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Industry Thought Leaders' Submissions on Structural Reforms in MSME Funding

- Sandeep Bakhshi
- R. Gandhi
- Shyam Srinivasan
- Rahul Shyam Shukla
- Umesh Revankar
- Alok Kshirsagar
- Siddhartha Gupta
- Binaifer Jehani
- Mahesh Thakkar
- L. Guru Raghavendran

Commentary and compilations by Ashvin Parekh Advisory Services LLP

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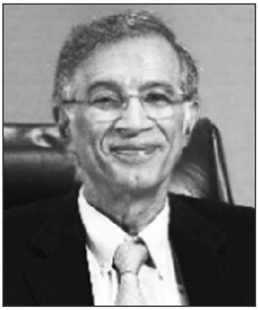
By reading this book, the reader accepts the disclaimer written herewith. Ashvin Parekh Advisory Services LLP (APAS), along with ASSOCHAM, has commented and compiled the book, which intends to provide information about structural reforms in MSME funding. APAS, along with ASSOCHAM, has obtained the information from publicly available sources. APAS and ASSOCHAM, have taken due care and caution in preparation of the book. APAS and ASSOCHAM do not guarantee the completeness and accuracy of the information. APAS and ASSOCHAM are not responsible for any kind of omissions, or errors resulting from the use of such information as mentioned in the book. The book does not contain any information from confidential data provided by any client to APAS and ASSOCHAM.

The opinions expressed in this book by the industry thought leaders are their own and do not necessarily reflect the views of any institution they are or were affiliated with.

Message from ASSOCHAM



Dr. Niranjan Hiranandani
President, ASSOCHAM

Banking System is one the crucial pillar of the financial architecture of the Indian Economy. Amidst the global economic doldrums beset by bad debt crisis to crippling credits dampening productive sectors, domestic investments and subdued employment and GDP growth. The current global and domestic waning economic growth has led to colossal changes in structure and practices of the banking system. Indian Banking system being an inevitable stake in the multifold economic growth poised, an appropriate harnessing of structural reforms in a need of hour.

The time is right for Indian Banking System to be resurrected out of its Cancer ailment. The economic data is flashing warning signs and pressing alarming bells to rejig and redesign sickening banking structure. The overhanging distressed loans need a cleaning spree with the fresh fiscal stimulus to pump in desired liquidity and relive the choked banking sector. Fresh borrowing and lending to the priority and labour intensive sector is crucial to recoup financial growth. The cascading impact will yield in to the increased employment and purchasing power helping to spur up the demand-consumption ratio.

Economic strengthening can be garnered via innovations in restructuring and redefining the policy governance. Alternative funding mechanism and avenues needs to be discovered which will act as a growth catalyst in future funding mechanism. The dearth to create enabling environment and supporting infrastructure is a key to retrieve funding mechanism and ease credit supplies to the core sectors.

In this 15th edition of Annual Banking Summit themed on 'Structural Reforms in MSME Funding' throws light on the stark effects of economic slowdown on cheap credit access and policy support to the fading MSME sector. Indian economy thrives on MSME sector as it forms the economic backbone. The Indian business growth thrives on MSME sector which is vital to reduce regional imbalance by providing large employment opportunities at comparatively lower capital cost and support industrialization of remote rural areas. MSMEs are complementary to large industries as ancillary units, and this sector contributes enormously to the socio-economic development of the country. Hence, there is a need to ensure seamless funding for the MSME sector.

Assocham along with its knowledge partner, APAS, presents a book on the key issues and roadmap to future by bringing together important stakeholders on a single platform to deliberate new growth opportunities, innovations and opportunity to access credit financing in order to achieve its ambitious target of $5 Trillion Economy.

Message from ASSOCHAM

Shri Deepak Sood
Secretary General, ASSOCHAM

The Associated Chambers of Commerce and Industry of India (ASSOCHAM) conducts an Annual Banking Summit to bring the stakeholders together in deliberating the new opportunities and radical ways to create an enabling environment and supporting infrastructure for improving access to financing and credit cycle to MSMEs sectors because it must be remembered that the financial industry is probably the only sector that can act as a facilitator and multiplier for overall economic growth and make the stability in the economy to achieving the vision of becoming a US$5 trillion economy.

Achieving this vision requires significant reforms and policy interventions towards ensuring timely availability of low-cost credit, improving ease of doing business and technology up-gradation, to take on the formidable challenge of creating millions of jobs by addressing issued faced by MSME Sectors as it is one of the main drivers of the Indian economy with significant contribution to GDP, innovation, employment generation, exports. This sector has emerged as a highly vibrant and dynamic sector of the economy over the last few decades. It contributes immensely to the economic and social development of the country by fostering entrepreneurship and generating employment at comparatively lower capital cost, next only to agriculture.

The endeavour to improve the MSME sector in India must begin from a vantage point of ensuring a holistic approach by lenders, regulators, policymakers and MSMEs together. Some of the vital focus areas include infrastructural reforms, sectoral reforms, bringing in conveniences of digital services and appropriate credit. Further, their creditworthiness should be assessed using innovative ways.

Numerous institutions across the country are working towards providing support to the MSME sector and facilitating its growth. Despite the steady growth of TReDS and GeM platforms, delayed payments to MSME suppliers is a cause of concern as it impacts their overall operational health. A regulatory body needs to be formed to ensure maximum payments are routed through such central platforms. Similarly, cross-border trade finance also needs to be brought under the ambit of platform-based settlements. Government has played a powerful role in supporting the MSME sector through active intervention, including qualifying lending in this sector mainly towards priority sector lending requirements of banks.

The new-age lending institutions in the private domain have proved to be very nimble and innovative in their approach to credit appraisal, but lack the reach and pull of larger establishments. On the other hand, PSU banks have the reach but lack flexibility in terms of credit policy and target market. By charting out a well thought out blueprint, a collaborative approach can help reach the unbanked and unbankable borrower in the most rural of markets. Co-origination of loans is a step in the right direction and should be supported with appropriate guidelines and structure.

In this context, ASSOCHAM and APAS are pleased to release this book. I would like to express my sincere appreciation to authors for their efforts and for sharing their views and insights.

I am confident that this book will be insightful and useful to all stakeholders.

Message from Shri Ashvin Parekh

APAS and ASSOCHAM are glad to present to you this book “Industry Thought Leaders’ Submissions on Structural Reforms in MSME Funding”. ASSOCHAM conducts an Annual Banking Summit with the objective to bring the stakeholders together for deliberations. This year, the theme of the Summit is ‘Structural Reforms in MSME Funding’.

APAS has been associated with this initiative as a knowledge partner for the last 4 years and this is the fifth year. This year is special since ASSOCHAM is celebrating its centenary year. The ASSOCHAM 15th Annual Banking Summit 2020 is a celebration of success of ASSOCHAM as a platform to bring together the MSME sector and banking sector, and as a platform for deliberating the new opportunities and radical ways in which an enabling environment can be created for the flow of credit.

What makes this year more special is that the RBI Governor Shri Shaktikanta Das is gracing the Summit as Chief Guest. He is inaugurating the event, addressing the Summit participants and releasing this book.

Every year, APAS prepares a knowledge report for the Summit. This year, we decided to do something different. We decided to create a book on structural reforms in MSME funding. We have added APAS knowledge in the initial parts of this book. For the rest of the book, we reached out to the thought leaders of the banking industry and other industries connected to banking and

MSME lending, such as NBFC, credit rating agencies, representative bodies, technology, consulting, etc. We sent them a questionnaire to get their views on different aspects of MSME funding, such as impediments, key infrastructural requirements, different measures to be taken, their efforts and initiatives, critical reforms needed, etc. The industry thought leaders sent their views in the form of articles, which we have compiled in this book. The book is envisaged to be in a structured way to ensure that the thoughts are collected from all the respondents to work towards constructing a treatise which will be read by all the stakeholders, including the policymakers and the regulators. The inputs from these thought leaders have really enriched the quality of this book.

It has been an enjoyable experience in developing this book. We got to interact with the industry thought leaders and learnt from their experiences during the making of this book. I want to thank each one of the thought leaders for providing their valuable time and inputs in the making of this book.

I would also like to thank the team from ASSOCHAM, led by Dr. Rajesh Kumar Singh, for their continued support. Lastly, I would like to thank my colleagues at APAS – Sujana Hari, Harsh Mirpuri, Kalpesh Mantri, Ankita Narnaware and Rishank Dabra – for assisting me in developing this book.

Ashvin parekh

Managing Partner

APAS

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How to read this book

The book begins with an executive summary of the current situation in the Indian MSME sector. After the summary, the initial 3 chapters in this book contain write-ups by APAS on the MSME sector in India, impediments to MSME funding and some recommendations.

After these chapters, the rest of the book is a compilation by APAS, of 9 articles written by industry thought leaders, comprising a retired RBI deputy governor, banking industry leaders and leaders of other industries connected to banking and MSME lending, such as NBFC, credit rating agencies, representative bodies, technology, consulting, etc. Each of these leaders were sent a questionnaire of 5 questions, which are as below.

1. What are the impediments to MSME funding?
2. What are the key infrastructural requirements?
3. What different measures should be taken according to you? 3 important things,
    a. Borrowers should do
    b. Bankers should do
    c. Policymakers should do
    d. Regulators should do
4. What are your efforts and initiatives or fresh approaches in this regard?
5. What are the 5 most critical reforms according to you, the system should adopt?

The leaders were requested to answer the above 5 questions through their articles. Each of the leaders have tried to answer the above questions through their articles, based on their experience in MSME financing.

These articles represent the leaders' own views and not those of APAS, ASSOCHAM or their respective past and present organizations.

Abbreviations

ARI: Agro & Rural Division

CGFMU: Credit Guarantee Fund for Micro Units

CGTMSE: Credit Guarantee Trust for Micro and Small Enterprises

CLCSS: Credit Linked Capital Subsidy Scheme

DATC: Data Analytics and Technical Coordination Wing

DCMSME: Office of the Development Commissioner of Ministry of MSME

DIC: District Industries Centre

GDP: Gross Domestic Product

GeM: Government e-Marketplace

GST: Goods & Services Tax

GSTN: Goods & Services Tax Network

IBC: Insolvency & Bankruptcy Code

IDR: Industrial Development and Regulation Act

IF: Integrated Finance Wing

IFC: International Finance Corporation

IU: Information Utility

IRDAI: Insurance Regulatory & Development Authority of India

LAP: Loan Against Property

MFI: Micro Finance Institution

MSE: Micro & Small Enterprises

MSEFC: Micro & Small Enterprises Facilitation Council

MSME: Micro, Small & Medium Enterprises

MSMED: Micro, Small & Medium Enterprises Development Act

NBFC: Non-Banking Finance Company

NCGTC: National Credit Guarantee Trustee Company

NPA: Non-Performing Asset

PMMY: Pradhan Mantri MUDRA Yojana

PSL: Priority Sector Lending
RBI: Reserve Bank of India
RRB: Regional Rural Bank
SCB: Scheduled Commercial Bank
SFB: Small Finance Bank
SFC: State Financial Corporation
SHG: Self Help Group
SIDBI: Small Industries Development Bank of India
SME: Small & Medium Enterprises
SSI: Small Scale Industries
TReDS: Trade Receivables Discounting System
UAM: Udyog Aadhaar Memorandum
UAN: Udyog Aadhaar Number
UCB: Urban Cooperative Bank
UT: Union Territory
ZED: Zero Defect Zero Effect

Executive Summary

MSME sector is one of the most important drivers of the Indian economy with significant contribution to GDP, innovation, employment generation and exports. This sector has emerged as a highly vibrant and dynamic sector of the economy over the last few decades. It contributes immensely to the economic and social development of the country by fostering entrepreneurship and generating employment at comparatively lower capital cost, next only to agriculture. MSMEs complement large industries as ancillary units and therefore, contribute considerably to the inclusive industrial development of the country. There are more than 64 million MSME enterprises in various industries, employing close to 111 million people. Of these, close to 51 Percent are based in rural areas. Around 31 percent are engaged in manufacturing activities, 36 percent in trade and 33 percent in other services. In all, MSME sector accounts for nearly 30 percent of GDP and more than 40 percent of the exports.

State of Uttar Pradesh had the largest number of estimated MSMEs with a share of 14.20% of MSMEs in the country. West Bengal comes as close second with a share of 14% again. The top 10 States together accounted for a share of 74.05% of the total estimated number of MSMEs in the country.

