctuated from 4.8 percent per annum in the Eighth Five Year Plan (1992-96) to a low of 2.4 percent during the Tenth Plan (2002-06) before rising to 4.1 percent in the Eleventh Plan (2007-12), as shown in Figure 1.2

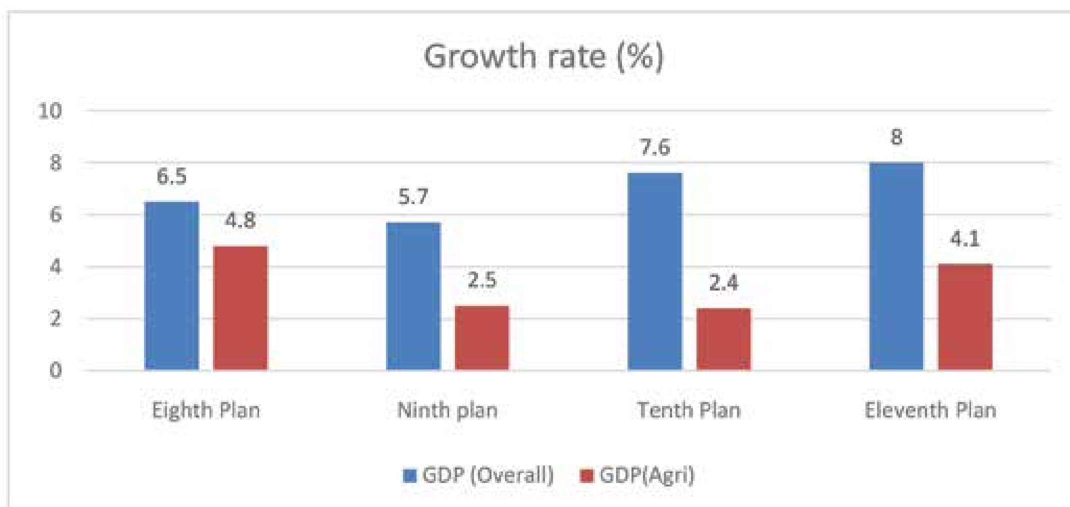


Fig 1.2: Growth of agriculture GDP in comparison to overall GDP over 8th to 11th 5-year plans

Sector-wise Share in GDP at Constant (2004-05) prices:

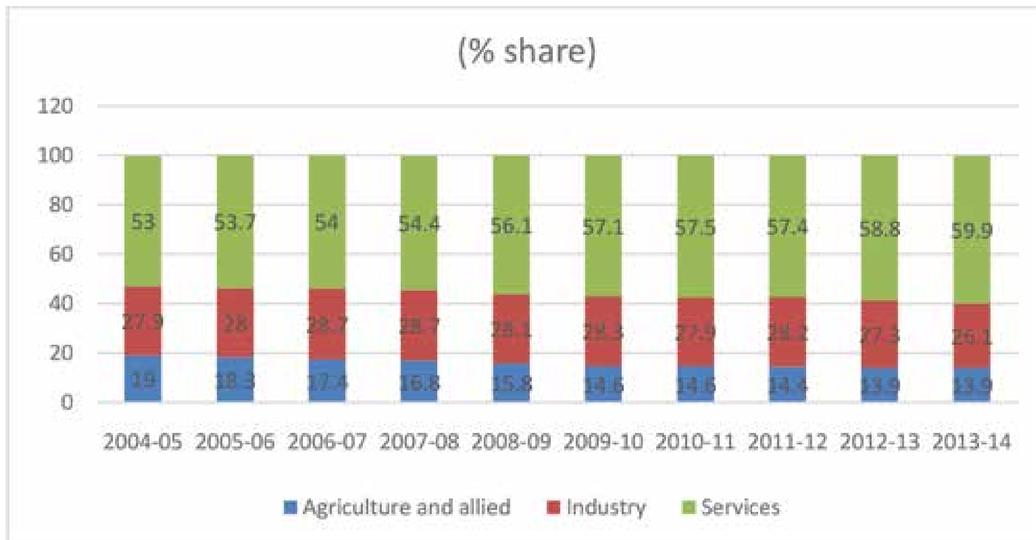


Fig 1.3: Sector-wise contribution to GDP at 2004-05 prices

Capitalizing on Global Trade Opportunities for agriculture:

India has emerged as a significant exporter of rice, cotton, meat, oil meals, pepper and sugar. Export competitiveness has been developed in certain specialized agriculture products like basmati rice, guar gum and castor. During 2014-15, agricultural exports was to the tune of INR 2,29,996 crores, as compared to

INR 1,22,188 crore of agricultural import bill. The increase in value of agricultural exports during 2014-15 was mainly on account of higher exports of marine products, basmati and non-basmati rice, meat and meat preparations, cotton, oil meals, spices and guar gum. Imports of vegetable oils, pulses, cashew nuts, spices, sugar and cotton have also registered an increase during the period. During 2015-16 (Apr-Dec) due to subdued global demand, total agricultural exports were estimated to be INR 1,58,129 crores as compared to INR 1,82,385 crores during the same period last year. Agricultural imports on the other hand, have increased to INR 1,06,935 crores during Apr-Dec (2015-16) as compared to INR 94,634 crores during the corresponding period in 2014-15.

The share of India's agricultural exports and imports in world exports/imports is shown in Fig 1.4 below:

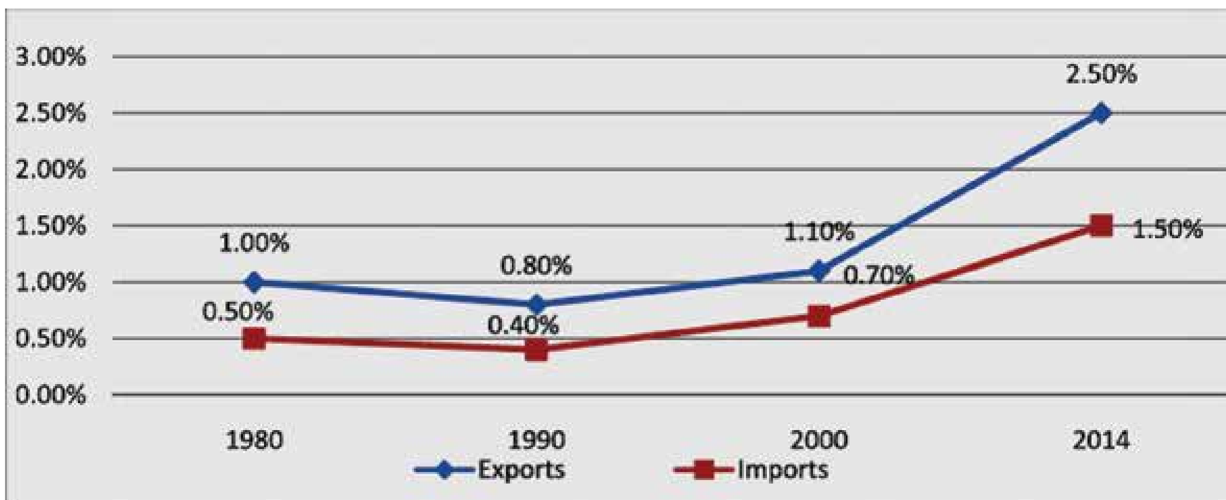


Fig 1.4: India's agricultural exports and imports as a percentage of global exports/imports

Employment in Agriculture

Post a review of income generation from agriculture, we take a look at the employment generation and other related impact in this section. As a country develops, its economic activity draws away from agriculture and native economic activities. Therefore, India has seen a similar trend in the past few years. The percentage of agricultural workers in the total workers in the country has come down from 58.2 per cent to 54.6 per cent during 2001 to 2011 (Census, 2011). The recent NSSO report on Employment and Unemployment Situation in India (68th Round) also states that the accepted wisdom that employment in agriculture declines with the increase in economic growth and development. The Survey shows that the share of the primary sector in total employment has gone below 50 per cent for the first time in 2011-12. Another thing to be reviewed is that, the decrease in agricultural employment has not been in proportion with the increase in employment in other section of economy. The share of agriculture and allied sector in GDP has come down sharply from 52 per cent in 1951-52 to 13.9 per cent in 2011-12, whereas, share in workforce remained high at 54.6 per cent, declining by merely 15 percentage points during the same period. The slow pace of structural transformation in agriculture can be attributed to lack of non-farm employment opportunities in rural areas to absorb a larger proportion of the workforce from agriculture. The resultant high level of dependence on agriculture makes the sector more vulnerable, as any drop in agricultural production, can affect incomes and expenditure of large number of population and have a direct impact on poverty.

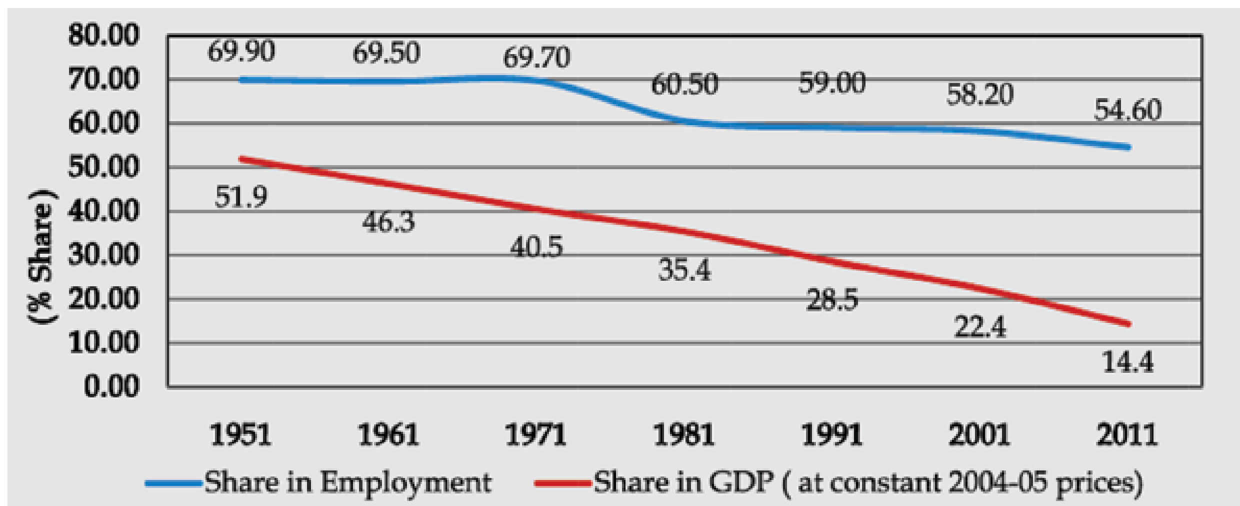


Fig 1.5: Employment generated by agriculture

Broad-basing Agricultural Credit

Funding agriculture has been one of most essential agendas of the Governments, that have been in existent since independence era. The funding has been through formal and informal sources. Formal sources comprise of Banks, NBFCs, Co-operative Banks, etc. Whereas informal comprise of private moneylenders, friends, relatives, commission agents, traders, etc.

Policy initiatives revolving around replacing the informal sources of lending to farmers by formal sources and to support enhancement of production and incomes, have been made. Over the decades, the agricultural credit system has improved through various efforts such as cooperative credit societies at various levels, expansion of rural branches of commercial banks, and setting up of regional rural banks. Between 2004-05 and 2014- 15, institutional credit to agriculture increased from INR 1,25,309 crores to INR 8,45,328 crores, registering a compounded annual growth rate of 24 per cent. It is noteworthy that the flow of agricultural credit has not just increased over the years but has consistently exceeded the target. During 2015-16, against a target of INR 8,50,000 crores, more than 70 per cent of the credit has been disbursed by December, 2015.

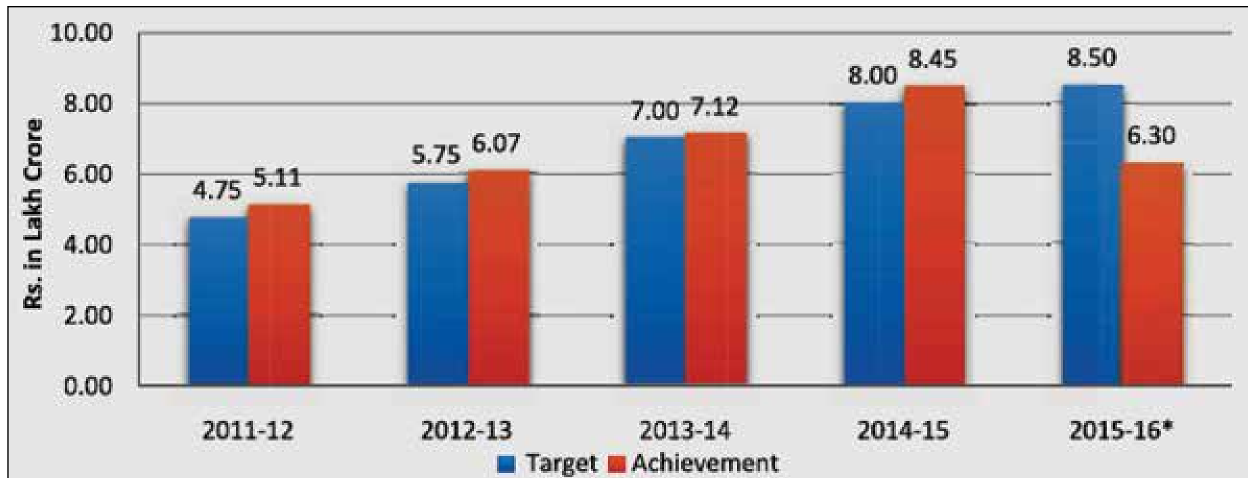


Fig 1.6: Target and achieved credit flow to agriculture

Cost of funding:

Non-institutional sources of funding have consistently retained a higher share in funds flow to agriculture, despite the efforts of banks and NBFCs to reach out to the farmers in rural and remote areas, and also higher interest rate charged by them.

As much as 71 per cent of the outstanding dues from non-institutional sources attracted interest rates of more than 15 per cent in 2013 whereas the corresponding figure for institutional sources was only 10 per cent. Further, outstanding debt at rates above 30 per cent was as much as 34 one per cent for non-institutional sources and only one per cent for non-institutional sources. It is, however, significant that non-institutional agencies also grant loans at zero per cent rate of interest and the share of interest-free debt in the outstanding debt was almost 18 per cent and18.3 per cent in 2002 and 2013, respectively. The graphs below depict the spread of quantum of loans along with the interest rate range charged by institutional and non-institutional sources of funds:

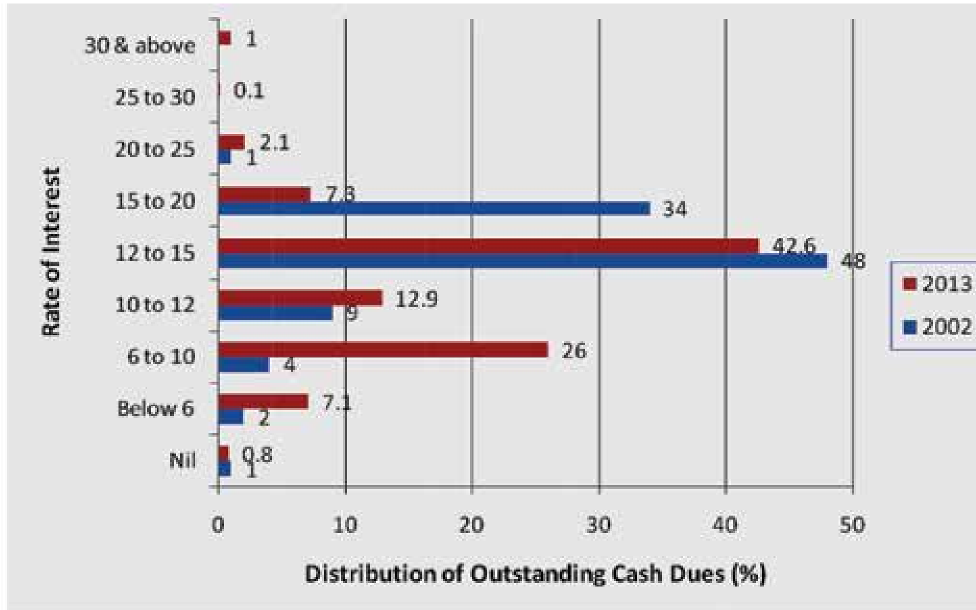


Fig 1.7: Interest rates with outstanding cash from institutional agencies

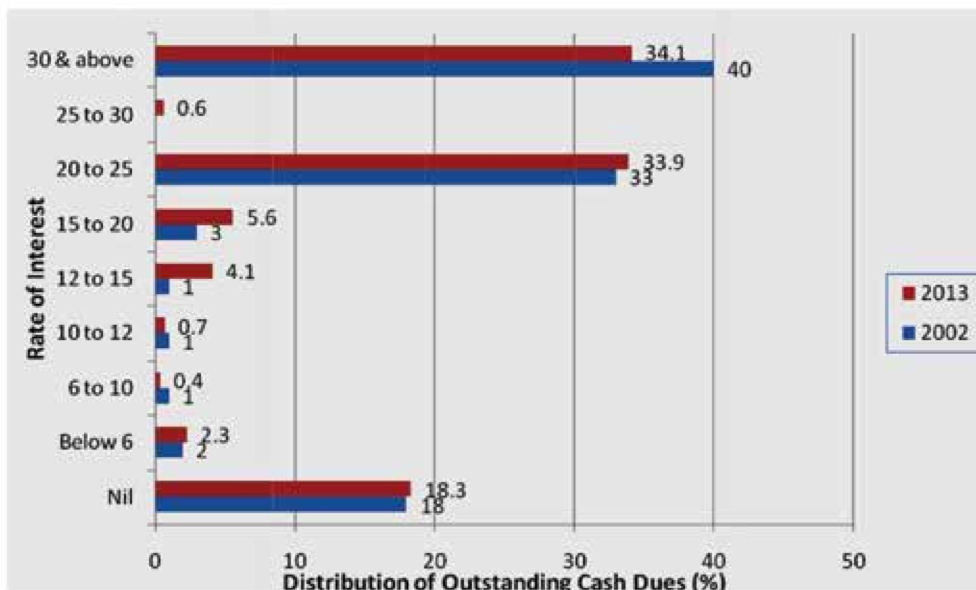


Fig 1.8: Interest rates with outstanding cash from non-institutional agencies

Trends in Institutional Credit

Institutional credit to farmers comprises of co-operative banks, commercial banks and regional rural banks and takes the form of either short-term or long-term credit. In addition, there is substantial lending for agriculture related activities, which is deemed to constitute indirect financing of agriculture. Short-term agricultural credit or crop loans constitute of loans provided to cultivators to procure inputs such as fertilizer and seeds needed for seasonal agricultural operations, while long-term credit comprises of investment in

fixed assets, such as irrigation pumps, tractors, agricultural machinery, plantations and those related to dairying, fishing and poultry. Short-term credit is also meant to cover the cost of hired labor as well as a part of the consumption needs of poorer farmers. Indirect finance of agriculture includes loans to input dealers, loans for setting up agri-clinics and agribusiness centres, loans to microfinance institutions, loans to dealers in agricultural machinery and drip and sprinkler irrigation systems, loans for construction and running of cold storage units, irrespective of their location, loans to food and agro-processing units, and diverse other activities related to agriculture. There has been a manifold increase in the volume of direct agricultural credit advanced by institutional agencies in the last four decades or so. Between 1975-76 and 2011-12, the volume of short-term credit from commercial banks, co-operative banks and RRBs rose from INR 1,096 crore to INR 3,46,737 crore, that of long-term credit from INR 499 crore to INR 1,07,162 crore and that of the total from INR 1,595 to INR 4,53,899 crore at current prices. The figure below explains growth of credit flow to agriculture vs both short term and long-term credit flow to agriculture.

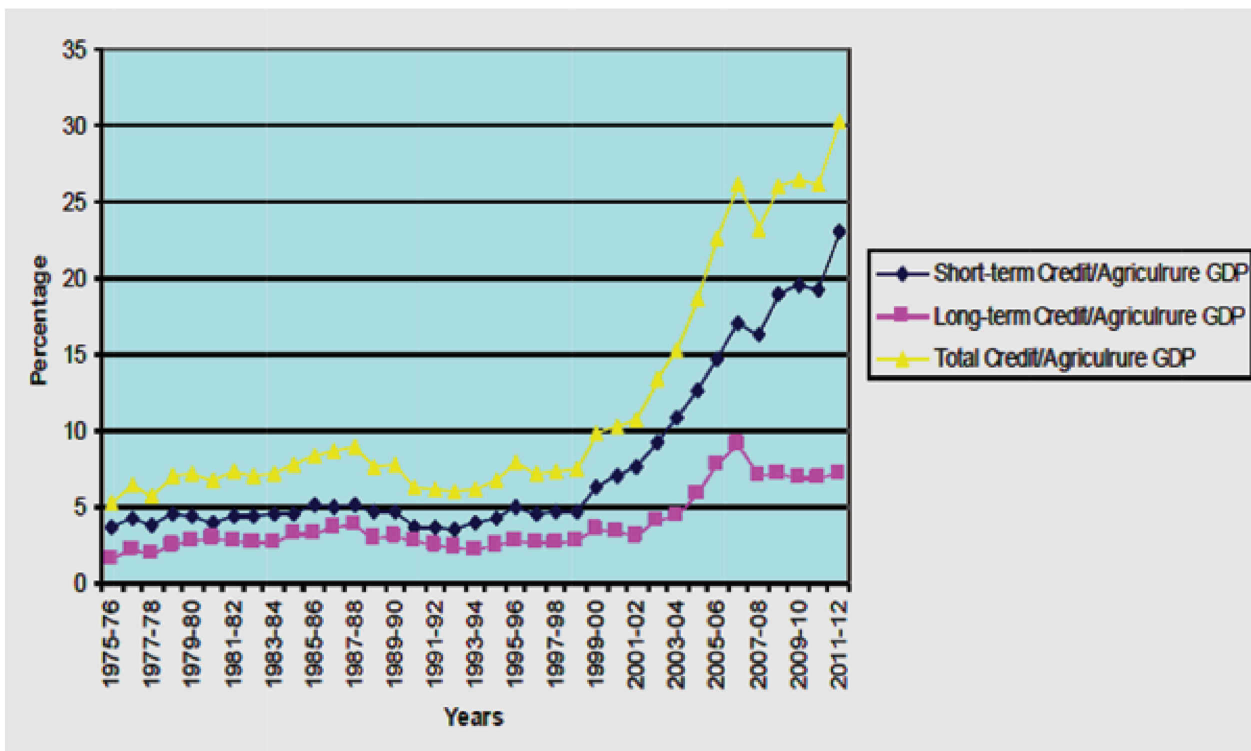


Fig 1.9:short-term credit and long-term credit as a percentage of agricultural GDP

Trends inagricultural credit growth

There are three distinct features of the growth in agricultural credit, which have had a major role in determining the extent of increase in credit supply as well as its distribution within the agricultural sector. These features are discussed separately in the sub-sections below.

The Role of Indirect Finance

As we can see, a significant proportion of the increase in total bank credit to agriculture in the 2000s was accounted for by indirect finance to agriculture. Of the total increase in credit supply to agriculture between 2000 and 2011, about one-third was contributed by indirect finance. In the decade of the 1990s and after, the share of indirect finance in total agricultural finance has consistently risen (Fig 1.10). Between 1985 and 1990, there was a fall in the share of indirect finance in total agricultural finance; the share began to rise after 1990 to reach 15.5 per cent in 2000, 23.9 per cent in 2005 and 25.5 per cent in 2007. Thus, while the share of indirect finance in total agricultural finance had begun to rise in the 1990s, its increase in the 2000s was considerably faster.

Year	Share in total agricultural credit (Per cent)		Total
	Direct finance	Indirect finance	
1985	83.2	16.8	100
1990	86.8	13.2	100
2000	84.5	15.5	100
2005	76.1	23.9	100
2006	72.1	27.9	100
2007	74.5	25.5	100
2008	77.5	22.5	100
2009	77.1	22.9	100
2010	76.1	23.9	100

Fig 1.9:short-term credit and long-term credit as a percentage of agricultural GDP

Increase in Agricultural Loans with Large Credit Limits

Year 2000 onwards, there was a significant increase in large quantum of loans (INR 10 crore and above particularly INR 25 crore and above). The table below describes the distribution of amount of agricultural advances (Direct and indirect) along with credit limit size-classes of loans for the period 1985-2011.

A comparison of figures for 1990 with those of 2010 shows that the share in total of advances of loans of size “less than INR 2 lakh” shrunk significantly. The share in total advances of advances of size less than INR 2 lakh declined from 82.6 per cent in 1990 to 44.3 per cent in 2010. On the other hand, the share in total advances of advances of size above INR 10 crore increased sharply from 1.3 per cent in 1990 to 20.4 per cent in 2010.

Credit limit size class of loans (Rs)	Share of amount outstanding in total amount outstanding (%)			
	1990	2000	2005	2010
Less than 2 lakh	82.6	67.6	51.9	44.3
2 lakh to 10 lakh	4.3	11.7	17.9	22.6
10 lakh to 1 crore	7.6	6.6	6.4	6.4
1 crore to 10 crore	4.2	6.7	8.0	6.3
10 crore to 25 crore	1.3	1.7	3.3	2.7
Above 25 crore		5.7	12.6	17.7
Total advances	**100.0**	**100.0**	**100.0**	**100.0**

Fig 1.10: Direct and indirect credit to agriculture with ticket sizes

Agriculture debt waiver and NPAs as a result

In addition to subvention on short-term credit introduced in 2006-07, debt waiver has been an additional instrument which results not only in a waste of financial resources but also has adverse consequences for the banking system and seriously impairs its ability to deliver agricultural credit on a regular basis. The table below depicts the year-wise amount on which the debt has been waived off:

Year	Amount (Rs. Crore)
2008-09	25,000
2009-10	15,000
2010-11	11,340.41
2011-12	1,176.39
Total	**52,516.86**

Fig 1.11:Year-wise debt waived

Generalized debt relief discourages prompt repayment in future in the expectation that there may be more such waivers in the pipeline. As might be expected, the massive write-off of loans has taken its toll on the banking system and the non-performing assets of commercial banks have risen three-fold in nominal terms between 2009-10 and 2012-13 (Table 10). As a share of outstanding loans in agriculture also, the NPA is steadily moving up and has now gone beyond the levels prevailing before the waiver. The table below depicts the NPAs in agriculture sectors as a part of SCBs' loan books:

Years	NPA of SCBs in Agriculture (Rs. crore)	NPA as a share (%) of outstanding loans by SCBs
2005-06	6716	3.48
2006-07	7367	2.93
2007-08	9735	3.29
2008-09	7149	1.95
2009-10	10353	2.25
2010-11	16700	3.31
2011-12	24800	4.23
2012-13	30200	4.77

Fig 1.12: Year-wise agriculture NPAs

Factors contributing to the growth of agricultural credit:

Rural branches of commercial banks

Enactment of the Co-operative Credit Societies Act (1904) introduced institutional financing in rural areas through co-operative banks and started providing affordable financial services to farmers for agricultural purposes. Commercial banks did not appear on the rural scene until after independence. Post-independence, the nationalization of banks act, paved the way for a greater push in banking, whose effects were reflected on formalization of credit flow to rural areas to some extent, by opening up branches in rural areas. The spread of banking to unbanked areas received focused attention after nationalization. Apart from the adoption of

a branch licensing policy to serve this objective, the Lead Bank Scheme was launched under which a 'lead bank' was designated for each district to take the lead role in surveying the credit needs of the population and developing banking and credit facilities. The 11 banks were also mandated to ensure that rural and semi-urban branches maintained a credit deposit ratio of 60 per cent. As a result, of the 10,543 branches opened in the period between June 1969 and December 1975, as many as 5,364, or more than 50 per cent, were in rural areas. Between 1976 and 2014, the number of rural branches of commercial banks increased from 7690 to 44,699. During this period, commercial banks became the lead institutional credit agency, accounting for 73 per cent of credit flows in 2012-13. Obviously, the increase in the number of bank branches and the fall in the branch/population ratio helped improve the access of farmers to commercial banks and helped increase credit volumes.

Year	Rural Branches	Population per Branch
1975	5598	87442
1981	8471	64650
1991	11344	57992
2001	14597	52319
2011	23097	36335

Fig 1.13: Year-wise rural branches and population per branch

Establishing Regional Rural Banks (RRBs)

In order to widen the reach of institutional credit, particularly among small and marginal farmers, the government also decided to establish Regional Rural Banks (RRBs) in 1975. The branches of RRBs served to improve further the farmers' access to credit. The number of RRBs as on March 31, 2014, stood at 57 with a network of 19,082 branches covering 642 districts throughout the country, although it accounts for only 10 per cent of total agricultural credit flow. RRBs have contributed to the growth of institutional credit flow not just to agriculture but to priority sector lending as well.

Agricultural lending under priority sector lending

The government, along-with regulator was of the view that commercial banks should play a developmental role in the country. The Reserve Bank of India moved to improve the availability of farm loans from commercial banks to neglected areas in 1972 by introducing the requirement that banks allocate a proportion of aggregate bank advances to priority sectors. The banks were advised to increase their share to 33.5 per cent of adjusted net bank credit (ANBC) or the credit equivalent amount of off-balance sheet exposure (OBE), whichever is higher, by March 1979. This was later revised upwards to 40 per cent in March 1985. The original target was set to be 40 per cent for priority sector lending and the sub-target of 18 per cent for agriculture which still remain valid. However, the target for agriculture now applies not only to direct lending to farmers but

indirect financing as well, with a sub-target of 4.5 per cent. Indirect agricultural loans include loans up to Rs.5 crore to dealers/sellers of agricultural inputs, loans for setting up of agri-clinics 12 and agribusiness centres, loans to customs service enterprises who provide tractors, bulldozers, well-boring equipment, threshers, combines for being hired by farmers, loans up to Rs.5 crore to co-operative societies of farmers for disposing of the produce of members, loans for construction and running of storage facilities including cold storages, and loans to MFIs, NGOs and RRBs for on-lending to farmers. Even the outstanding deposits under RIDF, warehouse Infrastructure Fund, Short-term Co-operative Rural Credit Refinance Fund and Short-term RRB Fund with NABARD are treated as indirect agriculture loans. The targets and sub-targets are strictly enforced on banks. Scheduled commercial banks, which fall short of achieving the agricultural sub-target, are allocated targets for contribution to the Rural Infrastructure Development Fund (RIDF), established with NABARD, by the Reserve Bank of India. These amounts are determined on the basis of the shortfall in achievement of the sub-target for agriculture; the rate of interest payable to them by the RIDF is also related to the deficit as shown in Fig 1.14. It will be seen that the banks incur a substantial penalty for underperformance and the level of such penalty rises with the level of shortfall.