India is currently one of the fastest growing economies of the world. MSME sector is likely to continue to play a significant role in its growth story. This sector is universally considered as a growth engine for economic development and so, development of a dynamic MSME sector is perceived as a policy priority in both developed and emerging economies. Small and Medium Enterprises (SMEs) account for about 90 percent of businesses and more than 50 percent of employment worldwide. With Indian economy temporarily slowing down from high levels of growth, it is imperative to focus on MSMEs to bring the economy back on track. In such a context, it is extremely important to understand the bottlenecks and challenges and work around policy and structural changes to accelerate growth. All the stakeholders in the MSME eco system should play their role more efficiently for bringing in progressive changes to the sector.

Due to certain constraints and challenges, the sector is unable to perform at its full potential and grow. The major one being adequate and timely funding. This book throws light on major impediments to funding, the key infrastructural requirements, various measures to be taken by the lenders, borrowers and the policy and legislation makers. It discusses some of the critical reforms that are need of the hour.

Improper financial statements, inadequate financial literacy and financial awareness, lack of standardization in rating mechanism, lack of depth in credit markets, complexity in portability of MSME loans, inadequate use of technology and technology obsolescence, lack of formalization, problem of delayed payments, factoring related issues and issue with the definition of MSME are some of the impediments discussed in this book.

This book has a compilation of views of the industry thought leaders on the subject. These eminent industry experts have also shared with us, their approach to addressing this issue.

At INR 17 trillion, lending to MSMEs accounted for around 25% of corporate lending in India as of fiscal 2019.The financial institutions have limited their exposure to this sector mainly because of small ticket size, higher cost of servicing, limited availability of collateral, and unreliability of the financials of the enterprises. Due to the lack of credible information on the functioning and performance of the MSME units, MSMEs have been found to be deprived of institutional credit. Major part of the debt demand in this sector is met through informal sources while formal sources cater to just around 16 percent of the total demand. Within formal financial sector, scheduled commercial banks cater to nearly 81 percent, NBFCs, RRBs, UCBs, government financial institutions are among the rest. Despite increase in credit flow to the MSME sector in the recent years, the credit gap is estimated to be INR 20 – 25 trillion, while the debt demand for this sector is estimated to be INR 37 trillion.

With appropriate policy interventions and structural changes, considerable part of currently excluded demand can be met. As per IFC report on financing MSMEs in India, Micro and Small Enterprises together account for 95 percent of the viable debt gap that can be addressed by the financial institutions in the near term.

Let us understand in more detail what the stakeholders can do to overcome the impediments and contribute to advancement of this sector.

CHAPTER - I
About MSMEs in India

Definition of MSMEs

The definition of MSMEs differ widely across countries due to heterogeneity in MSMEs themselves as well the nature of economies in which they operate. According to the World Bank definition, a business is classified as MSME when it meets two of the three criteria viz., employee strength, assets size, or annual sales.

The most widely used variable for defining an MSME is the number of employees. Other variables commonly found in MSME definitions are turnover as well as value of assets. A few countries also use alternative variables such as loan size, formality, years of experience, type of technology, size of the manufacturing space, and initial investment amount, among others. In India, the definition is based on investment in plant and machinery/Equipment.

In India, as per MSMED Act 2006, MSMEs are classified as below:

Manufacturing Sector	
Enterprise Category	Investment in plant & machinery
Micro Enterprises	Does not exceed 25 lakh rupees
Small Enterprises	More than 25 lakh rupees but does not exceed 5 crore rupees
Medium Enterprises	More than 5 crore rupees but does not exceed 10 crore rupees
Service Sector	
Enterprise Category	Investment in equipment
Micro Enterprises	Does not exceed 10 lakh rupees
Small Enterprises	More than 10 lakh rupees but does not exceed 2 crore rupees
Medium Enterprises	More than 2 crore rupees but does not exceed 5 crore rupees

The MSMED Act, 2006, was enacted to provide enabling policy environment for promotion and development of the sector. Prior to this Act, MSEs in India were collectively termed as Small Scale Industries (SSIs) under the Industrial Development and Regulation (IDR) Act, 1951.The MSMED Act, 2006 has provided the legal framework for identifying the concept of ‘enterprise’ which includes entities both in manufacturing and service sectors and has categorized the enterprises into three tiers viz., Micro, Small and Medium.

MSMED Act 2006 has brought in great clarity on many subjects and concepts within MSME sector and aided in growth and development of MSMEs post 2006. While the Act covers major issues, there is further need to update it to the changing needs of the sector.

Organizations facilitating growth: Legislation, Policy formulation & Interventions

Numerous institutions across the country are working towards providing support to the MSME sector and facilitating its growth. At the apex level, the Ministry of MSME formulates policies for overall growth of the sector while the Office of Development Commissioner MSME implements these policies through its various organizations. SIDBI is the apex body responsible for the development of the MSME sector. RBI and SEBI frame broad policies for facilitating funding support to the sector.

The primary responsibility of promotion and development of MSMEs is of the State Governments. However, the Government of India supplements efforts of the State Governments through various initiatives. Ministry of MSME and its organizations assist the States in their efforts to encourage entrepreneurship, employment and livelihood opportunities and enhance the competitiveness of MSMEs.

The Ministry of MSME consists of Small & Medium Enterprises (SME) Division, Agro & Rural (ARI) Division, Integrated Finance (IF) Wing and Data Analytics and Technical Coordination (DATC) Wing, besides the Office of the Development Commissioner (DCMSME) and other subordinate organizations.

One of the major steps in development of MSME sector has been enactment of MSMED Act 2006 which currently provides legislative direction to MSMEs in the country.

MSME Financing

MSME sector has been struggling to source adequate and timely funds. Many enterprises have closed down due to unavailability of adequate timely credit. In this context, it is important to understand the sources of funds for MSMEs in India.

In India, the total addressable demand for external credit is estimated to be INR 37 trillion while the overall supply of finance from formal sources is estimated to be INR 14.5 trillion Therefore, the overall credit gap in the MSME sector is estimated to be INR 20 – 25 trillion.

The funding needs of this sector is addressed by both formal and informal sources. Only 16 percent of the total demand is serviced by the financial institutions. The funding from informal sources is quite expensive and a trap in many cases where the MSMEs have no other way but to succumb to the pressures of informal sourcing. For the development of this sector, the efforts are towards improving accessibility to formal credit. However, the formal sources are hesitant to serve this underserved sector owing to high risk and higher cost of servicing, limited availability of collateral, and unreliability of the financials. Also, the presence of formal sources in rural areas is abysmally low.

Informal Sources of funds

As stated above, MSME sector has been borrowing heavily from informal sources as the fund flow from formal sources is inadequate, unavailable or extremely difficult to obtain. Typically, informal sources include borrowings from money lenders, friends, family and the interest rates are very high as compared to the formal sources.

Formal Sources of funds

Financial institutions - SCBs, SFBs, Foreign Banks, Cooperative banks, RRBs and NBFCs

The institutions lending to MSMEs in India include Scheduled Commercial Banks (Public Sector Banks, Private Sector Banks including Small Finance

Banks, Foreign Banks, Co-operative Banks and Regional Rural Banks) and Non- Banking Financial Companies including NBFC- MFIs. Other institutions engaged in providing or mediating capital to MSMEs include SME Exchanges, Angel Investors, Venture Capital and Private Equity.

At an aggregate level, the banking sector has credit outstanding of approximately INR 17.4 trillion to MSMEs as on March 31, 2019. Scheduled Commercial Banks account for 90% of this.

A lot of these institutions insist upon collaterals that are not always easy for MSMEs to produce. So, many government-backed schemes are introduced to facilitate credit to small businesses by giving collateral-free loans at reasonable interest rates.

Pradhan Mantri MUDRA Yojana (PMMY) is a scheme launched by the Hon’ble Prime Minister in 2015 for providing loans up to INR 10 lakh to the non-corporate, non-farm small/micro enterprises. These loans are classified as MUDRA loans under PMMY. These loans are given by Commercial Banks, RRBs, Small Finance Banks, MFIs and NBFCs. NBFCs have played a significant role in servicing MSME sector. They have spread themselves in the areas that are underserved and unserved by banks.

Some Credit Guarantee Trusts like Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE) and Fintech companies are also providing small collateral free loans.

Lending to MSMEs is not perceived to be lucrative and many banks have been lending to MSMEs as a part of the priority sector mandates. However, this sector offers unlimited potential and can be leveraged only when banks perceive it as strategic lending and find innovative ways of lending to unlock the potential.

Online lending is also developing in a big way reducing the need for physical interface. Many fintech companies are able to serve MSMEs as relatively lower cost of funding through use of technology is helping them.

Interventions are needed to make credit available in areas which are remote or have low levels of economic activity.

State Financial Corporations

State Financial Corporations (SFCs) were set up to promote MSME sector through extension of term loans and help them unlock equity financing. Their focus was Small Scale Industries (SSI). The authorised Capital of SFCs is fixed by the State Government within the minimum and maximum limits of INR 50 lakh and INR 5 crore and is divided into shares of equal value which were taken by the respective State Governments, RBI, Scheduled Banks, Co-operative Banks, other financial institutions such as insurance companies, investment trusts and private parties.

At present, there are 18 SFCs and only a handful of them are active.

SFCs grant loans mainly for acquisition of fixed assets like land, building, plant and machinery. They provide financial assistance to industrial units whose paid-up capital and reserves do not exceed INR 3 crore (or such higher limit up to INR 30 crore as may be specified by the Central Government). Also, they underwrite new stocks, shares, debentures etc., of industrial concerns. At the time when SFCs were conceptualized, credit markets were under-developed. SFCs were accordingly envisaged as an integral part of institutional finance structure in the country. Over the years, the number of lenders in the market have increased manifold. On the liabilities side, SFCs are unable to access low cost funding. They are unable to raise money directly on account of inadequate rating and are forced to rely upon the State Government and banks. High NPAs at most SFCs are indicative of poor lending decisions. Clearly, the role of SFC as a financial intermediary has diminished. The challenge facing States has also changed – from ensuring credit to MSMEs in general to ensuring that MSMEs across the State are able to tap opportunities.

Small Industries Development Bank of India (SIDBI)

SIDBI was set up in 1990 under an Act of Parliament, to act as the principal Financial Institution for promotion, financing and development of the MSME sector as well as for coordination of functions of institutions engaged in similar activities. SIDBI was set up as an apex bank for tiny and small industries.

In the almost three decades of its existence, SIDBI has been primarily engaged in the re-finance business, much of which has been through funds provided to it from shortfall of priority sector lending by banks. SIDBI has also made forays into direct lending, equity support and in supporting the setting up of institutions such as Rating Agency (Acuite Ratings & Research), an Asset Reconstruction Company (ISARC), a Trustee Company (STCL), a Venture Capital Company (SVCL), MUDRA, a TReDS platform (R-XIL), a Technology Company (ISTSL), a lending platform (PSB loans in 59 minutes) etc.

It also holds equity shares in many SFCs and Technology Consultancy Organizations. SIDBI has also been extensively involved in supporting Start-ups. SIDBI's re-finance book has been steadily growing but its contribution to overall MSME finance remains negligible. Its attempts at direct lending and equity support were not quite successful with very high level of delinquencies.

PSBLoansIn59Minutes, MSME Pulse publication, Micro Finance Pulse, MSME Sentiments Index, etc., are the initiatives of SIDBI and are good knowledge products from the institution.

Financial support by way of schemes

Some of the incentives and subsidies if availed by MSMEs can assist them in improving their financial position. Some such initiatives include availing financial support through "Zero Effect Zero Defect" certification and Credit Linked Capital Subsidy Scheme (CLCSS) for technology upgradation of MSMEs among others.

Credit Guarantee Schemes

A credit guarantee scheme provides third-party credit risk mitigation to lenders through the absorption of a portion of the lender's losses on the loans made to MSMEs in case of default, typically in return for a fee.

Credit Guarantees in India for MSMEs were introduced through the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) in the early 2000s. Then on, other Credit Guarantee Schemes have been introduced such as Credit Guarantee Fund Trust for Low Income Units by NHB, Credit Guarantee Fund for Micro Units (CGFMU), Credit Guarantees for Skilling Loans, Education Loans, loans extended under Standup India, factoring, loans extended to Scheduled Castes, etc. In addition, there are some Credit Guarantee Schemes being operated by the Private Sector on a smaller scale. Government of India has set up the National Credit Guarantee Trustee Company (NCGTC) as a single entity to house and administer different Credit Guarantee Funds. While both CGTMSE and NCGTC offer the credit guarantee product, the guarantee structure and features are different. Structurally, the primary difference is that the CGTMSE is a loan level guarantee scheme while CGFMU for MUDRA loans, run by NCGTC, is a portfolio level guarantee scheme. This means that pay-outs happen under CGTMSE when individual loans, covered under the scheme, start to default. In contrast, pay-outs happen in CGFMU only when the threshold NPA level of the portfolio is breached.