Shortfall in agriculture lending target for domestic commercial banks	Rate of interest (%)
Less than two percentage points	Bank Rate minus 2 percentage points
Between two and five percentage points	Bank Rate minus 3 percentage points
Between five and nine percentage points	Bank Rate minus 4 percentage points
Above percentage points	Bank Rate minus 5 percentage points

Fig 1.14: Shortfall in agricultural lending

We can see that directed lending by commercial banks under priority sector lending has been a critical factor contributing to the expansion of agricultural credit. It must be acknowledged, however, that the inclusion of indirect financing within the scope of lending to agriculture would have released the pressure on banks for direct lending to farmers.

Self-Help Groups (SHG)-Bank linkage Program

The SHG-Bank Linkage Program is an important part of the strategy for delivering financial services to the poor in a sustainable manner. Under this program, SHGs come together and gain financing access through banks by pooling in their resources. The pilot project was started by NABARD in 1992 as a partnership model between SHGs, banks and NGOs. The regulator approved guidelines to banks to enable SHGs to open accounts. This was conjoined with a commitment by NABARD to provide refinance and promotional support to banks for the SHG-Bank Linkage Program. In the initial years, the scheme progressed slowly but picked up gradually; the number of SHGs financed accounts increased to more than 73.18 lakh savings-linked Self-

Help Groups (SHGs) covering over 9.50 crore poor households as on March 31, 2013. The total outstanding amount is INR 39,375 crore and savings deposit of these SHGs with banks amounted to INR 8,217.25 crore (NABARD Annual Report, 2013-14).

Special Agriculture Credit Plan

With a view to ensuring that the flow of credit to agriculture increases substantially, RBI advised banks in 1994-95 to prepare an action plan for disbursement of credit to agriculture. Accordingly, each bank prepares a Special Agricultural Credit Plan (SACP), segregated into quarterly targets, which is monitored by the RBI. Earlier, the SCAP mechanism was applicable only to the public-sector banks but it was extended to private sector banks in 2005-06.

Initiative for increasing Agricultural Credit-2004

In June 2004, the central government announced a series of measures aimed at increasing agricultural credit over three years, starting with a credit growth of 30 per cent for 2004-05. The measures taken by the Reserve Bank and the Indian Banks Association in respect of commercial banks and by NABARD in view of co-operative banks and the RRBs included debt-restructuring and fresh loans to farmers affected by natural calamities, one-time settlement for small and marginal farmers, fresh finance to farmers whose earlier debts had been settled and relief measures for farmers indebted to non-institutional source of credit. This initiative fared well for the actual disbursement of credit and exceeded the three-year target. Encouraged by the expansion of credit, the central government fixed targets for subsequent years as well. The target increased at an annual compound growth rate of 21 percent in the period beginning from 2004 to 2014.

Banking correspondants:

The outreach of agriculture credit to farmers by covering them through bank accounts is one of the most important factors that have led to the recent expansion of agricultural credit. According to RBI data (2013), 68.8 per cent of rural households and 79.5 per cent of urban households had bank accounts. As part of the financial inclusion program, the government had launched the Swabhiman scheme in 2011 to extend the reach of banking in rural areas initially to approximately 74,000 habitations with a population of more than 2,000. It aimed to provide branchless banking services in the remotest areas through banking correspondents, making use of technology. Another significant step in this direction was the introduction of Jan DhanYojna to provide access to banking facilities to all households and almost every household has a bank account (PMJDY, Ministry of Finance). The government has already introduced the Benefit Transfer of LPG (DBTL) Scheme where consumers receive LPG cylinders directly in their bank accounts. Such financial inclusion programs enable rural households to be covered by mainstream banking, reducing further their dependency on non-institutional sources of finance.

Kisan Credit Cards

The Kisan Credit Cards Scheme, introduced in August 1998, is an innovative credit delivery mechanism to meet the credit needs of the farmer. Apart from providing short-term and term loans, a certain component of KCC also covers consumption needs. An important feature of the scheme from the outset was that once the documentation to establish the bona fide and assets of beneficiaries is done, they could approach financial institution for simple and hassle-free sanction of credit from the second year onwards. Further progress was made in later years and now the passbook has been replaced by a plastic card, and the Kisan Credit Card is an ATM enabled debit card. Under the earlier system, disbursal of short-term credit to agriculture was mostly through demand loans and cash credit, which permitted withdrawals mainly through debit vouchers, saving accounts and through bankers' cheques. However, the traditional system of loan disbursement through passbooks were replaced by ATM-enabled debit cards with facility for withdrawal/disbursement of loan. The main objective is to develop a cashless eco system by enabling the farming community to avail of banking facilities. Its use has spread over the vast institutional credit framework involving commercial banks, RRBs and co-operatives. According to the RBI, 12.84 crore Kisan Credit Cards had been issued up to 2012-13. This number exceeds the number of agricultural households given by Situation of Agricultural Households in India, NSSO (9.02 crore) for that year, implying that many households have multiple cards.

In order to discourage distress sale of crops by farmers, the benefit of interest subvention has been made available to small and marginal farmers having Kisan Credit Card for a further period of up to six months (post-harvest) on the same rate as available to crop loan against negotiable warehouse receipts. In order to ensure that all eligible farmers are provided with hassle-free and timely credit for their agricultural operations, the Government has introduced the Kisan Credit Card Scheme, which enables them to purchase agricultural inputs such as seeds, fertilizers, pesticides, etc., and draw cash to satisfy their consumption needs. The KCC Scheme has since been simplified and converted into ATM enabled debit card with, inter alia, facilities of onetime documentation, built-in cost escalation in the limit, any number of withdrawals within the limit, etc., which eliminates the need for disbursement through camps and mitigates the vulnerability of farmers to middlemen.The main objectives of the Scheme are: to meet the short term credit requirements for cultivation of crops, post-harvest expenses, produce marketing loan, consumption requirements of farmer household, working capital for maintenance of farm assets and activities allied to agriculture, like dairy animals, inland fishery, etc. Investment credit requirement for agriculture and allied activities like pumpsets, sprayers, dairy animals, etc. The State Governments were advised to launch an intensive branch or village level campaign to provide Kisan Credit Card to all the eligible and willing farmers in a time bound manner. KCCs have now been converted into Smart Card cum Debit Cards to facilitate its operation through ATMs. The cumulative number of KCCs as on 31 October, 2015 and the outstanding loan amount is given in Fig 1.15 below:

Agency	Total operative KCC Accounts	Amount outstanding (Rs. Crore)	Out of these ATC enabled RuPay KCC-cum-Debt Cards
Commercial Banks (as on 31.03.2015)	2,25,24,560	3,30,384.51	76,14,956
Cooperative Banks	3,88,40,776	1,13,324.37	2,50,086
Regional Rural Banks	1,25,26,342	84,235.03	31,01,504
Total	7,38,91,678	5,27,943.91	1,09,66,546

Fig 1.15: KCC account data(2015)

Joint liability group (JLG):

A Joint Liability Group (JLG) is an informal group comprising 4 to 10 individuals coming together for the purpose of availing bank loan on individual basis or through group mechanism against mutual guarantee. The JLG mode of financing serves as collateral substitute for loans to be provided to the target group, i.e., small, marginal, tenant farmers, oral lessees, share croppers, etc. It builds mutual trust and confidence between the bank and the target group and minimizes the risks in the loan portfolio for the banks through group dynamics, cluster approach, peer education and credit discipline. The objective of the JLG mode of financing is to provide food security to vulnerable section by enhanced agriculture production, productivity and livelihood promotion. JLGs can also easily serve as a conduit for technology transfer, facilitating common access to market information, training and technology dissemination in activities like soil testing, training and assessing input requirements, etc.

The Scheme for financing of Joint Liability Groups of Tenant Farmers was started by NABARD in 2005-06. The scheme was extended to non-farm sector from 2009 onwards. Thus, JLGs consists of those of farmers and also non-farmers. The exclusive scheme for Bhoomi Heen Kisan was launched by Government of India during the Union Budget Announcements - 2014-15, with a target for financing 5 lakh Joint Farming Groups of “Bhoomi Heen Kisan” through NABARD. The total number of JLGs and total loan amount provided (cumulative) as on 31.12.2015 are as under

No.	Amount
14.11 lakh	Rs.13968.76 crore

2014-15		2015-16 (up to December, 2015)	
No.	Loan Amount (Rs. Lakh)	No.	Loan Amount (Rs. Lakh)
456,636	441443.81	282,126	277860.00

Conclusion:

Institutional vs. non-institutional credit: Despite an impressive growth in institutional credit since 1951, the dependence of farmers on non-institutional sources for agricultural credit remains as high as 36 per cent in 2013. There was a steep fall in the share of non-institutional sources in the total outstanding agricultural credit from 89.8 per cent in 1951 to 33.7 per cent in 1991. However, in the next decade, non-institutional sources wrested back some of their lost share, which stood at 38.9 in 2002. In 2013, there was a small decline in their share of outstanding loans but, at 36 per cent, it was still above the 1991 level. A rising trend in the share of private moneylenders from 17.2 per cent in 1981, 17.5 per cent in 1991, 26.8 per cent in 2002 and 29.6 per cent in 2013 can be seen.

Role of Commercial Banks: There has been a huge increase in credit flows from institutional sources in recent decades. The direct agricultural credit flow at current prices from all institutional agencies has increased from INR 1,595 crore in 1975-76 to INR 4,53,899 crore in 2011-12. The total agricultural credit flows (direct and indirect) at current prices has increased from INR 2,152 crore in 1975-76 to Rs.3,81,009 in 2007-08. The direct institutional credit as a proportion of the agricultural GDP rose from 5.33 per cent in 1975-76 to 30.28 per cent in 2011-12. Within institutional sources, scheduled commercial banks have registered an increase in their lending operations with their share in direct credit flows rising from 25 to 73 per cent during the period 1975-76 to 2012-13 while the share of co-operative banks has gone down from 75 to 17 per cent during the period. The share of RRBs has also increased from less than 0.13 to 10 per cent. Co-operative banks have yielded their dominant position as the provider of loans to the agriculture sector to commercial banks.

Trend in short-term credit from institutional sources and coverage of input costs: During the 1970s, 1980s and 1990s, the aggregate short-term credit as a proportion of input costs in agriculture was in the range of 13-20 per cent. However, since then, the increase in short-term credit has been much larger than the input cost, so much so that in 2012-13, it was as much as 99.97 per cent of the input cost, including compensation to hired labor.

Trend in long-term credit and private capital formation: Long-term loans from institutional sources have also increased substantially, although their share of total institutional credit has registered a decline from 31.3 to 23.6 per cent between 1975-76 and 2011-12. In long-term credit, the main contribution has come from commercial banks, which accounted for almost 88 per cent of the credit in 2012-13. Long-term credit constituted 32.50 per cent of private capital formation in 1975-76 but in 2012-13, the share had risen to 57.62 per cent. However, the contribution of long-term credit to private capital formation has been fluctuating and there have been years (such as 1981-82 and 2006-07) in which such credit accounted for more than 80 per cent of private capital formation.

Cost of funds for institutional and non-institutional credit: As might be expected, the rates of interest on credit from institutional sources are much lower than on credit from non-institutional sources. Further, the outstanding debt at rates above 30 per cent was only one per cent for institutional sources and more than 34 per cent for non-institutional sources. The non-institutional agencies seem to be flourishing even though they charge exorbitant interest rates. Two points emerge from the analysis. First, that the lower interest rates charged by institutional sources may have had a moderating influence on the rate of interest charged by non-institutional sources. The proportion of outstanding cash dues at interest rates in excess of 30 per cent in loans taken from non-institutional sources seems to have fallen from 40 per cent in 2002-03 to 34.1 per cent in 2012-13. Second, non-institutional agencies advance a significant proportion of loans on an interest-free basis. This flexibility no doubt helps them to retain their hold on clients, who also carry the burden of usurious rates of interest. A greater investment in infrastructure would help institutional lenders to greatly connect with their customers.

Micro, Small and Medium Enterprises

In the Indian economy, the MSME sector serves as the backbone in its growth story. It forms an integral part of the economy, with nearly 36 million enterprises involving 80 million people. MSMEs play crucial role in providing large employment opportunities at comparatively lower cost than large industries. MSMEs are complementary to large industries as ancillary units. It is playing a key role in acting as a catalyst to the socio–economic transformation of the country. The contribution of this sector to the GDP has been

growing consistently at 11.5% over the past 5 years outperforming the GDP and IIP growth rates. The sector plays a crucial role in the financial objective of inclusion, generating employment, averting poverty and also balancing the rural-urban migration. These enterprises, help build a thriving entrepreneurial eco-system, in addition to promoting the use of indigenous technologies.

MSMEs' contribution in growth of an Indian economy is huge, some of the highlights are given below:

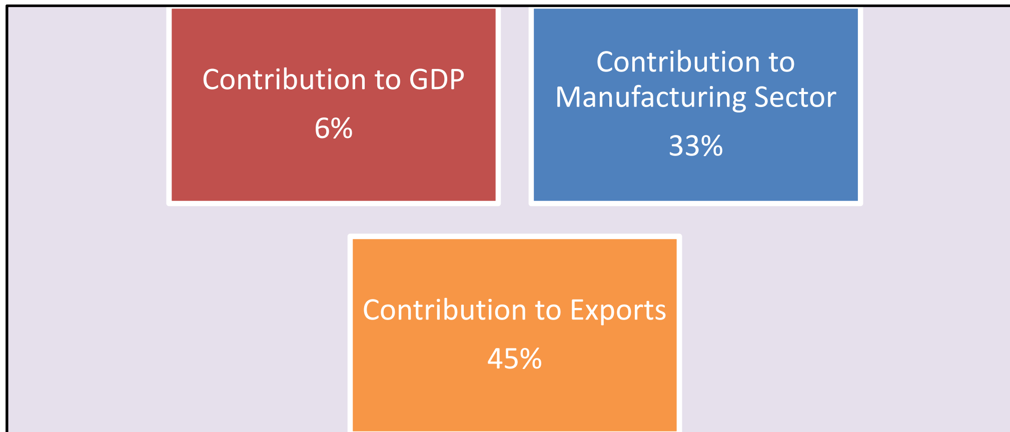


Fig 2.1: MSME Contribution

Investment in Plant and Machinery (INR)		
Industry	Manufacturing	Service
Micro	Less than 25 lakhs	Less than 10 lakhs
Small	25 lakhs to 5 crores	10 lakhs to 2 crores
Medium	5 crores to 10 crores	2 crores to 5 crores

Fig 2.2: Definition of MSME by RBI

Broadly, MSME sector is classified by two major activities – manufacturing and services.

Manufacturers are involved in a wide variety of goods, from handmade products to high precision machine parts, contributing to the supply chain of local to large global enterprises. Here, food processing is the key manufacturing industry. It is also characterized by being more capital intensive with longer working capital cycles, and consequently have higher working capital requirements.

The service industry is dominated by retail trade, maintenance stores, transport operators and knowledge-based enterprises etc. In the recent past the knowledge-based industries have experienced a gradual growth in the sector.

Geographies

Distribution of enterprises in this segment are divided across rural and urban areas, with nearly 40% in urban and 60% in rural area. It has been also noted that the percentage of enterprises lean toward urban areas when measured against the registered units.