Equity and venture capital

MSME sector has been over the years, heavily dependent on debt funds.

Debt products such as Loan Against Property (LAP) and Jewel Loans, etc. have been preferred products of borrowing while equity as source of finance is being utilised by very few enterprises. Formal sources of equity or equity-like capital for MSMEs are Angel Investors (pre-seed and seed-stage) and Venture Capital Investors (early stage but where revenues are available). Venture Debt is a relatively new instrument in the Indian market that provides high-risk debt to early stage enterprises.

Listing on SME Exchange also provides MSMEs with equity capital.

Refinancing and Securitization

MUDRA offers a single refinance product. As most of the refinance is funded by PSS, interest rate caps apply on the pool of loans taken up for refinance. MUDRA is restricted to refinancing portfolios of PMMY loans only. MUDRA's resources for refinance are heavily dependent on the inability of banks to meet PSL targets and sub-targets.

Trade Credit Insurance

Trade Credit Insurance is an insurance product that secures the payment of receivables and helps MSMEs sell to new buyers who may often be in distant geographies. There is a need to widely publicise this insurance product to MSMEs.

CHAPTER - II
IMPEDIMENTS TO FUNDING

MSME sector over the years has been grappling with the issue of unavailability of adequate and timely credit. While the situation has improved over the years, the sector still has a long way to go before it can see smooth flow of easy credit. Further, deceleration in economic activity and burgeoning NPAs in the past couple of years has led to significant slowdown in credit flow to the MSE sector.

There are umpteen challenges faced by the enterprises to avail formal credit. Some of the challenges which are deterring the flow of funds to the sector are discussed below.

Governance issues and Improper maintenance of financial statements

Credible and proper financial statements are extremely critical for lending by financial institutions. They are the basis for sanction of loans and drive the risk profile of the enterprise. Many enterprises still struggle to maintain proper financial statements or tweak the statements to favour their cases under different situations. Inconsistencies in financial statements submitted to tax authorities, creditors and for operations is not unheard of. This is partially due to financial illiteracy or deliberate attempt to evade tax or show rosy picture to obtain funds.

Improper maintenance of financial statements by some enterprises in this sector leads to perception of high credit risk translating into no credit or credit at very high interest rates.

Lack of standardized rating mechanism

Credit rating from a trusted agency assist large corporates in obtaining faster and cheaper credit. However, when it comes to MSMEs, there is no standardization in the rating mechanism. This is due to varied nature, uniqueness of MSMEs and most importantly non-availability of data.

Absence of standardized rating mechanism leads to lender specific assessment models, delaying the credit risk assessment. Lack of appropriate data leads to lender doing detailed analysis and hence delaying the credit decision. Further, in the absence of information on credit score/ rating of prospective buyers, MSMEs end up with delayed debtor collection, leading to stress in business.

Lack of credit market depth

The higher risk of default, information asymmetry, challenging exit process and high cost to serve MSMEs have kept many lenders away from MSME financing.

Insufficient lenders in rural regions. While many urban areas have sufficient lender coverage, there is very poor credit depth in large parts of the country. This remoteness translates into weaker access to formal credit. Emergence of new kinds of lenders is important for addressing the credit gap in this sector. There is a need to increase penetration of institutional lenders. Also, lenders able to address the challenges through innovative means are needed. Example of such lenders are fintech companies who could significantly reduce the cost of servicing by use of technology.

PSBLoansIn59Minutes is an online marketplace, which enables in-principle approval for MSME loans up to INR 1 crore in 59 minutes from Public Sector Banks. On this platform, MSME borrower is not required to submit any physical document for in-principle approval. The solution uses algorithms to analyse data points from various sources such as IT returns, GST data, Bank Statements, etc. After receiving the in-principle approval letter, the beneficiary is expected to contact the concerned branch to get the in-principle approval into regular sanction to obtain disbursement of the loan. However, entrepreneurs are still finding post in-principle approval process tedious and time consuming.

Complexity in portability of MSME loans

Loan portability is a feature offered on loans which enables the borrower to switch, from existing lender to a new lender. Such portability is sought for various other reasons. The need for loan portability could arise from various factors including inadequate credit limits, service deficiencies, potential for lower rates and need for value-added services such as trade finance and forex.

Small enterprises that grow into Medium enterprises often outpace their lender's willingness or ability to extend credit to them. Providing a facility to shift MSME loan accounts from one lender to another in a hassle-free manner can help in improving service quality of lenders, increases healthy competition and more importantly reduce costs for the borrowers.

Currently, portability of loans is not seamless and poses challenges.

Inadequate financial literacy and lack of awareness

An important element of enhancing the capability of MSMEs is to make them financially literate, so that they are better positioned to take advantage of the various benefits that the financial sector can offer them. For example, being aware and choosing the most appropriate payment and deposit services, including digital ones is crucial for MSMEs. Similarly, it is important for them to understand the benefits, risks, costs and limitations related to digital services and platforms for funding the business (such as crowd funding, peer-to-peer lending and initial coin offerings).

Many MSMEs are not aware of the various schemes and subsidies that the government offers them, due to which they are unable to access funds. While many schemes have been launched by various ministries, regulatory bodies, there is no one stop access to all the available schemes.

Inadequate use of technology and technology obsolescence

In this decade, technology interventions have changed the way in which business is done. Automation and artificial intelligence are going to be the future. While the world is moving so fast with technology, many MSMEs in India are yet to catch up with basic technology upgrades. Either the processes are manual or are on technology which is obsolete leading to higher costs and lower productivity. Technology upgradation not only helps better manage operations but also helps in efficient management of finances at the same time making them attractive to lenders.

While that is the story of inadequate use of technology from borrowers' perspective, many lenders are still on obsolete technology and not using latest technology developments that simplify lending to MSMEs making it less risky and viable.

Lack of formalization

MSME sector lacks formalization as many of the enterprises are not registered. This not only makes it challenging for lenders to conduct diligence but also constrains credit support and reach of various schemes.

To address the timely flow of funds and subsidies to the sector, various schemes have been designed by the government. However, for such schemes to function effectively, more formalization of the sector is needed.

Also, access to information about market opportunities and various schemes and benefits available to MSMEs is sub optimal and unstructured. A one stop platform for such information shall be beneficial to the enterprises in this sector.

To bring formalization to the sector, one of the steps taken by the government is introduction of Udyog Aadhaar Memorandum (UAM), a one-page online registration system for MSMEs based on self-certification. As per provisions of the MSMED Act 2006, MSMEs file Entrepreneurs Memorandum (Part-I) at District Industries Centres (DICs) before starting an enterprise. After commencement of the project, the entrepreneur concerned files Entrepreneurs Memorandum (Part-II)/[EMII]. Prior to enactment of the Micro, Small & Medium Enterprises Development Act, 2006 (MSMED Act, 2006) there was a system of registration by small scale industrial units to the DICs. Since September 2015, EM-II has been replaced by the Udyog Aadhaar Memorandum (UAM). The entrepreneurs in the MSME sector just need to file online, a simple one-page UAM on http://udyogaadhaar.gov.in to instantly get a unique Udyog Aadhaar Number (UAN). The information sought is on self-certification basis and no supporting documents are required at the time of online filing of UAM.

However, low level of registrations of MSMEs in Udyog Aadhaar Memorandum (UAM) is seen. Promoting formalization and digitization amongst MSMEs and encouraging them to register in UAM has remained a challenge.

MSME definition and its impact on finances

Definitions based on investment limits in plant and machinery/ equipment were decided when the MSMED Act was formulated in 2006 and does not reflect the current increase in price index of plant and machinery / equipment leading to pressure on finances of the firm. Furthermore, MSMEs due to their informal and small scale of operations often do not maintain proper books of accounts and hence find it difficult to get classified as MSMEs as per the current definition and hence may not be able to avail the due benefits and flow of funds.

There is a need to redefine the MSMEs based on changing dynamics of the economy in general and this sector in particular. Now, government has proposed new definition based on the turnover. In future, there is a need to review this definition periodically to make sure that it reflects the economic conditions and the sectoral dynamics.

Problem of delayed payments

One of the biggest concerns of MSME sector has been delayed payments by large buyers. Most large corporates operate with MSMEs only on a credit basis. When the buyer does not honour the invoices on time, MSMEs face a financial crunch in the business. Their interest burden increases, cash flow becomes stressed and business continuity is impacted. Several initiatives have been taken to address this issue. But the issue still persists.

To solve the problem of delayed payments of small-scale (Micro and Small) sector, Delayed Payments Act was promulgated in 1993. In MSMED Act, 2006, the provisions of Delayed Payments Act, have been strengthened. Micro and Small Enterprises Facilitation Council (MSEFC) set up to resolve delayed payments issues. Sections 15-24 of The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 deal with the issues relating to the Delayed Payments to Micro and Small Enterprises (MSEs) by the buyers to the MSE supplier. In the case of delay in payment beyond 45 days, MSEs suppliers may approach the Micro and Small Enterprises Facilitation Council (MSEFC) constituted under the Act in all States/UTs. Under Section 16 of the MSMED Act, delayed payment to supplier units, attracts compound interest with monthly interests at three times of the bank rate notified by the Reserve Bank. However, the mechanism of facilitation council has not been uniformly effective primarily because of the limited bargaining power of the MSEs and the fear of retaliation from the buyers.

Also, the scope of MSEFC is limited to Micro and Small enterprises and does not cover Medium enterprises. Also, there is only one Facilitation Council per state and it is clearly not adequate to handle all the cases.

An Information Utility (IU) could help resolve this problem. IUs are set up under the Insolvency and Bankruptcy Code (IBC). An IU is a repository of electronic legal evidence pertaining to any debt/claim as submitted by a financial or operational creditor that is verified and authenticated by parties thereby making the information non-refutable or prima facie evidence. IBC mandates financial creditors to submit information to an IU, but only encourages operational creditors to submit information.

MSMEs may still hesitate to file default against their large buyers, fearing loss of future business/debarment.

Electronic bill discounting systems (such as TReDS) have provided a partial solution but the problem persists.

TReDS is introduced to solve the problem of delayed payments and liquidity issues of MSMEs. TReDS is an electronic platform where receivables of MSMEs drawn against buyers (large corporates, PSUs, Government Departments, etc.) are financed through multiple financiers at competitive rates through an auction mechanism.

The usage of this facility remains rather low, as the number of large corporates, PSUs and Government Departments on-boarded on the platform is still low.

Factoring related Issues

Factoring is an accepted method of receivables financing across the globe and is regulated by a stringent set of rules and procedures.

Factoring is a financial option for the management of receivables. It is a tool to obtain quick access to short-term finance and mitigate risks related to payment delays and defaults by buyers. Receivables form a major part of the current assets of MSMEs and management of such receivables is the most important concern for them. Factoring helps MSMEs manage such receivables.

In the process of factoring, the seller sells its receivables to a financial institution ("Factor") at a discount. After the sale, there is an immediate transfer of ownership of the receivables to the Factor. In course of time, either the factor or the MSMEs, depending upon the type of factoring, collects payments from the debtors. Factoring helps the MSMEs to improve their cash flows and cover credit risk.

Initially, in India, factoring was not a typical or mainstream financial service in the absence of legislation. However, with the enactment of Factoring Regulation Act, the necessary legal framework is now in place for factoring to gain traction.

But unfortunately, reservations on part of corporates and PSU buyers to accept assignment of receivables made in favour of factors, issues with the legal system and dominance of banks in factoring business have been hampering the growth.

CHAPTER - III
RECOMMENDATIONS

Given the paramount importance of MSME sector and its contribution to the economy, the government and policy makers have been working continuously towards removal of roadblocks to MSMEs funding. While borrower's efforts have always been towards improving their funding prospects, they should consciously take steps to make themselves appear lucrative to lenders. Lenders on the other hand need to perceive lending to this sector as a strategic business opportunity and not as an obligation and that can happen only through continuous innovative changes to unlock the potential of this sector. Below are some of the recommendations and steps that could be taken to overcome the impediments of funding that the sector is currently facing.

Recommendations for the borrowers

1. Enterprises need to register themselves as MSME to avail the benefits of being part of this sector. The registration process has been reasonable simplified by the government and therefore, the enterprises should take advantage of this and become part of the MSME eco system. With increasing schemes and benefits for this sector from the government, the benefits of being registered largely outweigh the reasons of staying out of it.

2. Bringing in professionalism, maintaining ethical practices and proper financial statements, upgrading management skills, improving financial literacy and adoption of latest technology will benefit the borrowers and reduce the risk perception associated with them, thereby improving the flow of credit at best possible interest rates. Participate in financial literacy and awareness programmes.

3. Instead of heavily relying on debt, the enterprises should explore suitability of new ways of financing including equity from venture capital funds and other financial instruments available.

4. Get certifications such as “Zero Defect Zero Effect (ZED)” to avail interest/ processing fee concessions.

Recommendations for the lenders

1. Lenders need to adopt artificial intelligence and other advanced technology solutions to obtain the unstructured data available with various sources. This helps in better risk assessment of the borrowers in MSME sector and reduce the number of NPAs. Further, Banks should use surrogates like personal guarantee, bank statement, GST data, standardized score cards to evaluate credit worthiness of MSME borrowers. Also, banks should find ways of obtaining and monitoring data from partners for early warning signs. For example, in case of e-commerce sellers, any change in seller rating, velocity of sales, etc. could be monitored.

2. There is a need to simplify loan application process and assessment process. A uniform process across all the financial institutions shall smoothen the hurdles faced by the applicants. escrowing of cash flows is needed for quicker decision making and reducing turnaround time.

3. There is a need to develop new MSME products suitable to the unique nature of MSMEs and the changing market dynamics.

4. Banks can identify certain branches and designate them as MSME centres and equip such branches with specialized, trained and experienced professionals to expedite loan approval process.

5. Currently, banks assess working capital and term loan requirement of MSME units based on various methods including Cash Budget Method, minimum 20% of Turnover Method, Traditional or Operating Cycle Method. Of these methods, assessment based on projected turnover based method is generally used by banks. The banks should move from Balance Sheet or turnover based Working Capital financing to cash flow based, or supply chain/ cluster-based financing.

6. Banks need to build their ability to capture cash flows of MSME borrowers on a regular basis, for which they need to tie-up with Industry Majors / Aggregators / Online platforms.

By implementing the above, banks will find lending to MSMEs more strategic than obligatory.

Recommendations for the policy makers

1. RBI has recently given detailed guidelines on Co-origination of loans by Banks and NBFCs. If they are extended to Non-Systemically Important ND-NBFCs with a minimum credit rating, it would encourage more of new generation lenders (fintech companies/those using alternate data for underwriting) to lend to this sector.

2. Increase the limit for non-collateralised loans to INR 20 lakh to address a significant proportion of MSEs needs. Similarly, Loans to SHGs may be made collateral free up to INR 20 lakh, as against INR 10 lakh at present.

3. MSME loan portability, if simplified and made seamless, will help several MSMEs.

4. Design of insurance products that address the special needs of MSMEs at affordable prices should be encouraged by IRDAI. Also, Trade Credit Insurance needs to be publicized widely by IRDAI.

5. Policy makers should regularly participate in industry summits and seek continuous feedback to make appropriate policy changes meeting the needs of this vibrant sector.

Recommendations for the Government

1. With introduction of GST, turnover based definition of MSMEs is more suitable and progressive. Under the new tax regime, turnover details of enterprises are being captured by Goods and Services Tax Network (GSTN) and turnover declared by GST registered MSME units can be easily verified through GSTN. Therefore, as proposed by the government, the new turnover based definition of MSMEs should be implemented, and such definition should be reviewed from time to time to ensure that it reflects the market dynamics and the changing economic scenario.

2. There is a need for increasing the number of Facilitation Councils, especially in the larger states and states with higher volume of MSMEs. Also, the scope of Facilitation Council is currently limited to redressal cases of Micro and Small enterprises only. Medium enterprises supplying to large corporates are deprived of redressal forum and therefore, the scope of facilitation council should be extended to Medium enterprises as well.

3. Conduct awareness campaigns to ensure that the schemes designed for the MSME sector are availed by all beneficiaries.

4. Currently, State Finance Corporations' contribution is not very efficient, and the state governments need to relook at the functioning of SFCs.

5. Government should partner with private sector for capacity building especially for skilling and technology development.

6. Government should also look at creating a platform that would encourage and facilitate impact/angel funds. Further, raising funds from multi-lateral institutions could be explored.

7. Government should look at strengthening “Cluster Development Program” in India as it has been highly effective in various developing economies. Such a program will ensure seamless flow of data and focussed approach towards application of developmental strategies. Clusters are geographic zones which house enterprises of similar size, producing similar products and/or services. Such Cluster development ensures efficient policy and resource dissemination. It is more focussed approach to development of the sector and helps in addressing issues such as lack of awareness and insufficient participation in developmental programs and schemes by the government.

8. More tax sops and incentives to encourage MSMEs introducing or upgrading technology should be introduced.

9. The IBC provides for a differentiated regime for insolvency/ bankruptcy of firms, proprietary firms and individuals. Detailed legislation in this

regard will help in increasing predictability regarding recovery of default loans of MSMEs and therefore boost lender confidence leading to reduction in credit gap.

10. Creation of a unique id for single identity of enterprises across all registrars will bring in formalization within MSME sector. Further, it will facilitate deduplication, fraud detection, and electronic verification.

11. Usage of platforms like GeM and TReDS should be made mandatory and heavy penalties should be applied for delayed payments noticed through these platforms as many MSMEs hesitate to complain against the large corporates/buyers owing to huge difference in negotiating power.

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Articles by Industry Thought Leaders

1

Sandeep Bakhshi
MD & CEO
ICICI Bank

India's economy is vibrant and complex. For us to achieve higher growth, it needs concerted effort across the economy. However, one of the quickest ways for us to move towards the $5 trillion target by 2024 is to make sure that the MSME sector functions at its peak efficiency.

This is vital because MSME sector is the backbone of the economy, as it contributes almost one-third of the country's economic output and employs over 110 million people.[1] Moreover, the sector produces 33% of the total manufacturing output and more than 45% of Indian exports – making it a crucial contributor to India's growth. [2]

The endeavour to improve the MSME sector in India must begin from a vantage point of ensuring a holistic approach by lenders, regulators, policy makers and MSMEs together. Some of the vital focus areas include infrastructural reforms, sectoral reforms, bringing in conveniences of digital services and timely credit. Further, their credit worthiness should be assessed using innovative ways. A lack of expeditious and hassle-free formal credit not only hampers the daily business activity of a small enterprise, but also greatly reduces its bargaining power, impacting its ability to choose the most efficient vendors and finance the supply chain. At the same time, their business remains highly vulnerable to externalities and even one slow month can put their expansion plans on the back burner indefinitely.

There are nearly 63 million MSMEs operating in the country today. As per reports, the credit requirement for MSMEs in the country is pegged at about Rs. 45 trillion, of which only Rs. 25 trillion is met by the formal credit mechanism. Thus, a financing gap or opportunity for scale up in financing of about Rs. 20 trillion (40% of the total demand) exists [3]. This need is currently met by informal channels such as family, friends and moneylenders.

- <u>Impediments to MSME funding</u>

  The major reason why MSMEs are lagging behind in access to formal credit is the lack of formalisation in the sector. More than 95% of all MSMEs function as proprietorship / individuals with limited formalisation such as financial records.[3]

1 https://msme.gov.in/sites/default/files/Annualrprt.pdf

2 https://www.livemint.com/news/india/msme-ministry-to-work-towards-promoting-economic-growth-create-jobs-gadkari-1559633062869.html

3 https://msme.gov.in/sites/default/files/Annualrprt.pdf

As a result, credit decisioning is impeded because banks cannot do proper risk assessment owing to the lack of financial information, historical cash flow and P&L accounts. This also ties in with the fact that very few MSMEs are able to attract institutional equity support or venture capital financing.

In summation, credit flow to MSMEs is restricted due to this informational asymmetry where a lender is tasked with not only providing low cost, low value credit to MSMEs but also assessing their credit risk position based on limited financial data and historical benchmarks.

As a result, the underwriting follows a 'high-touch' approach which involves more time, effort and manpower that directly translates into higher operating cost making MSME lending unviable for some lenders while reducing incentives to expand the coverage for most others.

The problem is exacerbated due to lack of lender coverage in the remote parts of the country where the depth of formal credit keeps thinning as one goes from a big city to a smaller town and finally to a district composed of far-flung villages.

Traditionally, credit risk assessment models involve a score card which rate the potential borrower across various indicators that predict their ability and willingness to service the loan. The traditional system is not only expensive to administer but also results in high turnaround time.

Digital innovation is the answer

The way to overcome these challenges lies in digital transformation of both the lenders and the borrowers. By utilizing innovative solutions such as digital Know-Your-Customer processes, online applications as well as e-signatures, GSTN, account aggregators, e-NACH, E-LIEN among others, banks/financial institutions can effectively speed up the onboarding process without having to deploy additional resources. At the same time, digital technologies provide a firm backbone to the underwriting process which benefits from having large data pools that can deliver both intelligence and insights.

The crucial bit here is that financial institutions should step into the new-age lending paradigm with absolute customer-centricity in their business models. The aim should be to remove friction and build a sustainable lending practice.

❖ Key infrastructural requirements

The path towards a well-funded MSME sector traverses the road to infrastructural development and support. The vibrant ecosystem of this sector requires urgent attention and concerted action in terms of infrastructural support to not only help with formal credit but also to improve their overall quality and competitiveness.

Currently, the MSME sector seems fragmented and concentration of business hubs in a few towns and regions makes it difficult for these enterprises to seek institutional support or compete with their bigger peers.

The scale of MSME sector as a whole is formidable but it requires policy interventions as well as collective action to propel each individual unit into a velocity path of economic prosperity with global competitiveness.

Major infrastructural pillars that can boost MSME sectors in India include the following:

1. Access to technology

In the digital age, all infrastructural development must rest on the pillar of technology. A key component of growing MSMEs is to make it easier for them to access advanced technology and use it to improve their business processes – inbound and outbound. Even as the proliferation of smartphones and inexpensive data has brought the entrepreneurs online, their organizations must catch up too.

There's a role to play here for all stakeholders including lenders who can come together to hand-hold the businesses through their digital transformation journey and incentivize them to use the latest technology in order to make them more competitive.

2. SME incubators

While 'clusters' can provide MSMEs with the right policy support and peer-groups to achieve competitiveness, SME incubators can provide the environment conducive to high-end innovation. Cutting edge technologies, expert guidance as well as venture capital funding are all advantages of incubators. The government currently provides financial assistance to set up business incubators, but the key objective is to fast-track the creation of incubators as well as induction of MSMEs – both technology and non-technology-based enterprises.

3. Entrepreneurship and Skill Development

To fully harness India's demographic dividend, efforts must be aligned towards introducing entrepreneurship and skill development to current and potential entrepreneurs. Be it soft skills or technical skills, business owners can greatly benefit from a well-conceptualized skill development program that not only trains them in the ways of doing business but also keeps them on the path of greater efficiencies.

At the same time, these programs can serve as great induction tool to get new and potential entrepreneurs to take the leap and enter the vibrant MSME sector in the country.

Apart from the above listed pillars, focus must not move away from imparting financial literacy as social and economic inclusion begins with financial inclusion. Financially literate and aware citizens make good entrepreneurs and enable their organizations to take maximum advantage of various incentives and benefits on offer across programs.

4. Cluster development

A major thrust of infrastructural development for MSMEs includes building clusters which are defined as geographically proximate zones housing enterprises of similar size and producing similar kinds of products and services.

By focusing on comprehensive cluster development across the country, efficient resource and policy dissemination can be achieved. For instance, MSMEs in a cluster can obtain concentrated flow of resources, information as well as funding which can help them grow out of that cluster and compete nationally – and globally.

At the same time, clustered MSMEs can become a rich source of data and information for all institutions to avoid redundancies as well as improve the innovation potential.

Currently, the Ministry of MSME runs the cluster development initiatives in the central government. A replication of the model at a local government and state-level will also provide another impetus to ensure a vibrant cluster model of MSME growth and advancement.

❖ A holistic approach

To unlock the value of India's MSME sector and create opportunities for both the businesses and the lenders to capture this growth, a holistic view must be taken. If all the actors work together in this initiative, the potential value unlock compounds exponentially.

The common goal should be to ensure that a larger number of MSMEs every year reach the maturity stage from the startup stage and many of them go on to become billion-dollar enterprises over the next decade. This will require a holistic change in both philosophy and action from all the stakeholders involved. There's a need to develop a new framework for these enterprises whereby they can seize the domestic and global opportunities. Everyone has a role to play in this transformation and the following pointers list down some of the opportunities that lie before us.