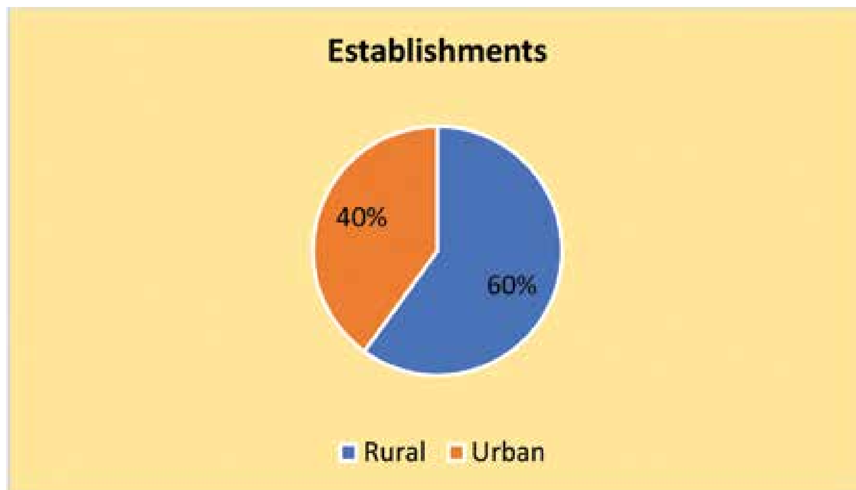


Fig 2.3: MSME establishments – Area wise

MSME: Successes and Contribution to the Economy

The sector's growth and improvement has been consistent in the past 5 decades due to a combination of governmental support, implementation of technological enhancements and support provided by the banking sector. The opening up of our economy coupled with a high growth rate has been a major stimulus to these developments. Direct indicators of this development are the number of enterprises and employment in the sector. The overall growth rate in number of establishments during the intervening period of FifthEC (2005) and Sixth EC (2013) is 41.73%.

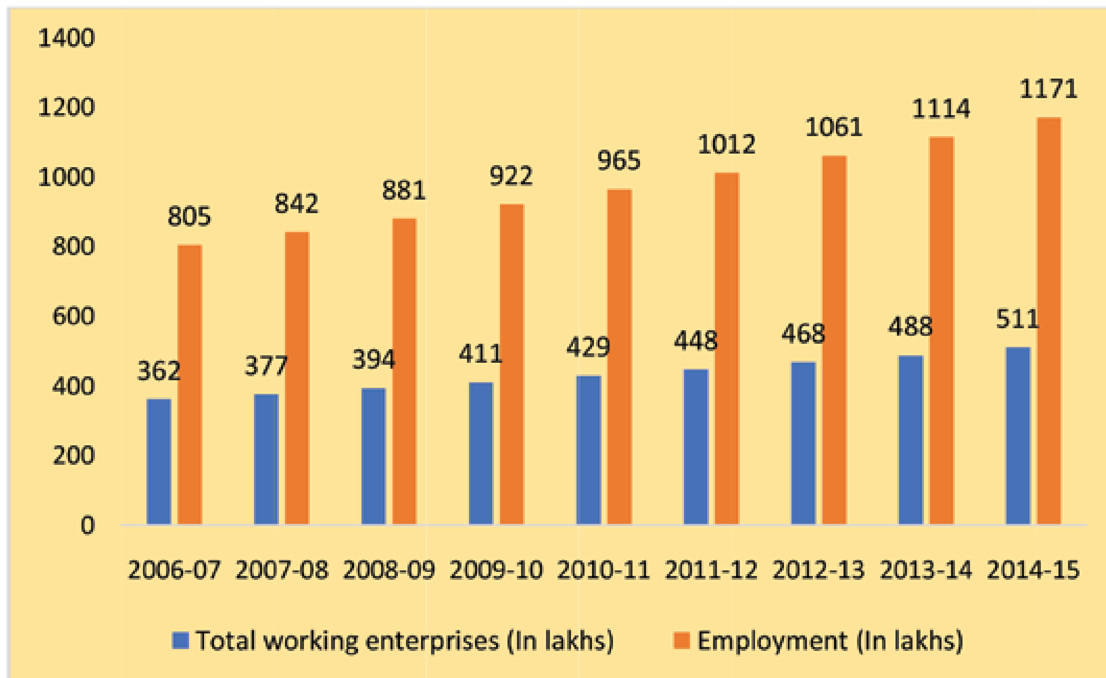


Fig 2.4: MSME statistics

In spite of various constraints, these enterprises have made their presence felt both domestically and globally.

The sector is unique in its functioning, it supports big industries yet employs a big chunk of unskilled labor. Being manpower intensive, the sector has a great potential to reduce the socio-economic imbalances. It can support in the development of rural areas by increasing entrepreneurship and also reduce the stress on metros by balancing the inflow of migrant workers.

The sector is evolving and as stated above has become the vital cog in the wheel of growth. This is bolstered by positive changes such as implementation of newer technologies, international practices, ease of doing business, skilling of entrepreneurs and innovative financing. These additions will improve the sector's efficiency and its output.

Establishments in Top 5 states		Employment in Top 5 states	
Uttar Pradesh	11.46%	Maharashtra	11.26%
Maharashtra	10.48%	Uttar Pradesh	10.77%
West Bengal	10.09%	West Bengal	9.04%
Tamil Nadu	8.64%	Tamil Nadu	8.46%
Andhra Pradesh	7.25%	Gujarat	7.1%

MSME: Access to Credit

The access to credit plays an important role in the growth of MSME sector and India has been performing pretty well in this regard if we go by World Bank ranking on various parameters of ease of doing business. Yet, there is still miles to go in order to improve the access to timely credit to entrepreneurs in the MSME sector.

India ranked 100th in World Bank's ease of doing business ranking.

In order to further throw light on the issues faced by the MSME entrepreneurs, the gaps of debt servicing in this sector is enumerated below, to get a sense where action is required. Further to the debt gaps, equity gaps are also addressed.

Credit Gap

The recent economic survey observed that loans extended under the Pradhan Mantri Mudra Yojana during 2016-17 have crossed the target of Rs 1.8 lakh crore. "Of this amount, INR 1.23 lakh crore was lent by banks while non-banking institutions lent about INR 57,000 crore. The overall demand for finances in the MSME sector is estimated to be INR 32.5 trillion. The majority of these are in the form of debt. In the context of debt

demand, what part of this demand is addressable and viable for the formal financial institution needs to be identified.

Debt Gap

The demand for debt varies among enterprises in the sector, with different expectations and capabilities. Let us explore this issue among different players in this sector.

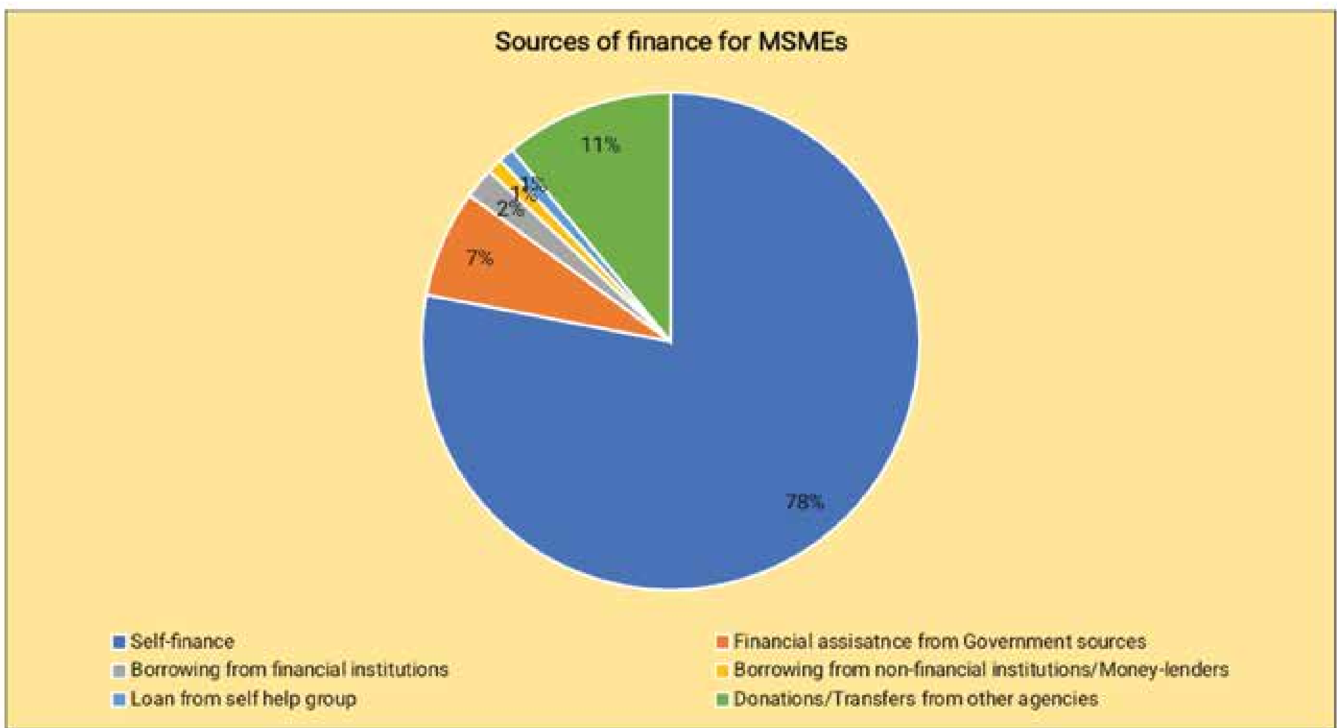


Fig 2.6: Sources of finance for MSME sector

Micro Enterprises

The micro and small sub-segments together account for the majority of the debt demand. As they mostly operate in industries such as retail trade, repair and maintenance, restaurants and textiles among others, have a significant demand for working capital.

Small Enterprises

Enterprises in this segment require higher capital investments and tend to operate in value-add manufacturing and knowledge based services. It is estimated that 0.7 million small enterprises are viable for financing by formal sources.

The average credit requirement of this sub-segment is estimated to be INR 4 – 4.5 million and cash continues to be a preferred form of transactions. These enterprises have access to both formal and informal sources of

financing, in case of formal it is found to have relationships with one or two institutions. Entrepreneurs here have relatively more knowledge regarding formal sources of finance.

Medium Enterprises

In case of this sub-segment, the enterprises are more structured, have a predictable demand for debt and prefer formal sources of finance. The average credit size tends to be higher and there is access to a traceable credit history. In addition, these organizations are professionally run and form relationships with multiple financial institutions.

Sector-Wise Demand

Among manufacturing and the services sector, even though the latter accounts for more in numbers, manufacturing is more capital intensive. It nearly accounts for 61% of the viable demand in the sector. Hence, higher requirement of working capital is characteristic of this industry. The average requirement for capital expenditure in manufacturing enterprises is INR 0.5 million per year.

The working capital cycle for enterprises, involved in trade finance, export oriented, servicing large supply chains, tend to be longer. In the services industry, enterprises involved in retail trade, repair and maintenance, and restaurants have typically cash business with shorter turnaround. On the other hand, the knowledge based services industry such software development, management consulting and Information Technology, the financing requirements of such are similar to those of manufacturing. The share of working capital as a portion of the average debt demand for service enterprise is estimated to be 30% and rest for the manufacturing.

The knowledge based services require working capital primarily for investing in people. For this, they depend on internal accruals or internal equity investments, as debts from formal financial institutions for financing manpower costs still remain a challenge.

Equity Gap

The equity gap in the sector is a combined result of demand-side challenges such as the legal structures of enterprises, as well as supply-side gaps, such as a lack of investment funds focused on MSMEs. The requirements for the sector are concentrated in the growth-stage enterprises (~70 percent).

One of the primary reasons being, the smaller ticket size per investment size tends to drive the overall transaction and management costs. In addition, it is estimated that all the micro and a big portion of small enterprises are in the proprietorship or partnership structure, making them resistant to external equity infusion.

Excluding the equity demand of INR 1.23 trillion from proprietorship and partnership enterprises, equity gap is estimated to be INR 0.67 trillion. With appropriate policy interventions and support to the MSME sector, a considerable part of the currently excluded demand can be made financially viable for the formal financial sector. Of the viable and addressable demand-supply gap, the debt gap is INR 2.93 trillion and the equity gap is INR 0.64 trillion.

Micro and Small Enterprises

In this sub-segment, there is a low level of willingness and ability of the entrepreneurs to control and mange formal sources of equity. Concerns of ownership and management forms a major deterrent for equity infusion.

The equity demand for enterprises in this sub-segment which have ownership structure other than proprietorship and partnership is high.

Medium Enterprises

With a more balanced debt-equity ratio due to increased ability of entrepreneurs to contribute capital, legal structures and scalable business models have a wider horizon in raising equity. The equity demand for medium enterprises is estimated to be INR 0.42 trillion.

The micro, small, and medium enterprise segments respectively account for INR 2.25 trillion, INR 0.5 trillion and INR 0.18 trillion, of the debt gap that is viable and can be addressed by financial institutions in the near term. Nearly 60% of the demand for finance arises from the manufacturing sector. The share of the debt gap in the manufacturing sector is also considerably higher at 73% of the total gap.

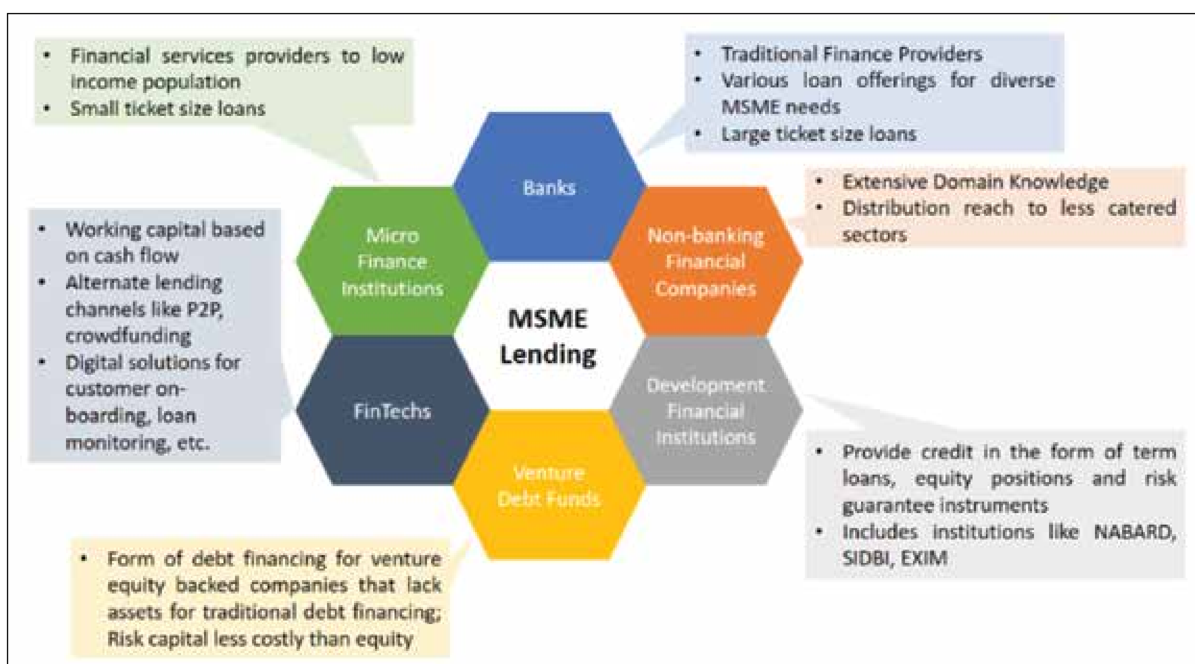


Fig 2.7: Players in MSME lending

Credit flow to MSME sector

The dependency of financing by commercial banks in this sector is very high. Let us further discuss the products offered and understand the debt process flow along with the roadblocks faced by banks in servicing this sector.

Types of Products Offered to MSMEs by Banks

Products offered to MSMEs can be divided into two types:

a) Fund based
b) Non-fund based

List of key fund based products offered to MSME sector by banks are over-draft, cash credit, short-term loan, long-term loan, asset-based financing and credit cards. List of key non-fund based products offered to MSME sector by banks are letter of credit, bank guarantee, current account, savings account and remittance.