Borrowers

MSME borrowers must be made aware of the various ways in which they can improve their chance as well as cost of funding. Lenders and industry associations must take the lead on this and inform the MSME borrowers about formal credit and how should they go about availing it.

As a beginning, it must be ensured that borrowers file their statutory returns regularly with the government. At the same time, they should encourage independent audit of their books in a timely manner, depending on the size and nature of the business.

At the same time, they should be incentivized to do digital transactions and move to digital business processes such as e-contracts and e-signatures. This will not only lend security to their business but also provide relevant financial footprints for lenders to assess credit needs and serviceability better.

MSME borrowers can hugely improve their business competitiveness as well as credit eligibility by being part of government initiatives such as Udyog Aadhaar and Zero Defect Zero Effect. By registering for the latter, they can get concessions on interest rates, processing fee as well as faster approvals while availing loans.[4]

Alongside, it is also incumbent on all the sectoral stakeholders to help create awareness towards credit behaviour of MSMEs. With the rise of credit bureaus, digital trails of credit history, it is important for MSMEs to consciously build the credit history of their firm as well as of the proprietor / partners to enable timely available credit from formal sources of credit.

Bankers

As bankers, the most attention while designing the MSME lending plan should be paid to the goal of removing hindrances from their business instead of creating them. The industry here has a role to play by incentivizing entrepreneurs to obtain formal credit by:

- Moving from traditional risk assessment models to alternate data-based models which take into account for example, cash flows, GST returns and point-of-sale machine data
- Disbursing digitally to remove the paperwork and hassle from the process
- Improve MSME support system by regularly collating and disseminating information on market making initiatives to the borrowers. This could include information like business trends and latest research on tariff guidelines for export among others.

[4] https://zed.org.in/

- Introduce purpose-based very short term lending especially for new-to-credit borrowers for specific uses like tax payments, payment of invoices and utility bill payments. It will act as a stepping stone for many MSMEs to come into the fold of formal credit, hitherto unable to get a credit line.

Systemic changes

Some of the major systemic initiatives to propel MSME growth can include:

- The proposed amendment to the definition of MSMEs based on their turnover instead of their investment is a good step to rationalizing the space and levelling the playing field for both service and manufacturing companies. [5]

- MSMEs can further be advised to upload all their invoices on an Information Utility set up by the government. Continued non-payment by their vendors could be disclosed on the authority's website to ensure that MSMEs get timely responses to their bills. It will also bring in payment discipline in the sector for all stakeholders.

- Evaluate creation of seed fund pools to channel venture capital in the MSME sector. For example, the Govt. of Israel owned Yozma Venture Funds, was successful in attracting capital amounting US$263 million. In turn, these funds invested in 164 start-ups.[6]

- An information utility collating crucial financial information about MSMEs can be built. This utility will not only provide information on business vintage, but also on GST payments, direct tax payments, PF and ESI as well as net worth of the promoters.

- Combined with informational utility and personal guarantees, the industry can assess a new credit scoring mechanism for the MSME segment which allows for digital finance

[5] https://economictimes.indiatimes.com/news/economy/policy/government-to-soon-change-definition-of-msmes-nitin-gadkari/articleshow/71705230.cms

[6] https://rbidocs.rbi.org.in/rdocs//PublicationReport/Pdfs/MSMES24062019465CF8CB30594AC29A7A010E8A2A034C.PDF

- Evaluate the possibility of creating an institutionalised method to let MSMEs check credit ratings of their buyers, based on consent, through their primary bankers in order to ensure fair business and due diligence

Many of the above mentioned initiatives are already under discussion and when implemented can give the MSME sector a boost.

❖ Innovative initiatives by ICICI Bank for serving the needs of MSMEs:

We believe that 'ease of doing business' and 'digitisation' are key parameters for the growth of the MSME businesses. Also, MSME customers need quick delivery of services and credit. In order to fulfill their requirement, we have implemented digital and data led processes so that they save time and bring in greater efficiency into their businesses.

With this guiding principle, we have taken a fresh approach to serving the needs of the MSMEs and have digitised solutions across the entire spectrum of life-stage of the MSMEs—from inception to working capital needs to growth-- that can enable them to transact seamlessly and grow to their maximum potential.

A brief overview of these innovative initiatives is below:

- Digital application form for opening current accounts in a few hours, without visiting a bank branch. Developed at our innovation center with a start-up, the 'Smartform' uses state-of-art technology like 'Application Programme Interface'(APIs) to validate KYC documents and 'Optical Character Recognition' (OCR) that recognises written characters in documents and auto-populates them seamlessly and accurately.
- Instant overdraft facility for MSME customers in 3 clicks, in a completely online and paperless manner. An industry first, it leverages on data analytics, it enables lakhs of pre-qualified current account customers of the bank to instantly get an OD facility of upto Rs 15 lakh using the bank's internet and mobile banking app. There is no requirement to visit a branch and submit physical documents.

- Overdraft facility based on a new credit assessment parameter of turnover of GST reported in the Goods and Services Tax (GST) returns of MSMEs. This path breaking facility is available to any MSME including non-customers of ICICI Bank for loans upto Rs. 2 crore.

- Digital online platform for simplifying export-import transactions that enables corporates, as well as MSMEs, to undertake almost all their cross-border transactions online. Additionally, 'Trade Online' is the first digital banking platform to offer quick and convenient credit of inward remittances within minutes.

- A comprehensive and dedicated mobile application, InstaBiz for MSMEs encompassing over 115 services. It allows MSMEs and entrepreneurs to undertake almost all business-banking transactions digitally and on-the-go. It brings in unprecedented convenience for them by eliminating branch visits for transactions; providing access to instant OD even to non-customers of the Bank; instant tax-payments, inward remittances among many others. We believe that this 'all-in-one' digital platform service will provide easy banking services to MSMEs, free up their bandwidth from paper-intensive procedures and thus boost their business growth by improving overall productivity and efficiency. It has received an encouraging response with over a million downloads within a short span. In the first 100 days, we saw number of transactions in the segment surge by 35%, while over 30% of cash management services, trade and OD attachments also moved to this app.

- Digital Point-of-Sale (PoS) application on a mobile application, Eazypay. It enables merchants / retailers and professionals to collect payments from their customers through multiple digital modes like including Unified Payment Interface (UPI), credit / debit card & internet banking of any bank, Aadhaar Pay, Bharat QR Code and 'PocketsbyICICIBank' digital wallet. Also, MSMEs can undertake innovative services like instant and paperless application for card-swipe machine and bar code scanning for instant invoicing.

- An API Banking portal that offers 250 APIs of the Bank, to help foster rapid innovation and co-creation with businesses. MSMEs including start-ups can now seamlessly sign up on it, create an application, select the application, test it out and get the sample code to bring out new customer solutions in a frictionless manner, all from the convenience of a single portal It will also boost productivity for them, as they can now partner with the Bank in a short span of time ranging from just a few weeks to few days as compared to the few months taken earlier.

- An integrated payments solution called 'Connected Banking' using which the bank has tied up with popular ERP solution providers to MSMEs. The solution provides immense convenience to MSMEs, who hold current accounts with us to undertake a host of banking transactions such as payments and reconciliation of entries from within the ERP software itself, without having to toggle between a banking platform and ERP screen. It allows MSMEs to seamlessly connect their banking and accounting, which was once available only for large companies with large IT and infrastructure budgets.

❖ A fresh look at reforms

Overall, the MSME sector in India is well-primed to continue contributing to the country's growth year on year. However, it is crucial for stakeholders to find ways to support the sectoral efforts in order to make it globally competitive and unlock the economies of scale and ecosystems.

The reliance of the country's economy, exports, manufacturing output as well as workforce on the sector makes it critical for it to be continuously growing and optimising. Some of the reforms and new approaches that would enhance the MSME industry are:

- Advanced credit assessment: Lenders including new-age startups are piloting proprietary credit assessment workflows which leverage machine learning and artificial intelligence to assess the credit risk of SME borrowers even with minimal traditional financial data. These surrogate systems must evolve to include more information such as

GST filings and PF outflows backed by personal guarantee to improve the underwriting as well as credit decision making.

- Ecosystem approach: The days of silos are over. In the digital age, lenders must seek to build capacity and industry benchmarks by collaborating with their new-age peers, NBFCs, startups as well as technology companies to build more robust models as well as capture data through platform integration.

- Video KYC: To further accelerate customer onboarding and reduce the marginal cost of acquisition, lenders should seek to adopt video-based KYC tools which can enable non-physical customer onboarding and shorten the timelines further.

- TReDS: The Trade Receivable Discounting System, an online discounting platform that was instituted for MSMEs to liquidate their trade receivables has witnessed spectacular growth over the last couple of years. Additionally, an awareness drive can be undertaken outside the metros to replicate its success in the big cities.[7]

- Co-origination: To improve the flow of credit, co-origination of loans has already been introduced. It can be scaled up further by the industry participants.

- Digital as a way of life: The most crucial bit of change has to come from within all of us and that's embracing digital as a way of life. The whole philosophy needs to be adopted by all stakeholders for these efforts to succeed. Digital payments have proved that the glide path to rapid formalisation is very achievable. The same has to be replicated now in other areas of MSME operations and the industry will do well to build a digital DNA for a future ready organisation.

[7] https://economictimes.indiatimes.com/small-biz/sme-sector/treading-the-right-path-for-cash-starved-businesses-treds-can-be-an-invaluable-lifeline/articleshow/68369054.cms?from=mdr

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R. Gandhi
Former Deputy Governor
RBI

The impediments to MSME funding arise from both endemic and external factors. First, it is a very common, but unhealthy practice of MSMEs that their official financial statements do not fully reflect the true picture of their financial position. Under invoicing of their turnover and over invoicing of their costs, with the mistaken belief that it will fetch them benefits in terms of low or nil taxation, is a common malaise. As their official financial statements do not reflect the real picture, the formal financial system that heavily relies on financial statements is forced to assess the funding requirements of the MSMEs to be much lower than what they will actually need. Secondly, the customers of many MSMEs are either the departments of various governments and large corporate entities. Unfortunately, both the government departments and the large enterprises typically indulge in unhealthy practice of delaying payments to MSMEs. The delay ranges anything from six months to as long as one year. This unfair and exploitative behaviour of the government departments and the large enterprises results in the formal financial system deems such long pending receivables not only as ineligible to be financed, but also classify such MSMEs as of higher risk to be financed. Thirdly, many MSMEs and their promoters do not have much collateral to be offered to get financing of their endeavour and the formal financial system places heavy reliance on collateral, despite contrary regulations and advice. This results in under funding of the financing needs of the MSMEs. Lastly, though the Reserve Bank policy towards financing MSMEs has moved away from the Tandon and Chore Committees norms, many formal financial entities still rely heavily on those norms. This many a time results in inadequate funding of the MSMEs.

MSMEs infrastructural needs span multiple areas of MSME value chain. Availability of power, access to scientific and efficient logistics, and marketing and sales infrastructure are the critical requirements.

Different measures that should be taken by different stakeholders are as below.

a. Borrowers should do

- Borrowers need to be truthful about their financial statements. This will help them get adequate financing, at right times, from the formal financial system.

- MSME Borrowers, especially the micro and small entrepreneurs, should strive to get financial literacy; they should understand the distinction between return on capital and cost of capital, the profits versus wages for their own service.

b. Bankers should do

- Bankers should have empathy for the MSMEs. They should have a good appreciation of the travails of an MSME and pragmatic about the situation.
- Bankers should enhance their model of credit appraisal on MSMEs with reliable alternate data and information, beyond formal financial statements.
- Bankers should move beyond Tandon and Chore Committee norms in assessing the working capital credit needs of the MSME borrowers and be realistic about the account receivables.

c. Policymakers should do

- Policy makers viz., government should inculcate a sense of urgency in the minds of the bureaucracy in settling the bills of the MSMEs promptly.
- A new policy - making government a partner in the MSMEs, especially the micro and small enterprises, by capital contribution, not as a subsidy - needs to be framed.
- MUDRA Ltd, or a new entity, should be a market maker in purchasing and discounting the bills of MSMEs
- Government should enable access to GSTIN data relating to MSMEs by the formal financial system for making the credit appraisal robust.

d. Regulators should do

- The regulators should examine whether the prudential norms applicable for the MSME financing can be tweaked based on country's needs.

- The regulators can explore an automatic debit mechanism for MSME dues of large enterprises and government departments.

Fresh approaches needed will be to explore how the cash flows of the MSMEs can be made robust, to design identified/ new entities to specialise in this respect, legal/ regulatory framework for smooth and prompt cash flows, continuous financial literacy for MSME entrepreneurs.