Debt process flowchart and Roadblocks

The financing environment for this sector has traditionally been serviced by the public sector banks, following a one-size-fits-all strategy for credit quality assessment. In addition, fixed assets have been predominantly used as collateral. Furthermore, enterprises in this sector, excluding manufacturing units, do not have large investments in fixed assets. This practice has resulted in a financially underserved sector and with the traditional methods not being successful, banks have adopted different methods to improve this condition.

The process for debt finance to the MSME segment comprises the following: (a) understanding the market (b) product and service design (c) sourcing (d) underwriting (e) serving and (f) monitoring.

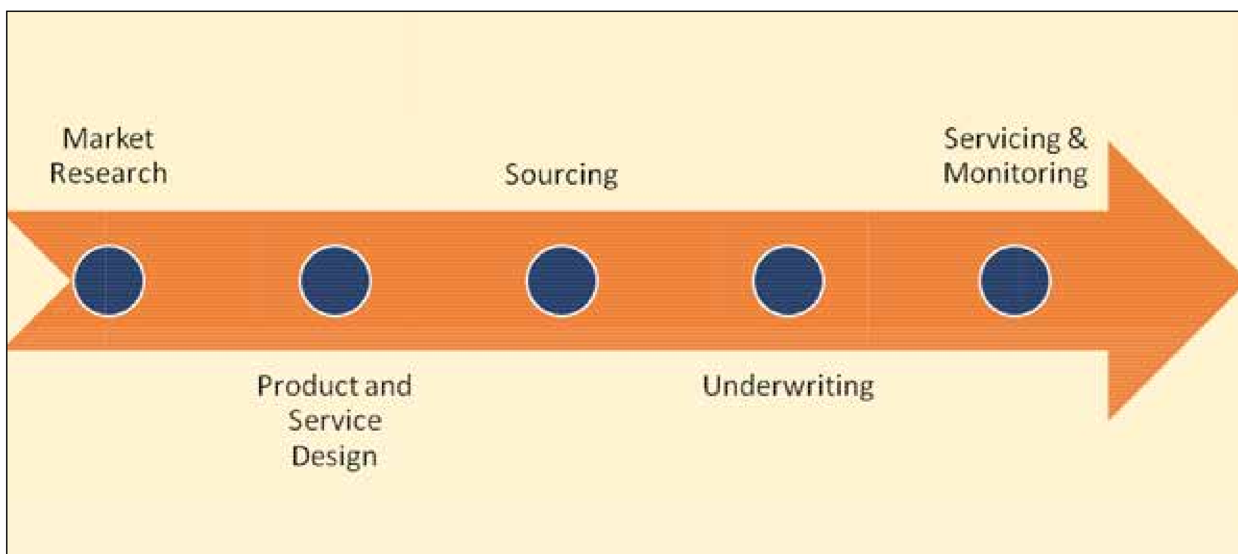


Fig 2.8: Debt process

Understanding the market

Segmentation of market remains a problem. The MSME sector is extremely heterogeneous and the market needs to be segmented beyond the size criterion of MSMEs. Several parameters such as area of operation, industry segment, vintage, legal structure, cluster operations are used by the financial institutions to judge the creditworthiness of the company and also which can be further leveraged to help banks to serve beyond institutional levels.

Product and Service Design: The process of product and service design is closely related to understanding the market. Information about key business drivers and cash flow cycle remains a major hurdle in this sector. Clarity in the above-mentioned parameters would better help financial institutions develop targeted products and services. Furthermore, interest rate, collateral requirements and repayment cycle can be evaluated while designing products.

Sourcing: Characterized by smaller ticket size and weak credit history leads to higher transaction costs while servicing an MSME clients. The cost of sourcing micro enterprise is same as that to a medium or small enterprise which is why, financial institutions prefer to serve a larger number of small and medium enterprises than micro enterprises. In order to circumvent this roadblock, the government is introducing cluster based infrastructure facilities to MSMEs of the same industry.

Underwriting: The lack of information required to successfully assess the creditworthiness of the client in the sector poses a major hurdle.In order to overcome, banksinstead of relying solely on financials to assess creditworthiness of enterprises, financial institutions can use softer parameters such as relationship with customers and suppliers, background, and the psychometric profile of entrepreneurs. However, while softer aspects may help address informational asymmetry, it also carries the risk of increasing the cost.

Servicing: A financial institution begins the relationship with an enterprise at disbursement stage, which is either on demand or in tranches, requiring multiple transactions. The main challenge in this part of the segment for the financial institutions lies in managing transaction and operating costs (which includes manpower cots) due to smaller credit size.

Monitoring: Effective monitoring is essential to manage the asset quality and capture critical data that can be leveraged for future credit assessment of MSME clients. Through monitoring, financial institutions can positively impact portfolio quality, allowing for early warning of potential default. The lack of clear financials, absence of professional management, and seasonal changes in business makes it extremely difficult for financial institutions to monitor these accounts.

Banks have evolved the entire credit assessment process, inculcating new methods such as data mining, risk assessment techniques, credit risk management, and also using statistical methods. Additionally, products

offered have also been backed with integrated IT applications and data mining capabilities covering areas such as working capital management, term loans, wealth management, bancassurance, etc. In spite of the improvements, banks still need to invest heavily in automation of risk monitoring processes and events based triggers which would help in ensuring uniformity in responses and in improving cost efficiencies.

MSME: Challenges and Demands

There have been great strides in the performance of the MSME sector, yet the growth has been restricted by various factors. The lack of availability of timely credit and high costs, collateral requirements and access to equity capital are considered the prime causes of concerns for this sector.

The financing needs of the sector depend on the size of operation, industry, customer segment, and stage of development. Financial institutions have limited their exposure to the sector due to a higher risk perception and limited access of MSMEs to immovable collateral.

In the normal source of financing, enterprises in MSMEs still rely on banks as a source of finances. Among these, public sector banks (PSBs) account for a major share, compared to private and foreign banks.

The following obstacles prevent MSME from obtaining adequate financing-

Informational Asymmetries

Informational asymmetry is always present in enterprise financing transactions. Entrepreneurs possess privileged information about their businesses that cannot be easily accessed—or cannot be accessed at all—by prospective lenders or outside investors.

This leads to the following problems –

1. Lenders/investors cannot differentiate between high quality and low quality companies.
2. They may not be able to assess if the enterprise has utilized the funds in an appropriate manner.

Hence investors may adopt precautionary measures. One of them is financing needs to be collateralized. The information that MSME can realistically provide to external financiers (in the form of financial accounts, business plans, feasibility studies, etc.) lacks detail, is not fully accurate and realistic. This problem is often provoked by low level of education. Hence, outside financiers adopt a very cautious attitude towards MSMEs, reduce the amount of financing sought or may refuse it completely. This problem is particularly acute in developing countries.

Risk Profile

MSMEs face difficulties in accessing finance to their higher risk profile. It is regarded as riskier for a number of reasons. Some of them are – uncertain competitive environment, variable rates of return and high rates of failure. They are less equipped in terms of both human and capital resources. Inadequate accounting systems is also one of the major problems faced.

In developing countries, the volatile operating environment has a negative impact on the security of transactions. Also, there is a greater risk that lenders/investors will not get paid, or that assets will not be properly registered.

Transaction Costs

The handling of MSME financing is an expensive business. The cost of appraising a loan application or of conducting a due diligence varies as per the size of financing. Fixed costs include administrative costs, legal fees, costs related to acquisition of information. For smaller loans or investments, it is difficult to recover these costs. The problem is acute in developing countries. This is mainly due to lack of management information systems, undeveloped state of the economic information industry and the poor state of public services.

This problem can be resolved by raising the cost of financing through a higher interest rateorclosing fee. This approach is possible only to a certain extent.

Lack of Collateral

Lenders request for collateral to mitigate risks. Now, the lack of collateral is the most widely mentioned obstacle faced by MSMEs in accessing finance. In some cases, the enterprise is not able to provide sufficient collateral either because it is not firmly established or it is insufficient in view of the size of the loan requested.

In other cases, the collateral may be insufficient simply because the managers-owners tend to siphon off resources from the company for personal or other purposes. Again, this is closely related to the risk profile. In developing countries, this issue is much more severe.

Institutional factors

Institutional and legal frameworks are undeveloped. This prevents the possibility of pledging the owned assets as collaterals. Many developing countries have highly concentrated and uncompetitive banking sectors. This is due to restrictive government regulations. Hence lending policies are made conservative or high interest rates are charged. If banks can thrive with a stable pool of well-established clients, they have no real incentive to improve the range of financial products — and no incentive to go down market, to meet the needs of small businesses.

In spite of the various policies created to augment financial support to MSMEs and the growth in the credit limits of banks, MSMEs still face challenges when it comes to accessing timely and sufficient credit at a reasonable cost. The credit flow to them is not aligned to the needs of the economic activities undertaken by them. Small businesses rely on multiple sources of financing ranging from internal sources namely personal funds and funds from friends, to external sources, both formal and informal, which include financing from banks, NBFCs, venture capital funds, trade credit factoring, etc. Due to this, importance of alternative source of financing for MSMEs in India has been increasing.

Development of alternate sources of finance like factoring, Supply chain finance and Angel funds or venture capital funds would prove beneficial.

These financial aids and processes will not only give the MSMEs a much-needed reprieve from their liquidity crunch, but also help them in instilling the rigor of process, transparency and quality.

Innovation is the only way to come out of the challenges and lead the way of doing business at every marketplace. Having the vision of high economic growth in place, MSME contribution and its growth becomes critical. Government and regulator have recognized crucial gap in the demand of credit to MSME and its supply from lending institutions. Meeting credit demand of MSMEs has always been a challenge to various lenders due to various reasons.

Some developed countries take a capitalistic approach with little government incentives for MSME financing, while others use government guarantees and other measures to reduce risks and costs. In emerging economies, to date, most MSMEs (including formal sector firms) are financed from sources outside the formal financial sector, which is expensive for the enterprise and can hamper the flow of financing, thus hindering its growth. New capital requirements and banking regulations imposed on financial institutions worldwide are making the financing of MSMEs even more difficult and expensive. Against this backdrop, the

emergence of alternative, technology-enabled means of financing, such as new business models based on advanced data analytics, supply chain and e-commerce based finance, crowd funding and other innovations may offer a way out of the cost trap.

Government aims to foster the flow of financing to the real economy, with a focus on finance for MSMEs. This will involve, among other things, innovations in supply-chain financing and government procurement, use of technology to reduce risks, enhance efficiency leading to lower costs, securitization and other means of obtaining capital relief for traditional sources of finance, introducing non-traditional sources of long-term capital and capacity building for both financiers and MSMEs.

While asset-based finance is a widely-used tool in the MSME financing landscape, alternative forms of debt have had only limited usage by the MSME sector, even within the larger size segment which would be suited for structured finance and could benefit from accessing capital markets, to invest and seize growth opportunities. In fact, alternative debt differs from traditional lending in that investors in the capital market, rather than banks, provide the financing for MSMEs. To foster the development of a corporate bond market for MSMEs, mainly mid-caps, policy makers have especially targeted transparency and protection rules for investors, to favour greater participation and liquidity. Recent programmes have also encouraged the creation of MSME trading venues and the participation by unlisted and smaller companies. In some countries, public entities participate with private investors to funds that target the MSME bond market, with the aim of stimulating its development. Private placements of corporate bonds by unlisted companies, which are subject to less stringent reporting and credit rating requirements. However, lack of information on issuers and of standardized documentation, illiquid secondary markets and issues with insolvency laws currently limit the development of these markets.

Debt securitization and covered bonds, which also rely on capital markets, had increased at high rates before the global crisis, as an instrument for refinancing of banks and for their portfolio risk management. However, in the wake of the crisis, these instruments came under increasing scrutiny and criticism, and markets plummeted. The post-crisis deleveraging in the banking sector, however, has contributed to reviving the debate about the need for an efficient – and transparent – securitization market to extend MSME lending. In recent years, new measures have been introduced at supra-national and national level to re-launch the securitization markets and some countries have lifted the limitations that did not permit MSME loans as an asset class in covered bonds.

Crowd funding (fund pooling) has grown rapidly since the middle of the 2000s, and at an increasing rate in the last few years, although it still represents a very minor share of financing for businesses. One specificity of this instrument is that it serves to finance specific projects rather than an enterprise. It has been used in particular by non-profit organizations and the entertainment industry, where non-monetary benefits or an enhanced community experience represent important motivations for donors and investors. Nevertheless,

over time, crowdfunding has become an alternative source of funding across many other sectors, and it is increasingly used to support a wide range of for-profit activities and businesses.

The market for hybrid instruments, which combine debt and equity features into a single financing vehicle, has developed unevenly in many countries, but has recently attracted interest of policy makers across the board. These techniques represent an appealing form of finance for firms that are approaching a turning point in their life cycle, when the risks and opportunities of the business are increasing, a capital injection is needed, but they have limited or no access to debt financing or equity, or the owners do not want the dilution of control that would accompany equity finance. This can be the case of young high-growth companies, established firms with emerging growth opportunities, companies undergoing transitions or restructuring, as well as companies seeking to strengthen their capital structures. At the same time, these techniques are not well-suited for many MSMEs, as they require a well-established and stable earning power and market position and demand a certain level of financial skills.

The regulatory framework is a key enabler for the development of instruments that imply a greater risk for investors than traditional debt finance. However, designing and implementing effective regulation, which balances financial stability, investors' protection and the opening of new financing channels for MSMEs, represents a challenge for policy makers and regulatory authorities. This is especially the case in light of the rapid evolution in the market, resulting from technological changes as well as the engineering of products that, in a low interest environment, respond to the appetite for high yields by financiers. Recent regulatory initiatives, which aim at making the financial sector safer, are perceived to be unduly onerous by some investors, who are also affected by the enduring uncertainty arising from expected regulatory revisions.

Alternative Financing Instruments

Traditional debt finance generates moderate returns for lenders and is therefore appropriate for low-to-moderate risk profiles. It typically sustains the ordinary activity and short-term needs of MSMEs, generally characterized by stable cash flow, modest growth, tested business models, and access to collateral or guarantees.

At the one end of the risk/return spectrum are financing instruments that sustain the short and medium-to-long term financing needs of MSMEs, but that rely on different mechanisms than traditional debt. This is the case of asset-based finance, such as asset-based lending, factoring and leasing, whereby a firm obtains cash, based not on its own credit standing, but on the value, that a particular asset generates in the course of its business. The close relationship between the liquidation value of an asset and the amount borrowed, as well as the broad range of assets that can be used to access lending, are the key factors that distinguish asset-based lending from traditional secured or collateralized lending, in which the loan amount and conditions also depend on the overall assessment of the firm's credit worthiness. Furthermore, asset based lending

generally provides more flexible terms than conventional secured lending, often allowing for revolving funds; as advances are paid off, the borrower can secure additional funds backed by other assets.

Trade credit is also an important source of finance for many MSMEs and start-ups, which can substitute or supplement short-term bank lending. This mainly consists of the extension of traditional credit instruments and credit-mitigation tools, such as loans and guarantees, to sustain import and export activities. Guarantees can take the form of letters of credit (L/C), which represent a bank obligation to pay, thereby reducing an export's payment risk on an importer/buyer.