Reforms should actually start from within the MSMEs themselves. Financial awareness and commitment to financial discipline as a culture are fundamental to any other reforms to be effective. Legal enablement of recovery of dues of MSMEs will go a long way in redressing the MSME financing problems.

3

Shyam Srinivasan
MD & CEO
Federal Bank

MSME: India's Goldmine to Growth!

There's absolutely no argument whether MSME, as a sector, is India's precious resource as also the most significant opportunity in our pursuit of growth! The relevance of the Micro, Small, and Medium-sized enterprises in a growing economy like us, has gained increased attention in recent times, primarily by the scale it can grow as also its strategic importance for equitable growth.

Broadly, the sector forms an integral part of the Indian Economy, be it Manufacturing, Services or Exports, contributing around 28% of India's GDP and over 48% of overall exports. It also plays a significant role in employment generation – especially since there are over 63 million MSMEs in various industries currently, employing close to 111 million people. It generates the largest employment opportunity at comparatively lower capital cost, next only to agriculture. Of these, nearly 20% are women-led enterprises, and close to 51% are based in rural areas.

Today, we, as responsible citizens and corporates, are integral to the national vision of taking the Indian Economy to the aspirational 5 trillion $ by 2024. Here, we must be mindful, this was something China could achieve almost 11 years back, and that too in a rather different world! They maintained a consistent 9.5% growth rate across four and half decades, brought in a lot of infrastructural enablers in being the 'Factory of the 'World' and now at a position almost four times that of our economy.

To achieve our vision for 2024, it is imperative that the operating rhythm of our economy punch above its weight, and MSME, being the anchor sector for exports and a Goldmine of an opportunity for India, holds the key. With a *blend of frugal innovation, entrepreneurship, demographic strength and people,* this is one sector which can record highest levels of growth in the ongoing decade. For Lender's too, this sector would be an attractive business opportunity, undoubtedly.

Analysis of lending data pertaining to MSME sector will give an idea on what's the unleveraged funding opportunity in that space. While the total outstanding is roughly INR 18.3 trillion (approximately 28% of the net commercial credit outstanding), the total addressable demand of formal credit is estimated at over 37 trillion. It is evidence to a huge overall credit gap in the MSME sector by roughly 20 – 25 trillion. Hence, it is axiomatic that a business realignment towards MSME lending is the antidote to the ills afflicting the Indian banking system currently. It is also proof to the relevance of this event, organized by ASSOCHAM, addressing the 'Structural Reforms of MSME Funding'!

About the lending gap and the opportunity thereof, we should consider two aspects, one, from a borrower stand point of view and, two, from lenders.

When we analyze the borrower spread from this sector, on almost every count, it is more or less similar to the varied demographics of India. *The gap (in scale, technology, people, borrowings etc.) between the smallest micro player to the other extreme end of the sector is ginormous*. But the lending system is yet to evolve to a level where it can clearly differentiate the players, and bring in ease of operations at every level of the sector.

Another issue that's heard the most often, hurdling the lending process is about the discipline of the borrower and the availability of sufficient documentation to swift through the process. They also face the high cost of credit which does not reach them on time, lack of access to equity, and collateral-related issues.

Remediation to this, is certainly about capacity building and in embracing Technology. In the last decade, the differentiator to success and scale, in highest probability, was technology. MSME should actively utilize technology for bringing down overall risk, integrate with effective supply chains, through transformation tools such as AI and IoT as also, adopt eco-friendly manufacturing practices, green technologies and resource recycling.

Now, from a Lenders perspective, the challenge is to ensure the process of lending is smarter, faster and cheaper. Through effective use of technologies like RPA (Robotic Process Automation), lenders should seek to develop robust as also 'easy-to-operate' onboarding machinery, that should aim to differentiate players with respect to their scale of operations. The system must be strengthened with capability in accessing surrogate data sources and make the overall user interface convenient, for onboarding, documentation, credit underwriting and monitoring.

Let me share a few significant highlights about MSME Lending in India:

- MSME Segment (with aggregate credit exposure of up to INR 50 Crores) constitutes 18.3 Lakh Crores outstanding (~28% of net commercial credit outstanding). Aggregate MSME lending as a proportion of the GDP has increased steadily to approx. 15%.

- Credit growth stood at 7.7%, 4.6%, and 1.9% for micro, small and medium enterprises, respectively, between September 2018 and September 2019. It is important to analyze the growth in MSME lending from the perspective of the overall macroeconomic environment to get a better picture of the improvement in financial access / lending intensity.

- Public Sector Banks who traditionally have been the largest lender to the MSME Segment, account for 60% of lending in Micro segment. The share of PSBs and Private Banks in Small segment of borrowers is comparable, with each having a market share of ~44%. NBFCs' share in the small and medium sized enterprises' lending segment is higher compared to the smaller and less formal MSME Segment.

- Over the last few years, Private Banks and NBFCs have successfully managed to gain market share from Public Sector Banks on MSME lending. However, in the quarter ending Jun'19, the share of NBFCs had declined for the first time in the last two years. NBFCs have also witnessed an increase in NPA rates in the quarter ending Sep'19.

- Non-performing assets (NPAs) of medium, small and micro enterprises (MSMEs) have risen 50 basis points (bps) to touch 12.2 per cent as of September 2019, as against 11.7 per cent in September 2018, according to data from Trans Union CIBIL.

- Study on vintage distribution of borrowers acquired in Q2 of FY19 shows that there is a significant increase in the acquisition of lower vintage borrowers (with credit history of 1-4 years).

- The ongoing trend of increasing formalization as well as financial inclusion implies that the number of new MSMEs has been consistently increasing across geographies. NTC borrowers entering the formal credit sector have accelerated quite substantially.

  Providing access to credit for NTC MSME entities is largely enabled by PSBs which have about 78% contribution in <10 Lakhs segment.

Moving on to specific responses on the questionnaire shared:

The Key impediments to MSME funding include:

Apart from the impediments that are described above including, the following are key to note:

- Lack of compliance towards documentation, regulatory adherence and financial discipline on the part of MSMEs results in lack of information required by lenders to estimate the creditworthiness of the MSME.
- High risk of default - Lack of competitiveness due to inadequate infrastructure, skilled manpower, inability to adapt to new technology and innovations, ineffective business planning and marketing strategy, low productivity and low quality. It also calls for lack in a robust system level recovery/collection framework.
- Lack of awareness: Lack of knowledge among MSMEs on the benefits available to them in the form of Govt schemes, subsidies, subventions etc.
- Inadequacy of structured information: Paper based approach for assessment of actual business turnover and funding requirements does not work, when it comes to MSME funding. Non-availability of accurate information about the borrower results in inaccurate risk grading and thereby leading to tightening of credit terms, delay in processing and higher pricing. There is perceived higher credit risk involved in financing SMEs due to due to non-availability of valid invoices, proper accounting systems and lack of known buyers
- High transaction Costs: The transaction costs involved in financing MSMEs are very high due to their small size and local presence, which leads to higher pricing

- MSME units get impacted by changes in economic conditions very easily, unlike big players operating in similar business. This increases the risk of lending to MSME

Key infrastructural requirements to ensure MSME sector progresses on its growth trajectory:

MSME units continue to face infrastructural bottlenecks, which not only restricts their day-to-day business operations but also their future growth prospects. Earlier, in this note, we had taken an example of China's economic growth. In the period they surged, one of the most significant differentiating factor which propelled their growth was the improvement in Infrastructure. We need to be mindful, in our journey to the 5 trillion mark, that, as equally as we focus on exports, we should be concerned about building up Infrastructural capabilities so that the world looks at our nation as an ideal investment destination and as the 'Services' factory of the world!

In addition to ensuring building infrastructure including space, co-working infra, bridges, connectivity avenues, auxiliary infra etc., the system should improve the governance levels as also transparency in ensuring the overall speed of the sector isn't curtailed. To list out a few specific requirements, it can be as follows:

- Land - Easy availability, reduced cost and simplified / less time-consuming process for acquisition. Ample work space for industrial clusters to compete in international markets

- Cost effective and efficient logistics/supply chain infrastructure.

- Dedicated infrastructure like ready to move -in, built in factories with plug & play facilities.

- Supporting facilities like tool rooms, testing labs, design centers etc.

- Proper market linkages.

- Easy availability of Power (cost of service), Water and Waste Management

- Formation of new clusters with facilitation centers which provides for skill upgradation, technical/ financial/ regulatory advisory services etc.

- Time bound and more digitalized Govt/ local body approval process to avoid undue delay experienced in the present bureaucratical set up. This should come along with proper and strong escalation mechanism and accountability structure.

Three important things that Borrowers/Bankers/Policymakers/Regulators should do; in terms of propelling growth in the sector:

a. Borrowers should do

In simple terms, behaving like a 'listed' firm, helps players across the MSME space, to think and behave differently. It calls to:

- Develop quality conscious mindsets and compliance culture - Adopt best practices in accounting, ensure regulatory compliance, statutory reporting etc

- Focus on Capacity building especially in terms of business knowledge, skills and attitude, stay updated about the support provided by the Govt / authorities for development of MSME Sector and Enrol in Campaigns and schemes launched by the Government to avail the benefits offered by these initiatives.

- Embrace technology and thrust on Innovative practices, thereby improving efficiency.

b. Bankers should do

Key role for a banker is to ensure the end to end lending process is seamless. There are already several use cases of benefits that's derived out of using new age technologies like RPA; and this needs to be leveraged further.

Considering the range of the players in the sector, Banks must be ready with tailor made suite of products for each category and that means, on boarding for a micro or a small client will be different from that of a trader, and which will be less documentation intense than an entry corporate. It demands for structural changes, some of which includes:

- Utilise surrogate data from several sources, including GSTN, Income Tax, Credit Bureaus, Fraud Registry, etc which are available online for speedier and robust credit underwriting standards for MSMEs; Develop Innovative digital solutions to address barriers related to asymmetric information and collateral shortage.

- Focus on cash flow based lending or supply chain / cluster based financing.

- To venture into creation of an API-enabled ecosystem and move from a linear value chain business model to platform-driven business models.

c. Policymakers should do

- *Be the Buyer:* Government, by itself, is an important buyer in our market. Though there is a plethora of schemes such as the 'Make in India', one point which the Government/Policy makers must ensure is devise plans in buying what's made in India to the level best possible. In an increasing government spending year on year, which has almost breached 13% of our GDP, there must be preferential packages for the procurement of domestic goods and services, which would, in a way get them a captive market, in turn helping to get their payment cycles meet well.

- *Technology Upgradation:* While the government upgrades itself technologically, the effectiveness of these facilities can be fully realised only if all users are made aware about the technical know-how of these facilities. Hence there should be focus on transfer of information and skill development to ensure effective utilisation of transferred technology.

- *Decentralised Grassroot attention:* States to give a special focus to the growth and development of MSMEs sector to ensure percolation of the reform measures taken by the Govt at the grassroots, thereby facilitating growth of MSMEs and overall socio-economic development in the states.

d. Regulators should do

- Take measures to Improve the credit information infrastructure.

- Rating agencies may be encouraged to build scoring models that consider newer sources of data including utility bill payments, GST, entrepreneur psychometrics and personal credit history of the entrepreneur so as to make the rating products more relevant and predictive of credit performance.

- Encourage MSME players to get themselves rated.

- Rationalization and Creation of revised NPA norms (after detailed analysis of IRAC) for MSMEs / Corrective action plans for units turning sick due to market/economic etc to be made effective and moratorium for revival of the unit / Setting up a repository for filing defaults by MSMEs.

- Implement 'Digital Public Infrastructure' as recommended by the expert committee on MSMEs for cash flow based lending as it will reduce Loan Operating Costs and address information asymmetry which in turn will improve credit access and quality in the ecosystem.

MSME Lending: Federal Bank

- We have been pioneers in lending to MSMEs, all over the country. Our Vision Statement is the best testament to this focus: in being the 'Most Admired Bank, digitally enabled, and serving the Micro, Small and Medium Enterprises, in India'!

- Nearly 12% of our advance as of Q2, FY20, is under MSME. 61% of our SME loans fall under the category of MSME of which 51% under MSE category. Several of our new initiatives including process automation, simplified applications and process notes for schemes, alternate/simpler assessment method like GST based assessment, have helped to make to credit flow easy to the segment with improved TAT. A noteworthy development is the use of technology in automation of renewals ensuring superior client experience, and improving continuous available of funds.

- About the recovery and collections front, Federal Bank has taken several initiatives in the recent past, specific, to MSME collections. It included devising a new tool for aiding the enterprise in managing their daily collections routed through the bank account daily ensuring proper accounting, routing, EMI payments etc. ensuring financial discipline.

- We have, in place, supply chain based financing and is currently working on Cash flow based lending product based on POS transactions. The Bank is also in the process of developing a digital portal for offering pre-approved loans / cash flow based products

5 most critical reforms, the system should adopt (the section-Three important things that Borrowers/Bankers/Policymakers/Regulators should do; in terms of propelling growth in the sector explain this, however, key 5 reform measures are highlighted below)

- Implementing Turnover based classification of MSMEs. This would eliminate the need for frequent inspections which is now required to check the investment in plant and machinery. It would be a non-discriminatory, transparent and objective criterion.

- Digital transformation holds potential to improve SME access to finance. Innovative digital solutions to address barriers related to asymmetric information and collateral shortage need to be developed. This would also require regulatory framework to support novel developments, while ensuring financial stability, consumer and investor protection at the same time.

- Cluster based approach for MSME units to be linked with infrastructure for storage, value-addition, marketing, export etc.
- Single window system to be made truly effective and technical/ marketing/ economic handholding till the unit become viable and self-sustained
- Relook at the multiple definitions of MSME in MSME act to improve the ease of doing business.
- End to end digitisation of project/ business approval process by Govt and Local Bodies

4

HDFC Bank

Authored by

Rahul Shyam Shukla
Group Head
Corporate Banking and Business Banking

Sumant Rampal
Business Head
Business Banking and Healthcare Finance

Dhanish Kothari
Strategy and Product Head
Business Banking and Corporate Banking

A Tribute to Our Nation Builders

1. Introduction

MSME banking is an industry in transition. From a market that was considered too risky and difficult to finance, it has now become a strategic target of banks in India. There are several reasons why such a mind-set shift has happened which will continue to have far-reaching consequences for the Indian economy over the next several decades. HDFC Bank continues to remain focussed in its efforts to be the premier MSME bank in the country. Over the last 5 years, the Bank has increased its MSME client base four fold. This trend is expected to remain robust.

a. Government has played a very strong role in supporting MSME sector through active intervention, including qualifying lending in this sector largely towards priority sector lending requirement of banks. Passage of time has proven that MSME lending celebrates the Indian ethos and value systems, that our entrepreneurs conduct business with integrity.

b. There is a strong importance of the MSME sector to the national economy as a whole. As per the reports by the SMB Chamber of Commerce and the Ministry of Micro, Small and Medium Enterprises, India currently has more than 63.4 million MSMEs [Table 1]. The Micro sector with 630.52 lakh estimated enterprises accounts for more than 99% of total estimated number of MSMEs. Small sector with 3.31 lakh and Medium sector with 0.05 lakh estimated MSMEs accounts for 0.52% and 0.01 % of total estimated MSMEs, respectively. Out of 633.88 lakh estimated number of MSMEs, 324.88 lakh MSMEs (51.25%) are in rural areas and 309 lakh MSMEs (48.75%) are in the urban areas [Table 2].

c. MSMEs contribute more than 45% of India's industrial output, 45% of the country's total exports and create 1.3 million jobs every year. MSME's provide employment to around 120 million and account for close to 6.11% of the manufacturing GDP and 24.63% of the GDP from service activities. This sector has been growing at a decent pace year on year in the past few years. As they prosper in our remotest areas, providing full banking services from wholesale to retail banking offers an untapped growth potential to banks for several decades. Alibaba in China is a successful example of a model built around MSMEs.

d. There have been several MSMEs in the last five decades which have transformed into successful, globally important large corporates. This trend will continue as India moves towards becoming a $10 trillion economy, lower in size only to US and China. A variety of studies show that the bank which supports a SME benefits from receiving the largest wallet share when such an entity becomes a large corporate.

e. With digitisation, banks have understood well that cashflows received by MSMEs are from governments and large corporates. Combining lending against security as well as cashflows lends itself to facility ratings much better than that of the underlying obligor.

f. Elevated NPA in the banking sector has brought home strongly the perspective and urgent requirement for movement towards granular lending. MSME lending has held up well in comparison with large corporate lending from an NPA perspective.

Table 1: Distribution of Enterprises Category Wise (Numbers in Lakhs)

Sector	Micro	Small	Medium	Total	Share %
Rural	324.1	0.8	0.0	324.9	51
Urban	306.4	2.5	0.0	309.0	49
Total	630.5	3.3	0.1	633.9	100

* Data source - Annual Report - Ministry of MSME, GOI

Table 2: Estimated Number of MSMEs (Activity Wise)

Activity Category	Estimated Number of Enterprises (in Lakh)			Share %
	Rural	Urban	Total	
Manufacturing	114.14	82.5	196.65	31
Trade	108.71	121.64	230.35	36
Other Services	102	104.85	206.85	33
Electricity*	0.03	0.01	0.03	0
Total	324.88	309	633.88	100

* Data source – Annual Report – Ministry of MSME, GOI

HDFC Bank has had a focused approach towards the MSME Segment. To connect its clients to the digital highway, the Bank has a comprehensive Digital SME Bank platform for its SME customers. A wide reach across geographies of the country – district by district, and understanding of local level business dynamics has helped HDFC Bank in achieving growth rates higher than the industry average. The Bank understands the particular needs and preferences of SMEs, and is developing tailored approaches to overcome the historical challenges of high credit risk and cost to serve this segment. The SME segment is served with a focussed relationship-based model.

2. MSME Market and Growth of Advances

Total credit exposure stood at Rs 116.7 Lakh Crores as of Mar ’19 of which the Corporate segment holds the largest share of 55% with exposure of Rs 65.5 Lakh Crores. The remaining exposure of Rs 52.6 Lakh Crores belongs to Individual Lending, including Consumer Lending, Business Lending and other Retail, Agriculture and Priority Sector lending.

While commercial credit has been steadily growing over the past few years, it slowed down in the quarter ending Jun ‘19. The YOY commercial credit growth was at 10.4% in the quarter ending in Jun ’19. However, a QoQ comparison shows that Jun ’19 quarter ending exposure is lower by 2.6% over Mar’19.

The total on balance sheet commercial lending exposure in India stood at Rs 63.8 Lakh Crores, as of Jun ’19, with Micro and SME segments constituting Rs 15.7 Lakh Crores exposure (~24.5% of commercial credit outstanding). Large corporates having aggregated credit exposure of more than 100 Crores, account for Rs 42.4 Lakh Crores (~66.5% of commercial credit outstanding). Micro Loans (less than 1 Crore) and SME Loans (1 Crore-25 Crores) in the commercial lending space experienced YOY growth of 12% for the period Jun’18 - Jun’19. While Mid Market (25 Crores - 100 Crores) segment has grown just by 3.6%, Large (>100 Crores) segment has shown reasonable growth of 10.8% from Jun’18 - Jun’19.

	Micro <₹1 Crore	SME ₹1-25 Crores	Mid ₹25-100 Crores	Large >₹100 Cr	Overall
Jun'17	3.27	8.09	4.97	34.45	50.77
Sep'17	3.48	8.47	5.17	34.75	51.86
Dec'17	3.74	8.88	5.40	36.40	54.41
Mar'18	4.04	9.59	5.50	37.82	56.95
Jun'18	4.13	9.86	5.52	38.30	57.81
Sep'18	4.29	10.03	5.54	39.88	59.73
Dec'18	4.58	10.59	5.75	41.15	62.08
Mar'19	4.78	11.40	5.91	43.43	65.52
Jun'19	4.62	11.04	5.72	42.42	63.80
Y-o-Y growth (Jun'18 - Jun'19)	12.0%	12.0%	3.6%	10.8%	10.4%

Exhibit 1: On Balance-Sheet Commercial Credit Exposure (In ₹ Lakh Crore)

Source: TransUnion CIBIL

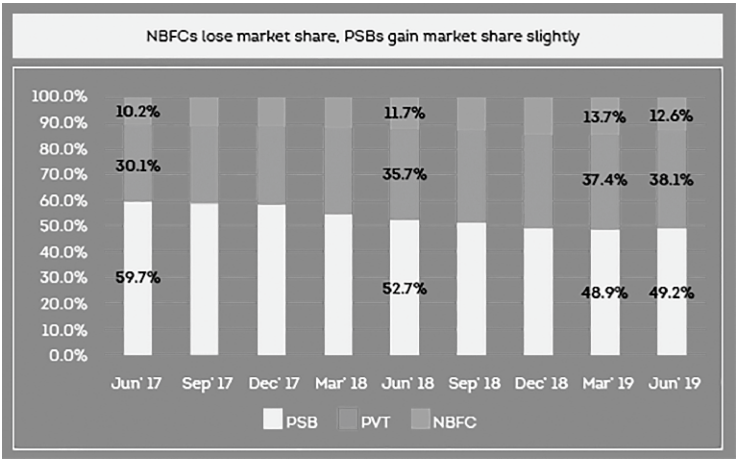
Public Sector Banks have traditionally been the dominant lenders to the MSME (Micro and SME Segment) sector. In last few quarters prior to Jun’ 19, Private Banks and NBFCs have gained consistently in market share of the MSME sector; especially NBFC’s considering their reach and leaner structure.

- Private Sector banks, lending to MSMEs has grown by 16.4% from Jun'18 - Jun'19.

- The market share of Private Banks in MSME lending has increased to 38.1% in Jun'19 from 35.7% in Jun'18.

- The market share of public sector banks in MSME lending has shown quarterly growth from 48.9% to 49.2% from Mar'19 to Jun'19.

- NBFCs market share has reduced from 13.7% to 12.6% between Mar'19 and Jun'19 due to certain contemporaneous factors.

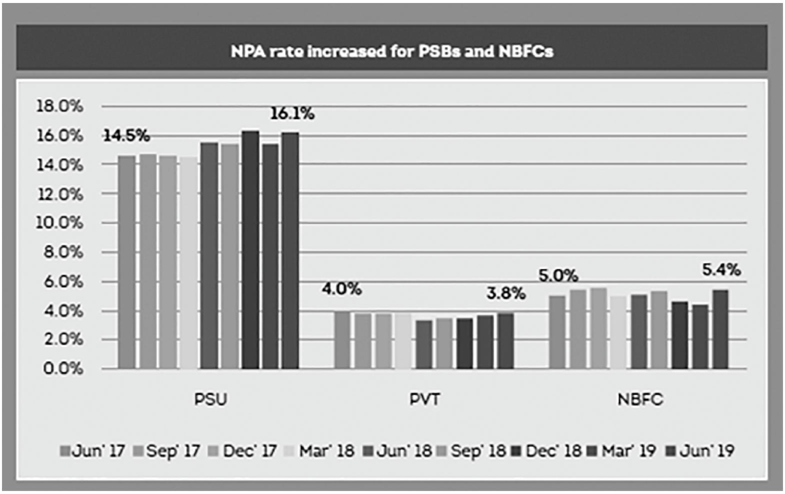


* Data source – SIDBI TransUnion report Oct'19

Sectors, which are the most dependent on NBFC funding, include Transport & Logistics which have 35% dependency on NBFC finance. Other sectors like Real Estate, Education, Healthcare, Mining and Construction are also heavily dependent on NBFCs for their credit needs. These are sectors with large cash conversion cycle and require term loans for their operations and hence NBFCs are able to cater to their credit needs. With recent NBFC crisis, these sectors have also got impacted due to lack of credit from NBFCs. Sectors like Food Manufacturing, Chemicals, Textiles, Auto Components, which typically have large parts of their requirement as Working Capital Loans have comparatively lower dependence on NBFCs for their credit needs.

3. NPA in MSME Segment

Private Banks have NPA levels in the range of 3% - 4% in the MSME segment. Within this, New Private Sector Banks on an average have the lowest delinquency rates. The NPA level of the PSBs has increased from 15.4% in Jun’ 18 to 16.1% in Jun’ 19. NBFCs have also witnessed an increase in NPA rates in the quarter ending Jun’ 19. Private Banks have also witnessed an increase in NPA in June’19 over June’18 however have shown improvement from Jun ‘17 levels of 4.0%.