Alternative forms of debt also exist, which can be considered "innovative" in the context of MSME financing because they have had until now limited applicability to the MSME sector. These alternative debt instruments include corporate bonds, securitized debt and covered bonds, in which investors in the capital markets, rather than banks, provide the financing for MSMEs. While corporate bonds are direct instruments of debt finance for MSMEs, securitization and covered bonds represent "indirect" tools for supporting MSME debt financing, in that the product issued to the firm is a loan. In particular, securitization of MSME debt allows banks to transfer their credit risk to the capital markets, as MSME loans are sold to a specialized company, which creates a new security backed by the payments of MSMEs. In this way, banks achieve capital relief and free up capacity for new loans to MSMEs. Over the last decade, securitized debt has grown rapidly, although the financial crisis hit this market severely. On the other hand, few MSMEs have succeeded in issuing corporate bonds, because of difficulties that small privately held companies have in meeting investor protection regulations and the high relative cost of bond issuance for small companies.

At the other end of the risk/return spectrum are financing instruments that enable an investor to accept more risk in exchange for a higher return and are expected to produce a better alignment of the interests of certain kinds of MSMEs and the providers of finance. Hybrid instruments, form a bridge between traditional straight debt and pure equity. Seed and early stage finance addresses the high risk-return segment of the business financing spectrum, boosting firm creation and development, whereas other equity-related instruments, such as private equity and specialized platforms for MSME public listing, can provide financial resources for growth-oriented MSMEs.

Alternative Debts

Alternative forms of debt differ from traditional lending, in that investors in the capital market, rather than banks, provide the financing for MSMEs. These include "direct" tools for raising funds from investors in the capital market, such as corporate bonds, and "indirect" tools, such as securitized debt and covered bonds. With alternative debt, the MSME does not access capital markets directly, but rather receives bank loans, whose extension is supported by activities by the banking institutions in the capital market.

These instruments have existed for some time, but they can be viewed as “innovative” financing mechanisms for MSMEs and entrepreneurs, to the extent that they have had until now been applied in a limited fashion to the MSME sector.

Corporate bonds are debt obligations issued by private and public corporations. By issuing bonds, the company makes a legal commitment to pay interest on the principal, independent of the company’s performance, and to return the principal when the bond matures. The terms of the contract can however provide the company with the right to “call”, i.e. buy back, the bond before the maturity date. If it calls the bond, the company will pay back the principal and possibly an additional premium, which depends on when the call occurs in relation to the actual maturity date.

The corporate bond market has been traditionally dominated by large firms with long pedigree, stable earnings and relatively low volatility stocks. On the other hand, only a very minor share of MSMEs has approached the market.

Corporate bonds typically require the issuer to have a certain size and scale, an established credit history and earnings record, and limited volatility on revenues and earnings. As most MSMEs do not meet these criteria, in the bond market they would attract low rating and high coupons and have limited dividends to cover these regular payments. Also, bonds are a relatively costly instrument to raise finance. In fact, the costs of bonds may be as high as 10% of issuance. Beside the costs of issuance, another relevant unattractive feature of corporate bonds for MSMEs is the fixed schedule of interest and principal repayments, which requires a relatively stable cash flow pattern. If payments are missed, the company defaults and becomes vulnerable to bankruptcy. Also, the amount of debt enters the firm’s balance sheet, which could affect future borrowing costs.

Debt Securitization and Covered Bonds

MSME loan securitization, a bank (“the originator”) extends loans to its MSME customers (the “primary market”), bundles them in a pool (the “portfolio”) and sells the portfolio to capital market investors through the issuance of notes, by a Special Purpose Vehicle (SPV) backed by the loan portfolio (Asset-Backed Securities, ABS). These asset-backed notes, rated by agencies, are placed with capital market investors, but can also be retained, at least in part, by the originator banks. Securitization allows banks to transform MSME loans in their balance sheets into liquidity assets, which can be used to increase lending itself.

Covered bonds work similarly to securitized debt, as they are debt securities (corporate bonds) backed by the cash flows from mortgages or loans.

Alternate Lenders

Alternate lenders including P2P lenders, marketplace platforms, digital lending platforms are targeting specific credit needs of retail consumers and micro and small businesses that remained underserved by banks and NBFCs, or specific market segments including e-merchants and other internet enabled businesses. The alternative lending business model is built around technology that enables highly efficient customer acquisition, approval and servicing activities within a relatively lighttouch regulatory environment. Most Indian banks' and NBFC's operating models, in contrast, include physical branches operating expenses, significant regulatory overheads, collections and recoveries functions that are needed to service an aged loan book. Despite the low cost of funds enjoyed by banks, these factors add to the average cost of a loan. The alternative lending model enjoys significant operating cost advantage as compared to the traditional banking and NBFC business model. Till now, most of the borrowers serviced by alternative lenders tend to fall outside the banks' risk appetite, and segments that value speed and convenience enough to pay a premium (for example SMEs, particularly in term loans, or high-risk retail borrowers applying for personal loans). In the medium to long term, emergence of alternative lenders is likely to have an impact on the NBFC's business in India. Unlike banks, most of NBFCs do not have access to the low cost of funds, and with higher acquisition and servicing costs, NBFCs may be outcompeted as alternative lenders gain traction in the Indian market. The robustness of the credit algorithm of FinTech players in this space is yet to be tested as the industry is yet to complete a full credit cycle. As the industry matures, appropriate controls need to be put in place to avert NPAs. Alternate lenders will have to focus on keeping NPA percentages lower than conventional banks. They must not prioritize quantity over quality of loans. This will ensure success of this model.

Benefits of MSME Fintech Lending

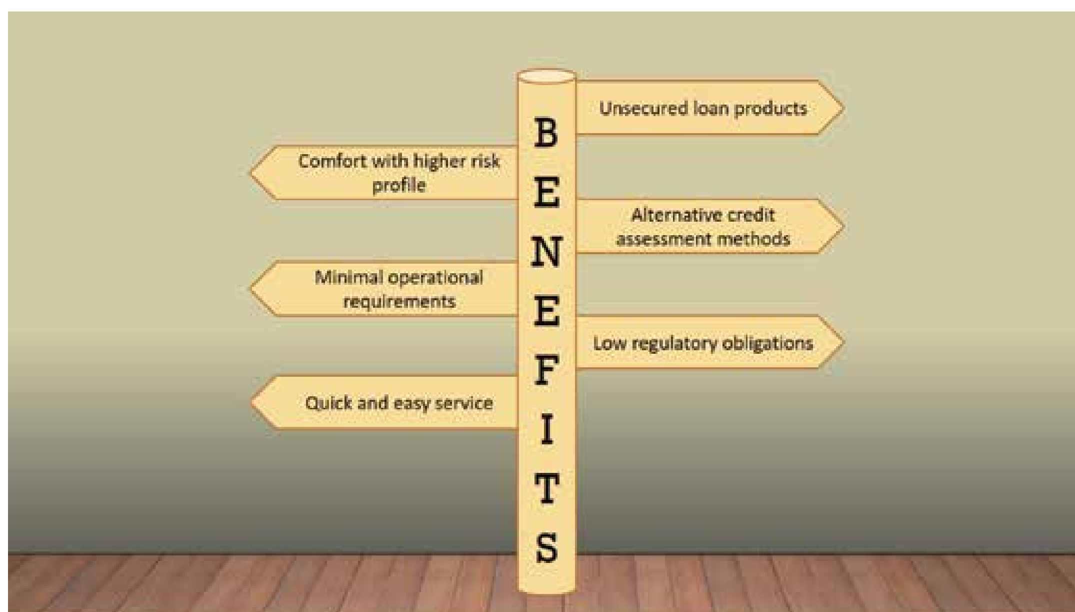


Fig 2.9: Benefits of Fintech lending

Crowdfunding

Crowdfunding is a technique to raise external finance from a large audience, rather than a small group of specialized investors (e.g. banks, business angels, venture capitalists), where everyone provides a small amount of the funding requested.

The concept of "crowdfunding" is related to the one of "crowdsourcing", which refers to the outsourcing to the "crowd" of specific tasks, such as the development, evaluation or sale of a product, by way of an open call over the internet. Through online platforms, the task, traditionally performed by contractors or employees, can be undertaken by individuals for free or in exchange for some specified return, whose value is however generally lower than the one of the contribution made to the firm. Crowd sourcers may in fact have intrinsic motivations, such as the pleasure of undertaking the task or participating to a community, as well as extrinsic motivations, related to monetary rewards, career benefits, learning or dissatisfaction with the current products.

Over time, crowd-lending has become increasingly mediated by online intermediaries. In the case of lending platforms, typically the lenders purchase notes issued by the sites, which use those funds to lend through Paypal or WebBank to borrowers. Thus, the online platform acts as an intermediary, for instance, collecting loan pledges from the crowd for private projects, releasing them at the moment a target is reached, according to a threshold principle, collecting repayment instalments from the debtor, and forwarding them to each crowd-lender. In some business models, the pledged amounts are transferred to an escrow account, which is managed by the platform or a partner bank. Once the threshold pledge is reached, payments are transferred from the escrow account to the project's account.

Peer-to-peer loans are usually unsecured loans, i.e. no collateral is required on borrowers, although, in some cases companies may offer secured loans. Nevertheless, transaction fees and interest on loans are charged by the online intermediary, which depend on the borrowers' credit risk, as assessed by accessing credit information from third parties or on the basis of information submitted by the borrowers themselves. The online platforms typically develop credit models for loan approvals and pricing and perform credit checks of borrowers. Indeed, P2P platforms make profits from commissions instead of the spread between deposit and loan. The longer repayment period that a loan lasts, the higher fees the borrower has to pay.

In the case of equity or investment crowdfunding, a firm offers a certain proportion of its equity for a set amount of capital it is aiming to raise. Crowdfunded businesses do not have to adhere to the strict accounting standards required of public companies and, at the same time, unlike other risk capital providers, crowdfunding investors may have no experience in making such investments. As the model taps into the sub–section of the public with an interest in entrepreneurship, in many cases investment will also be motivated by non–financial aims, such as becoming part of an entrepreneurial venture or supporting a particular individual or business.

In recent years, crowdfunding has been the object of important regulatory attention in some countries. The regulatory efforts have aimed to ease the development of this financing channel, while addressing concerns about transparency and protection of investors.

New proxies for Credit information

Alibaba in China has overcome the lack of reliable third-party credit information on MSME borrowers by relying on the transaction and payment data that Alipay, its proprietary payments system, collects. This has allowed it to build a predictive model for assessing credit risk among its pool of potential borrowers. Similar strategies are being pursued in the US and elsewhere by lenders that harvest user data from sources such as eBay, Amazon, PayPal and UPS in order to build similar predictive models. In addition, other approaches to using alternative data sources are beginning to appear. For example, in the US, debt crowdfunding platforms assess credit risk by using a range of alternative measures, such as buyer ratings on trading platforms such as eBay or Amazon, shipping information collected from DHL and utility consumption (to verify whether a business is operating as claimed). They also check the business owners' online social reputation via sources such as their Klout Score, which assesses an individual's online presence, number of social networking connections and how close those connections are geographically. This helps to indicate whether a business that seeks to raise money via a crowdfunding site will be successful in fundraising from its own friends and family networks. In addition, platform owners say that the more tightknit a business's network is in geographical terms the greater will be the social pressure on borrowers to repay their loans.

Legal and Regulatory Infrastructure

Frequently, the effective innovations in a particular sector are not new ideas. Nonetheless, their introduction can provide the legal and/ or regulatory certainty necessary to underpin trust on both sides of a transaction. It is the absence of trust that tends to make the costs of doing business prohibitive. In the absence of trust, finance providers rely disproportionately on collateral; small businesses can rarely provide collateral and when they can its quality can easily come into question. The creation of moveable asset registries is a good example of policies to address this failure and is being pursued in a number of countries: a recent review by the World Bank found that such policies tend to improve MSME access to bank loans, especially among smaller businesses.

Barriers to Innovative Finance for MSMEs

1.Lack of Financial Education amongst MSMEs

Undoubtedly the greatest challenge facing any financial innovator seeking to target the MSME market is generally the low level of financial awareness among those running small businesses. This encompasses both a lack of awareness of the range of options available and a lack of understanding of how those options work in practice, even after the business becomes aware of them. Often today, it falls to development banks and other public sector institutions to provide the necessary technical assistance and financial education. Although great efforts have been made in many countries to improve financial literacy among the business community, success to date has been very limited.

2. Limited Financial Infrastructure

Both innovative and traditional approaches to providing finance to MSMEs depend on access to effective financial infrastructure – from credit databases to payment systems. The record of financial innovators in developing new sources of data to aid in assessing credit risk where traditional public credit databases are not available demonstrates the key role that basic financial infrastructure plays in enabling the flow of funds to MSMEs. A keener focus by policymakers on ensuring improved access to financial information and encouraging the creation of basic infrastructure such as asset registries, credit bureaux or credit risk databases, such as the International Chamber of Commerce (ICC) Trade Register, is vital in enabling credit to flow.

3. Legal, Regulatory and Accounting Uncertainties

There are numerous instances where 'grey areas' of law and regulation can create barriers to innovation in financial services and obstruct the flow of funding to MSMEs. Examples include:

- Weak protection of minority shareholder rights in some jurisdictions, which discourages equity investment
- Uncertainty over the classification of receivables under accounting rules where payment terms are extended, for example in multi-lender platforms; also, some large companies have expressed concerns that these liabilities might need to be reclassified as loans rather than trade payables, which would affect key financial ratios.
- Uncertainty in some jurisdictions as to the status of factored receivables in bankruptcy, depending on whether the transaction is viewed by regulators as borrowing or the sale and repurchase of an asset.
- The need for clarification of the regulatory risk weightings to be applied to bank payment obligations
- Doubts over the regulatory status of new entrants, which can make it difficult for them to operate.

These issues all require detailed efforts by policymakers, regulators and interested parties, to ensure that work is done to clarify the rules that govern key financial intermediaries.

Initiatives to Improve the Conditions

Government and the RBI

Bank loans up to INR 5 crore per borrower per unit to Micro and Small Enterprises engaged in providing or rendering of services and defined in terms of investment in equipment under MSMED Act, 2006 are eligible to be reckoned for priority sector advances.

RBI has prescribed certain targets for banks for lending to MSME sector. Banks have been advised to achieve a 20% year-on-year growth in credit to micro and small enterprises, a 10% annual growth in the number of micro enterprise accounts and 60% of total lending to MSE sector as on preceding March 31st to Micro enterprises.

Public sector banks

Public sector banks have been advised to open at least one specialized branch in each district. Banks have operational flexibility to extend finance or render services to the borrowers. The flow of credit from banks to MSME sector is summarized in the following table.

Scheduled Commercial Banks	Outstanding Advances to MSME sector (In INR billion)	
	March 2016	March 2017
Public sector banks	7340.55	7419.58
Private sector banks	2923.42	3557.02
Foreign banks	287.75	336.36
Total	**10551.72**	**11312.96**

Private sector banks

Private sector banks too have changed their approach to finance MSMEs, by introducing innovative product and services like receivable financing, factoring, and cash flow based lending and collateralized lending. For example, ICICI bank has created a focused strategic business unit (MSMESBU) to cater to the emerging needs of the sector. The bank formulated a 4-C strategy for MSME financing based on following key business elements: a) customer focus, b) contain risk, c) managing cost and efficiency optimization, and d) cross- sell.

Using a sector specific approach (cluster approach) would help banks to get a better understanding of the sector and develop credit proxies to evaluate their business. Unlike the conventional financial based lending model, the cluster approach captures a 360-degree view of the MSME, bringing out the strengths in terms of its manufacturing capabilities, marketing strengths, position vis-à-vis competitors and other strengths. This gives a true understanding of the MSMEs' potential and the bank is in a better position to take credit views beyond just financial parameters.

Government Schemes

The ministry of MSME runs schemes aimed at financial assistance, technology assistance and upgradation, enhancing competitiveness and market development of MSMEs.

1. Role of SIDBI

Small Industries Development Bank of India (SIDBI), set up on April 2, 1990 under an Act of Indian Parliament, is the Principal Financial Institution for the Promotion, Financing and Development of the MSME sector and for Co-ordination of the functions of the institutions engaged in similar activities. This institution plays a vital role in facilitating the access to credit to enterprises in this sector. Let's thoroughly analyze its initiative. This will give us an insight about the credit to MSME ecosystem of the country.

2. Micro Units Development & Refinance Agency (MUDRA)

MUDRA has been set up on Aril 8, 2015 as a wholly owned subsidiary of SIDBI for funding the unfunded

micro enterprises. MUDRA refinances banks, micro finance institutions, and other lending institutions which are in the business of lending to micro/small business entities. Thus, MUDRA strengthens the micro and small businesses across the country. In FY2016-17, 3,97,01,047 loans have been sanctioned under Pradhan Mantri Mudra Yojana (PMMY) amounting to INR 1,80,528.54 Crores of which INR 1,75,312.13 Crores has been disbursed.

3. Credit guarantee fund trust (CGTMSE)

CGTMSE, established jointly by SIDBI and the government of India, extends credit facilities to the micro and small enterprises sector. The scheme facilitates lending institutions by the evaluation of the credit proposals on the basis of intrinsic merits of the projects, rather than merely on adequacy of collaterals.

Recently, the Government of India has announced the enhancement of Credit guarantee schemes for MSMEs for loans up to INR 2 Crores which initially was INR 1 Crore. This move further enhance access to funds for small businesses to fulfill growth potential.

During 2014-16 (till December 2016), about 13 lakhs proposals with credit guarantee of over INR 56000 crores have been approved.

The guarantee cover available under the scheme is to the extent of maximum 85% of the sanctioned amount of the credit facility. It is up to 75% of the credit facility up to INR 50 lakh (85% for loans up to INR 5 lakhs provided to micro enterprises, 80% for MSEs owned/ operated by women and all loans to NER including Sikkim) with a uniform guarantee at 50% for the entire amount if the credit exposure is above INR 50 lakh. In case of default, Trust settles the claim up to 75% (or 85% / 80% / 50% wherever applicable) of the amount in default of the credit facility extended by the lending institution. For this purpose, the amount in default is reckoned as the principal amount outstanding in the account of the borrower, in respect of term loan, and amount of outstanding working capital facilities, including interest, as on the date of the account turning Non-Performing Asset (NPA).

4. India SME Technology Services Limited

India SME Asset Reconstruction Company Ltd. (ISARC) commenced its operations in 2009, with primary objective of acquiring NPAs and to resolve them through an innovative mechanism with a special focus on MSME. As of March 31, 2016, ISARC has assets under management of INR 381 Crores representing outstanding security receipts and balance sheet assets.

5. Strategic Business Initiatives and Overall Operations

The business strategy of SIDBI has been reoriented towards filling up the financial and non- financial gaps in the MSME eco-system.

SIDBI extends refinance to Banks and Non-Banking Financial Companies (NBFCs) and also extend capacity building support to smaller commercial banks, Regional Rural banks (RRBs), Urban Co-operative banks (UCBs) andDistrictCooperative Banks (DCBs). Direct finance to MSMEs is being targeted at niche areas to address various financial gaps. This is done through specially designed products like risk capital, sustainable finance, factoring, invoice discounting, services sector financing, etc.

The equity/risk capital assistance supports growth requirements of MSMEs. It includes leveraging of senior loans, funding intangible requirements like expenditure for Research & Development, marketing / brand building, technical know-how, energy efficiency, quality control, working capital margin, etc. SIDBI provides assistance to start-ups and early stage ventures. During Financial Year 2011-12, Direct Risk Capital Scheme (DRCS) has been rechristened as Growth Capital & Equity Assistance Scheme for MSMEs (GEMs), with some modifications and additional features. This will help in assisting greater number of MSMEs.

SIDBI has executed a Memorandum of Understanding (MoU) with Technology Information, Forecasting and Assessment Council (TIFAC) for implementing the Technology Innovation Programme (Srijan Scheme). The main objective of the scheme is to support MSMEs towards development, up-scaling, demonstration and commercialization of innovative technology based projects.

SIDBI has also put in place a scheme to provide risk capital assistance to MSMEs. This has been done by way of line of credit / resource support. It also operates focused lending schemes with Line of Credit (LoC) support from various multilateral/bilateral international agencies. The main objective of these focused lending schemes is enhancing energy efficiency, reducing CO emissions and improving the profitability of the Indian MSMEs in the long run.

In addition to providing credit directly and indirectly, SIDBI has put in place a system for loan facilitation/ syndication services to MSMEs. This will help them avail credit from banks/FIs. In order to further enable MSMEs to access credit from banks, SIDBI has taken the initiative to set up Credit Advisory centres (CACs) with industry associations in select MSME clusters. Already 41 such centres covering 150 clusters have been set up by SIDBI.

MSMEs lack the information on how to start a business, Govt. schemes, sources of various finances, marketing, technology, etc. In order to address the information gap, SIDBI has launched a website named as www.smallB.in which acts as virtual mentor and handholding tool for entrepreneurs to set up new units and grow the existing ones. Further, SIDBI, along with GIZ, Germany, has initiated financialliteracy campaign among MSMEs in different cluster.

6. Financial Literacy and consultancy support

Banks have been advised to either separately set up special cells at their branches, or vertically integrate

this function in the Financial Literacy Centres (FLCs) set up by them. Through these centers, banks provide knowledge assistance to the MSME entrepreneurs in regard to financial literacy, operational skills, including accounting and finance, business planning etc.

Scheme to support entrepreneurial and managerial development of MSME sector has been started by the government. The objective is to provide early stage funding for nurturing innovative business ideas. The funding support would be for infrastructure development and pilot projects. Also, a scheme for Building Design expertise of MSMEs Manufacturing sector has been evolved. The support program aims to enable MSMEs develop new design strategies, get consultancy support from design experts and implement 'Design' projects.

Initiatives: Penetration

The main objective of the above initiatives is to empower the individual by enabling them to realize their potential. It has been estimated that only about 3% of the total workforce in India has undergone formal skill training as compared to 68% in UK, 75% in Germany, 52% in USA, 80% in Japan and 96% in South Korea.

Current skill development efforts by the Central Government are spread across more than 20 Ministries/ Departments. There is a lack of coordination and monitoring mechanism to oversee them. The same is replicated in most of the states also. There is no major effort towards convergence. This creates multiplicity of norms, procedures, certifications etc. Further, many of these skill development initiatives often remain un-aligned to demand. This defeats their entire objective. Also, information deficit and inadequate mentoring support is a challenge faced by an entrepreneur. The procedural hurdles at entry and exit are also cumbersome and they hamper entrepreneurship. These factors emerge large and hinder the emergence of entrepreneurship.

The availability of good quality trainers is a major area of concern. There is also a lack of focus on development of trainers.

93% of India's workforce is in informal/unorganized sector. This is one of the biggest challenges of skill development with sustainable livelihood. It is difficult to track the workers in the unorganized sector who receive informal training. Creation of jobs for skilled youth is also a major challenge. The lack of financial literacy, operational skills, including accounting and finance, business planning etc. represent formidable challenge for MSE/MSME borrowers underscoring the need for facilitation by banks in these critical financial areas. Moreover, MSE/MSME enterprises are further handicapped in this regard by absence of scale and size. The bank staff should also be trained through customized training programs to meet the specific needs of the sector. Keeping in view the high extent of financial exclusion in the MSME sector, it is imperative for banks that the excluded units are brought within the fold of the formal banking sector.

Funding and financing entrepreneurial ventures

Financial assistance is available from institutions such as Nationalized Banks, Small Industries Development Bank of India, Regional Rural Banks, National Small Industries Corporation, State Financial Corporations etc. depending upon the project requirement and promoters background. Financial assistance has two components. Loan for fixed capital is used to acquire Plant and Machinery, land and building. Working capital loan is used to meet day to day operational cost of the production. State Financial Corporation and National Small Industries Corporation generally provide working capital. However, under a package assistance, State Financial Corporations also provide a composite loan covering plant and machinery and working capital. Financial institution which is in close proximity to the project site is a better option.

Some portion of total investment has to be contributed by the Entrepreneur out of own sources. This is called margin money. Financial Institutions insist on 10 to 25 percent margin money depending upon the category of the entrepreneur, risk factor and existing scheme under which the project will be financed.

The general conditions for getting financial assistance are:

1. Eligibility criteria
2. Technical /Economic viability
3. Promoters contribution
4. Capacity to repay loan
5. Collateral securities/guarantee

RBI has evolved measures for ensuring liquidity within MSME sectors. That bit eased the liquidity issue but however the challenges prevailed. The growth of the MSME sector hinges on availability of funds. Therefore, it is essential that the intended measures should have a lasting impact in both deepening and broad basing credit availability to the sector.

SIDBI is committed to play the role of a catalyst by augmenting the resources of banks and NBFCs through refinance and resource support for the growth of the sector. SIDBI has been working on addressing identified gaps in the MSME eco system and develop niche products, processes and delivery channels to address various gaps, such as, financing both in debt and equity funding through structured and innovative products.

In addition, the following steps are being taken.

a) To boost collateral free lending, the current guarantee cover under Credit Guarantee Scheme for Micro and Small enterprises on loans will be extended from INR 1 crore to INR 2 Crores.
b) The lock in period for loans covered under the existing credit guarantee scheme will be reduced from 24

to 18 months, to encourage banks to cover more loans under the guarantee scheme.

c) Government will issue an advisory to Central Public Sector Enterprises and request State Public Sector Enterprises to ensure prompt payment of bills of MSMEs. Easing of credit conditions generally should help PSUs to make such payments on schedule.

These measures by RBI improved the credit flow to medium enterprises.

ATI (Assistance to training)

This Scheme envisages financial assistance for establishment of new institutions (EDIs), strengthening the infrastructure of the existing EDIs and for supporting entrepreneurship and skill development activities. The main objectives of the scheme are development of indigenous entrepreneurship from all walks of life for developing new micro and small enterprises, enlarging the entrepreneurial base and encouraging self-employment in rural as well as urban areas. It is done by providing training to first generation entrepreneurs and assisting them in setting up of enterprises. The assistance shall be provided in the form of capital grant for creation/strengthening of infrastructure and programme support for conducting entrepreneurship development and skill development programmes.

Above mentioned articles have been instrumental in developing entrepreneurs. However, entrepreneurs also need to have knowledge about gauging the quality of their organization and its public perspective. This can be done be skilling entrepreneurs in areas like rating and their impact on organizations.

Rating agencies

Credit rating agencies help entrepreneurs seek better and faster access to finance. These reveal new dimensions of information about entrepreneurs, whether they have credit history and collateral. This uncovers new opportunities both within, and outside, entrepreneur's capital mix. New dimensions of information mean a more complete and accurate understanding of credit risk. It enables lenders to reduce credit risk, safely increase portfolio size, and decrease costs and time to lend.

Now, entrepreneurs need the right approach to deal with the rating agencies which in turn gets them the right ratings. Some of these strategies may seem like common sense; however, they represent solutions to the most common reasons why the typical entrepreneur develops a less than perfect credit rating. These include late payments which is the most common negative information that appears on credit reports, credit card balances, avoidance of closure of unused accounts, application for credit only when needed, careful review of all credit reports and correction of any erroneous or outdated information that's listed, avoidance of too many hard enquires, avoidance of bankruptcy, avoiding consolidation of balances onto one credit card, negotiation with the creditors or collection agencies.

Government has started a scheme for providing financial assistance for performance and credit rating under PCR scheme (performance and credit rating scheme). The objective of the Scheme was to create awareness amongst micro & small enterprises about the strengths and weaknesses of their operations and their credit worthiness. The Scheme has been implemented by National Small Industries Corporation (NSIC). The rating under the scheme has being carried out through empaneled rating agencies i.e. CRISIL, ONICRA, ICRA, SMERA, Brickwork, India Ratings (earlier known as FITCH) and CARE. The enterprises are at liberty to select any of the rating agencies empaneled with NSIC. Any enterprise registered in India as a micro or small enterprise is eligible to apply.

Also, scheme for providing financial assistance on marketing support under Marketing Assistance Scheme has been started for MSME sector. The assistance is provided for organizing exhibitions abroad and participation in international exhibitions/trade fairs, co-sponsoring of exhibitions organized by other organizations/ industry associations/agencies and organizing buyer-seller meets, intensive campaigns and marketing promotion events.

MSME sector has remained a long-neglected area in the country although it contributes most to the economy of the country mostly because of the unawareness, regulatory framework and lack of skilled manpower. Creating a world class eco-system to encourage initiatives in MSME sector remains a big challenge. However, the scenario is expected to bring about a positive change in the coming future with plethora of initiatives taken by the Government in areas such as financing, infrastructure, literacy, ease of doing business, etc. An infrastructural framework dedicated to train entrepreneurs has been initiated. The success of these initiatives depends entirely upon their penetration in the society and the degree of receptivity.

Alternative means of Credit Scoring

Fig 2.11: Alternative means of credit scoring

There is a need to revamp the existing credit scoring system to bring empathy into the equation. Lenders should for example, factor in the stage at which an MSME is in its growth lifecycle and the market forces that surround it as well. Given the lack of quality data to perform the credit scoring process, new lending techniques based on alternative data have emerged as a substitute to the traditional models of scoring. This is being leveraged by fintechs. The major sources of alternative data include:

Online

This includes a digital footprint based on data from social networking and ecommerce sites such as Amazon and Facebook. They are useful in establishing income, stability and professional network size.

Mobile

Mobile data generally comprises Call Detail Records (CDR)and Transaction Detail Records (TDR). These records can be used in estimating the network size and financial stability of an entity.

Supplier payments and ecommerce transaction data

History of payments to suppliers can be used as an estimate of the willingness to pay, as well as of revenue and working capital.

Utility bill payments

Payments of mobile/telephone and electricity bills can be used as indicators of willingness to pay.

Psychometric data

Psychometric data has emerged as an effective indicator of an individual's character and willingness to pay. It could be collected during application time using surveys and questionnaires, In-person administration of questionnaire, however, involves higher cost in data collection, but with a potential of robust predictive power. In the era of technological revolution and digital data, such credit scoring models can be used by lenders instead of traditional models which can provide better insights of borrowers and hence improves lending decisions.

MSME Exports

Micro, Small and Medium Enterprises (MSMEs) are major vehicles to drive the Indian growth story. They contribute to around 8% of India's GDP through more than 6000 products which is expected to grow to 22% in the next three years. The Indian entrepreneurial spirit, paired with recent regulatory and policy changes, is bound to make MSMEs a buzzing sector.

In spite of a good share in exports, the industry continues to suffer from financing constraints and other operational struggles.

Challenges such as sub-optimal scale of operations, technological obsolescence, supply chain inefficiencies, increasing competition, untimely trade receivables from large and multinational companies, and insufficient skilled labour plague MSMEs. Working Capital financing, however, continues to be the major obstacle.

The basic types of export financing adopted by MSMEs are as follows:

1. Pre-shipment finance
2. Post-shipment finance

Both these finances help MSME exporters streamline their processes, and are vital to their growth.

Due to their current small-scale operations, MSMEs face various challenges in accessing these finances from commercial entities.

The MSME sector has been a major contributor to exports accounting for nearly 40% of total exports and constantly growing with major export destinations being USA, EU, UAE, etc.

Top products exported by MSME
Pearls, Precious stones, metals, coins, etc.
Electrical, electronic equipment
Pharmaceutical products
Articles of apparels, accessories
Article of iron or steel

Export financing challenges

The basic issues faced by MSMEs on a regular basis include scarcity and poor quality of raw material, marketing, and under-utilisation of capacity. Apart from these, access to capital is one of the major contributors to the slow growth of this industry.

If the overall export is to improve, of which MSMEs contribute a huge chunk, the sector will need financing. This working capital will help them ramp up their infrastructure for domestic and export operations.

Dependency on unorganized lenders

Many enterprises depend on loans from unorganised markets, and relatives of the management. The complicated procedure, paired with the high cost of credit, dissuade MSME exporters from seeking financial

assistance from banks. Moreover, the collateral required by banks on loans is in the form of infrastructure and inventory, which is unavailable with MSMEs during the early stages; this further creates disparity for the exporters.

Additionally, the profit contingency on loans by traditional lenders contributes to the credit crunch. This accessibility gap for finances widens further when the MSMEs are not equipped with adequate financial knowledge.

Few banks in India customise their offerings and processes to meet this vital MSME necessity. Though efforts have been taken to find simpler procedures, their funding approach in totality remains restrictive.

Financing challenges faced by exporters

Fig 2.13: Financing challenges

The way MSMEs can boost their exports

The MSME sector can take advantage of the following to augment their export competitiveness:

- Credit norms: RBI reforms are in the process of bringing MSMEs and their export units under the 'priority sector', which will transform financing for the sector. RBI has increased the upper limit for investment in plants and machinery, which ensures an even flow of credit to manufacturers. While RBI has included export credit in priority lending, there is still need for relaxations with respect to collateral terms.

- Relationship management: Transport, handling and logistics expenses run high for MSMEs and start-ups. To overcome this, MSMEs should leverage their business network and enter into long-term strategic relationships with their supply chain partners and distributors. This will help them build a sustainable cost advantage.

- Online presence: In today's scenario, having an online presence is critical to the success of MSMEs. This

serves two purposes - it brings credibility to the business, making it easy for lenders to trust them, and it makes them accessible to the end users of products and services, thereby gaining global customers.

- Quality and customer focus: MSMEs can overcome export challenges by manufacturing quality products and adopting a customer centric approach. They can use marketing strategies such as loyalty discounts, after-sales services, on-time delivery, etc.

If India wants to see accelerated growth in MSME exports, it needs to reduce export operational bottlenecks across the MSME industry. A need exists for increased government-led initiatives such as 'Make in India' as well as structural reforms that will help the sector gain momentum.

Banks and NBFCs need to strategize lending the 'MSME way' to provide them with customised options to meet their export requirements. These finances will help MSMEs build a sound infrastructure that is capable of competing in the global export market.

Government Schemes

Apart from the government schemes like PMFBY, PMMY etc., mentioned earlier in this report, there have been many other schemes which have been launched by the current central government recently in the area of social banking. Some of these are mentioned below.

1. Pradhan Mantri Jan Dhan Yojana (PMJDY):

In his first Independence Day speech in 2014, Prime Minister Narendra Modi announced the Pradhan Mantri Jan Dhan Yojana (PMJDY). It is a national mission to bring comprehensive financial inclusion of all households in the country.

Under this scheme, any individual above the age of 10 years and not having a bank account can open a bank account without depositing any money.

The scheme was to ensure the access to financial services such as basic savings bank and deposit accounts, remittance, credit, debit cards, insurance and pension in affordable manner. The scheme was mostly targeted to the people belonging to the Below Poverty Line, but is beneficial to everyone who does not have a bank account.

The scheme has been a great success. As on January 31, 2018, a total of 31.04 crore bank accounts have been opened so far under the scheme. Out of these, 18.27 crore accounts have been opened in rural and semi urban areas and 12.77 crore accounts have been opened in urban areas. Out of the total, the number

of female beneficiaries is 16.37 crore. 23.42 crore RuPay cards have been issued to the PMJDY accounts. A total amount of INR 73,878.73 crores has been deposited in these accounts.

Three Jan Suraksha schemes, namely Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY), Pradhan Mantri Suraksha Bima Yojana (PMSBY) and Atal Pension Yojana (APY) were launched together on May 9, 2014.

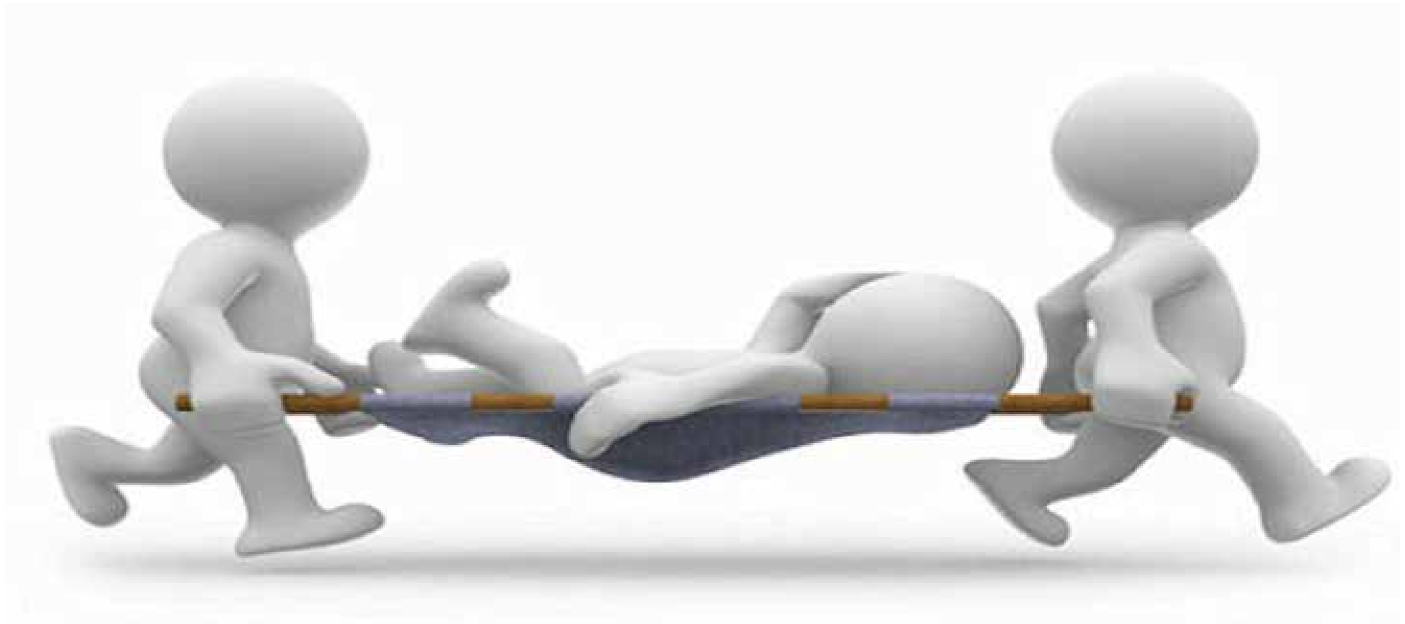
2. Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY):

PMJJBY is a government backed term life insurance scheme aimed at increasing the penetration of life insurance cover in India. It goes a long way in ensuring a safe financial future for the policy holders and comes with the lowest cost on a yearly basis.

Under this scheme, the policy holder can get a life insurance cover of INR 2 lakhs with an annual premium

of just INR 330, excluding GST. All Indian citizens between 18 to 50 years of age and having a savings bank account are eligible to avail the scheme.

As on December 29, 2017, a total of 5.23 crore policies have been sold under the scheme so far.



3. Pradhan Mantri Suraksha Bima Yojana (PMSBY):

PMSBY is a government backed accident insurance scheme aimed at increasing the penetration of accidental insurance cover in India. It targets social security through insuring accidental deaths and partial or permanent disabilities. A large population of India lives in rural areas and these people do not have access to insurance schemes. PMSBY is an initiative to cater to this population so that they can enjoy the insurance benefits at minimum contributions.

Under this scheme, the policy holder can get an accidental insurance cover of INR 2 lakhs with an annual premium of just INR 12, excluding GST. All Indian citizens between 18 to 70 years of age and having a savings bank account are eligible to avail the scheme.

As on December 29, 2017, a total of 13.26 crore policies have been sold under the scheme so far.

4. Atal Pension Yojana (APY):

APY is aimed at increasing the number of pension scheme beneficiaries across the country. It ensures old age pension to those who are not covered under any other pension or social security scheme. This way, those people who are working in private unorganized sectors and enjoying no pension scheme would be covered and can ensure a healthy and comfortable old age.

This scheme is especially targeted to the private unorganized sector, but is open to all Indian citizens between the ages of 18 to 40 years. The beneficiary has to make a contribution for at least 20 years before he/she can get a pension after attaining an age of 60 years. The scheme provides a monthly pension of INR 1000 to INR 5000 per month based on the contribution amount.

As on October 13, 2017, a total of around 69 lakh enrolments had been done under the scheme.

5. Sukanya Samriddhi Yojana (SSY):

Sukanya Samriddhi Yojana (SSY) was launched on January 22, 2015 as a part of the 'Beti Bachao, Beti Padhao' campaign. It is an ambitious small deposit savings scheme for the girl child. It lays special emphasis on financial empowerment of the girl child.

Under this scheme, a savings account can be opened in the name of the girl child and deposits can be made for 14 years. Parents of any girl child below 10 years of age can open a savings account for their daughters and operate it. After the girl reaches 18 years of age, she can withdraw 50% of the amount for marriage or higher study purposes. After the girl reaches 21 years of age, the maturity amount can be withdrawn, including the interest at rates decided by the government every year. The current interest rate is 8.1%.

The investments and returns are exempt from section 80C of Indian Income Tax Act. The scheme offers a high rate of return, even higher than PPF. A maximum investment of INR 1.5 lakhs per year can be made, while minimum deposit amount is INR 1000 per year. In case of more than one girl child, parents can open another account on a different name, but only for 2 girl children. The only exception is if the parents have twins and another girl child.

The scheme has been a great success. Until November 2017, more than 1.26 crore accounts have been opened across the country, securing an amount of INR 19,183 crore.

6. Stand Up India

Government of India launched the Stand Up India scheme on 5th April, 2016. The Scheme facilitates bank loans between INR 10 lakhs and INR 1 crore to at least one Scheduled Caste/ Scheduled Tribe borrower and at least one Woman borrower per bank branch for setting up greenfield enterprises. This enterprise may be in manufacturing, services or the trading

sector. In case of non-individual enterprises, at least 51% of the shareholding and controlling stake should be held by either an SC/ST or woman entrepreneur. The scheme, which is being implemented through all Scheduled Commercial Banks, is to benefit at least 2.5 lakh borrowers. The scheme is operational and the loan is being extended through Scheduled Commercial Banks across the country.

Stand Up India scheme caters to promoting entrepreneurship amongst women, SC & ST categories i.e. those sections of the population facing significant hurdles due to lack of advice/mentorship as well as inadequate and delayed credit. The scheme intends to leverage the institutional credit structure to reach out to these under served sectors of the population in starting greenfield enterprises. It caters to both ready and trainee borrowers.

To extend collateral free coverage, Government of India has set up the Credit Guarantee Fund for Stand Up India (CGFSI). Apart from providing credit facility, Stand Up India Scheme also envisages extending hand-holding support to the potential borrowers. It provides for convergence with Central/State Government schemes. Applications under the scheme can also be made online on the dedicated Stand Up India portal(www.standupmitra.in).

As on 9th February 2018, INR11,232 crores has been sanctioned in 51,908 accounts and INR 5999 crores has been disbursed in 40,598 accounts so far.

7. Pradhan Mantri Vaya Vandana Yojana (PMVVY)

Government of India launched the Pradhan Mantri Vaya Vandana Yojana (PMVVY) on 4th May 2017 to provide social security during old age and to protect elderly persons aged 60 and above against a future fall in their interest income due to uncertain market conditions. The scheme enables old age income security for senior citizens through provision of assured pension/return linked to the subscription amount based on government guarantee to Life Insurance Corporation of India (LIC).

The scheme provides an assured return of 8% per annum for 10 years. The differential return, i.e. the difference between return generated by LIC and the assured return of 8% per annum would be borne by Government of India as subsidy on an annual basis. Pension is payable at the end of each period during the policy tenure of 10 years as per the frequency of monthly/quarterly/ half-yearly/ yearly as chosen by the subscriber at the time of purchase. Minimum purchase price under the scheme is INR 1,50,000 for a minimum pension of INR 1,000 per month and the maximum purchase price is INR 7,50,000 for a maximum pension of INR 5,000 per month. The scheme is exempted from Goods and Services Tax (GST). The scheme is open for subscription till 3rd May 2018.

Pradhan Mantri Awas Yojana (PMAY)

Pradhan Mantri Awas Yojana (PMAY) was launched by Prime Minister Narendra Modi on June 25, 2015. PMAY or Housing for All by 2022 is an ambitious housing development project from the central government that aims to provide about 5 crore affordable homes in urban and rural areas across the country. It is divided into two parts – PMAY Urban and PMAY Gramin.

Under PMAY Urban, the Credit Linked Subsidy Scheme (CLSS) is a home loan scheme which offers affordable home loans for people belonging to the Economically Weaker Section (EWS), Low Income Group (LIG) and Middle Income Groups (MIG) 1 and 2 of the society.

First time home buyers i.e. households who do not own, at present, any pucca residential house in India and wish to buy a dream home for their stay may avail the benefit under this scheme.

An interest subsidy on the home loan will be available for a tenure of 20 years or the actual term of the loan, whichever is lower.

Female property ownership is mandatory for EWS/LIG category and not mandatory for MIG category.

Scheme grid

Category	Annual household income (INR)	Interest subsidy (%)	Subsidy calculated on maximum loan amount of INR	Maximum interest subsidy (INR)	Maximum carpet area of the property (sq. m.)
EWS	Up to 3 lakhs	6.5%	6,00,000	2.67 lakhs	60
LIG	3 lakhs to 6 lakhs	6.5%	6,00,000	2.67 lakhs	60
MIG-1	6 lakhs to 12 lakhs	4%	9,00,000	2.35 lakhs	120
MIG-2	12 lakhs to 18 lakhs	3%	12,00,000	2.30 lakhs	150

As on November 25, 2017, the government had sanctioned 30.76 lakh houses.

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EVOLUTION OF VALUE CREATOR

ASSOCHAM initiated its endeavour of value creation for Indian industry in 1920. Having in its fold more than 400 Chambers and Trade Associations, and serving more than 4,50,000 members from all over India. It has witnessed upswings as well as upheavals of Indian Economy, and contributed significantly by playing a catalytic role in shaping up the Trade, Commerce and Industrial environment of the country.

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ASSOCHAM is seen as a forceful, proactive, forward looking institution equipping itself to meet the aspirations of corporate India in the new world of business. ASSOCHAM is working towards creating a conducive environment of India business to compete globally.

ASSOCHAM derives its strength from its Promoter Chambers and other Industry/Regional Chambers/ Associations spread all over the country.

VISION

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ASSOCHAM represents the interests of more than 4,50,000 direct and indirect members across the country. Through its heterogeneous membership, ASSOCHAM combines the entrepreneurial spirit and business acumen of owners with management skills and expertise of professionals to set itself apart as a Chamber with a difference.

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ASSOCHAM derives its strengths from the following Promoter Chambers: Bombay Chamber of Commerce & Industry, Mumbai; Cochin Chambers of Commerce & Industry, Cochin: Indian Merchant's Chamber, Mumbai; The Madras Chamber of Commerce and Industry, Chennai; PHD Chamber of Commerce and Industry, New Delhi.

Together, we can make a significant difference to the burden that our nation carries and bring in a bright, new tomorrow for our nation.

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