* Data source – SIDBI TransUnion report Dec’18

4. Impediments to MSME funding

MSMEs are at lower chain of overall business value chain and are majorly dependent on funding from Banks / financial Institutions to effectively finance their business for capex as well as working capital. They are also considered as riskier assets by the Financial Institutions and thus are called for with better control and higher security. The major concern areas for MSME funding are:

a. Financial housekeeping and understanding its importance need improvement

b. Strength of collateral security and enforceability

c. Adequate capital commitment

d. Business model strength in the face of volatility in business and economic conditions, both domestically and internationally

e. Degree of fragmentation

5. Suggestions for Supporting MSMEs

There is a need for the entire eco system to put in efforts on various fronts to support MSMEs and make conducive environment and policies for them to start a business and grow the same efficiently in the global competitive environment. There is also a need for continuous review mechanism to ensure that supporting pillars for growth of MSMEs remain robust and evolve with time. Hence given below are few suggestions for MSME borrowers, Financial Institutions and Regulator / Policy makers should look at to support MSMEs in India.

i Important things that an MSME borrower should do to give comfort to financing institution

  a. Improve financial housekeeping

  b. More robust business models

  c. Tie up of business with requisite supply chain of large corporates or government

  d. Increased digital transactions will aid transparency ii Suggestions for fellow Bankers that will give confidence in lending to MSMEs and will also give financial support to MSME sector in India

a. Constant touch-and-feel approach with MSME clients

b. Reach out to clusters and associations for wider coverage

c. Supply chain financing structures for tier 2 and tier 3 suppliers of corporates

d. Rapid decision making for the benefit of MSME customers

e. Support and guide MSME clients to move on digital platforms

f. Help MSME to identify investors and strategic partners for their business needs

iii MSMEs are generally family run business with technocrat promoters who do not necessarily have expertise in all fields and are not capable of hiring professionals for all needs of business. Hence, they need lot of support on policies, process requirements, infrastructure, knowhow of technology, knowledge of subsidy / benefits available etc. Hence there are few things that policy makers and regulators can consider for development of MSME's as given below:

a. Corporates and Government should make sure that they release payment of MSMEs on time/ reject on time, if possible. This information can flow to the funding Bank as reverse feed through GST module. GST/ Tax refunds should be made available timely, portal can show expected date of refund to enable MSMEs plan their cash flow better. GST/ IT data can be made available to funding Banks, online, hassle free with only one-time consent for longer period.

b. Technology and R&D investment/ expenses by MSMEs can be exempted from tax to encourage research and adoption of new technology. Also, additional benefit, in terms of subsidy should be given to firm/ companies regularly upgrading the technology.

c. SMEs are finding it difficult to provide old historical data related to EDPMS / IDPMS, and blanket relief will be helpful in reducing their compliance burden with respect to very old items.

d. One of the major issues faced by MSMEs is labour laws hence labour laws / labour settlement should be addressed for simplification and streamlining. Legal cases / IT tribunal or any other judicial cases pertaining to MSME segment to be prioritised or a separate channel to be made available for speedy decision.

e. Impetus should be given on infrastructure availability at all the SME clusters / hubs. Electricity/ Power/ Road/ Digital connectivity to be made available. To ensure progress, a special committee to be formed for audit of infrastructure availability in clusters and various clusters can be ranked basis these parameters.

f. Regular trade fares dedicated to MSMEs to be organised all India where MSMEs can showcase their products and get business globally. Efficacy and success of the same should be monitored and measured to know business benefits as well as challenges faced by MSMEs so that it can be addressed by the government.

g. Financial management training and regular interaction by Bank/FIs for MSME customer should be done, government to have many camps for financial literacy to reduce dependency on consultants. MSE customers should be encouraged to go digital in transactions for faster payment and collection and managing the cash flow in an effective manner. Incentivising customer with 90%+ electronic transactions will be helpful. Efforts towards promoting Digital purchase and standardisation of products on digital platform (to be created for MSMEs) to be done to improve quality consciousness among entrepreneurs. MSME customers to be encouraged to use CRM system which helps in recordkeeping as well as developing business.

h. Subsidy / benefit in terms of transportation or port costs to be given to importer / exporter within heartland of the country for shipment from / to the country.

i. MSME classification basis turnover of the company to be passed as a bill and implemented at the earliest. It should also include exporters up to 200 crs annual turnover classified under MSME.

j. Bilateral Agreement with EU to make Indian garment export at par with Bangladesh

k. Export promotion zone land to be allotted for long tenor so Banks can take that as collateral security for export finance. For example, Noida Promotion Zone.

l. CLCSS subsidy is available if expansion of capacity is at least 50% of the existing capacity, this can be reduced to 25% to encourage expansion projects by manufacturers

m. Additional interest subvention for manufacturer exporters as compared to export traders to boost manufacturing and exporting in India and promoting “Make in India”

n. eCommerce Zones like SEZs can be developed for development of MSMEs which are only linked with ecommerce companies

HDFC Bank Ltd – Focused approach on MSE finance growth

As a Bank, we have been following a business vertical approach for focusing on lending to MSME sector with Emerging Enterprises Group (EEG) primarily focusing on Micro Enterprises, Business Banking Group Enterprises (BBG) focusing on Small Enterprises and Emerging Corporate Group (ECG) focusing on Medium Enterprises. These business verticals have, over a period increased their reach to cover large portion of HDFC Bank branches to cater to grow our MSE advances book.

Primarily the approach of BBG and EEG has been to generate business from existing relationship of branches where customers either have their current account or promoters Bank for their personal needs. The approach helps in better chance of customer giving us an opportunity and also supports in better asset quality. There is wide coverage of business profiles catered to which includes Manufacturers, Wholesalers, Distributors, Traders, Retailers and Services Enterprises.

To support on an ongoing basis with respect to fulfilment of Customer Requirements, Financial Literacy, Complaint Management and Handholding which are critical to the growth of MSME's in the country, HDFC Bank follows a relationship manager (RM) based model where every customer is assigned to an RM. Further Bank works on a unique model wherein the customers are sourced through large number of HDFC Bank branches and hence increasing the reach year on year to cater to MSME enterprises and show higher growth than industry growth.

Digital Initiatives of the Bank for MSMEs

The Bank has been focusing on Speed of delivery to the customer and changing the transaction experience with the help of various advanced products launched by the Bank under “Digital Initiative” for MSME's funding requirements (short, medium and long term). The Bank also covers the facility under CGTMSE Scheme to support MSME customers, wherever applicable. The Bank has been supporting the customers towards subsidy schemes like CLCSS, TUFS, NABARD subsidy, Warehouse construction subsidy, etc.

Product offerings from the Bank

- Cash Credit / Overdraft against property
- Bank Guarantees / Letter of Credit
- Export Finance
- Purchase Order Financing
- Bill Discounting
- Term Loan / Working Capital Demand Loan
- Treasury products and services
- Unsecured loans for business purpose
- Cash Management Services
- Investment Banking offerings for MSME's
- Corporate Cards and Digital Payment services
- Salary Account offerings
- Private Banking
- Corporate Credit Card
- Auto Loans / Loan Against Property / Consumer Loans etc to business and promoters
- Wealth Management/ Insurance Services and investment products

Digital Services

- E-Net – Corporate Net Banking for online transactions

- TON – Trade on Net for Trade transactions (BG/LC/Remittances) online

- SME Portal – Exclusive Service portal for MSME customers for viewing sanctioned limit, disbursements, applying for limit enhancements and tracking the same. This is a digital interface between customer and Bank made available for existing SME customers. This customer interface through Digital SME Bank is providing 24 * 7 secure e-Banking experience for accessing information related to their credit sanctions, submission of documents online, placing requests for TOD, Ad hoc facility, TL Tranche release etc hence transacting without a need of contacting the RM and depending upon Banking hours only. This again is first of its kind in the industry where customer can know about sanction limits, available Drawing Power, sanctioned undisbursed amount for all types of fund and non fund based facilities, alerts on facility renewal due date etc. Digital empowerment is a potential game changer and catalyst for an SME entrepreneur.

The Bank has used life cycle based approach while designing the digital offerings hence including key elements which are:

- Customer acquisition for the Bank,
- Enabling various transactions digitally,
- Self servicing enriched banking experience for the existing customers,
- Intelligent approach using analytics,
- Cross selling to the customer to offer various products to the customer.

MSME customers has corporate net Banking through ENet™, Online Trade transaction through "Trade On Net" facility to initiate various trade transactions electronically sitting in his office / on the go through mobile application and SME Portal, a customer Self Service Portal which is a very powerful tool offered by the Bank to the existing customer. This enables the customer to view and transact on his credit facilities thus giving a Digital experience to the customer divided into four modules, Enquiry or View module, Transaction Requests, Document submission module and Alerts / Reminders module to know key due dates along with attractive Offers by the Bank.

Bank also offers Host to host integration with Tally and other accounting softwares for SME customers which helps in auto reconciliation of accounts, ease of processing the payment transactions, upload salary payments etc. We offer CMS facility which provides collections support to MSE customers and provides customized MIS of transactions in the form and shape that suits the MSE enterprises business. This empowers the customer with end to end Digital Payment and Collections solution.

To have differentiated approach towards MSE customers, the Bank has recently launched IPA process (An In-principle approval process) using analytics where the Bank is in a position to have differentiated faster approval process for good quality credit. RM is able to confirm to the customer on the feasibility of approval across the table and basis that is able to convert the new to Bank customer faster. Final approval for smaller segment of MSME's are given hard final approval in 3 hours under IPA+3 hour process by the Bank. This empowers the front end to take informative decisions and also helps in quicker delivery to the customer. It supports RM to ask specific questions and relevant information for credit underwriting thus crunching the time of decisioning.

The Bank has been using analytics in a big way for Sourcing of new relationships and also in managing the portfolio by having Digital renewal (Auto renewal of CAMS), STP (Straight Through Processing), Pre approved Enhancement / Ad hoc facility, Pre approved TOD etc which is first of its kind in the industry.

Lending to MSE segment for the Bank has been increasing at a faster pace than the industry growth year on year for last many years. MSME lending book of HDFC Bank Ltd has doubled to over Rs 1.48 lakh crores in December 2019 in less than 3 years.

5

Umesh Revankar
MD & CEO
Shriram Transport Finance

With a sustained growth rate of over 10 percent in the past few years, the MSME sector has come to represent the ability of the Indian entrepreneur to innovate and create solutions despite the logistic, social, and resource challenges across the country. The IFC study shows that MSME sector is nation's largest employer, generating more than 124 million jobs through close to 56 million enterprises and contributing 31 percent of the nation's GDP and 45 percent of the country's overall exports , the relevance and role of the MSME sector as the central driving force behind India's assertive vision to be a dominant global economic power cannot be overemphasized. Given that MSMEs essentially rely on traditional or inherited skills and use of local resources, particularly in rural and industrially underdeveloped areas, the sector has the ability to empower traditionally resource-poor communities and markets to mobilize products and services, both nationally and globally.

Further the study done by IFC shows that of the overall debt demand of INR 69.3 trillion (USD 1.1 trillion), a major part – 84 percent or INR 58.4 trillion (USD 898 billion) – is financed from informal sources. Formal sources cater to only 16 percent or INR 10.9 trillion (USD 168 billion) of the total MSME debt financing. Priority Sector Lending guidelines set by the Reserve Bank of India require banks to provide debt to credit-strapped sectors such as MSMEs and agriculture. These lending norms have compelled banks to take a closer look at the MSME sector than previously done and develop strategic initiatives around lending to different industries and geographies within the sector and loan products that are best suited to the needs of different MSMEs.

Debt supply from NBFCs to the MSME sector is estimated to be INR 1.5 trillion (USD 22.8 billion), In the past few years, NBFCs have been increasingly turning to MSMEs as an avenue for growth. Part of this growth has been fuelled by the alternative credit assessment processes NBFCs use. This is a key distinguishing factor between banks and NBFCs. Banks largely look at enterprise balance sheets and accounts, as well as collateral to make a credit decision. On the other hand, NBFCs also factor in cash flows, future potential of the company, and assets other than immovable collateral. Still, they incur higher costs in many cases if they have to serve MSMEs for small ticket size in distant locations that are not well-connected. Additionally, NBFCs keep higher provisions for defaults since they are not protected by any guarantee schemes. The cost servicing small ticket and to lending to informal sectors such individuals and self-employed is also expensive and NBFCs do lend at much higher yield to cover their expenses.

There have been commendable efforts on the part of the government and the financial sector to develop and implement multiple support mechanisms for the MSME sector. But many of the recently administered interventions are still in early stages or are yet to be operationalized and therefore their impact remains to be seen. Some of the key initiatives include the MSME (Amendment) Bill, 2015, revamped PSL norms, Insolvency and Bankruptcy Code 2016, Trade Receivables Discounting System (TReDS), among others. However large part of informal MSME's do not get credit from formal financial system.

There are several potential interventions that can be undertaken to expand the access to MSME finance in India. Thus, proactive steps from credit suppliers, specific interventions in supporting environment, and regulatory impetus can significantly augment the credit flow to the sector.

The challenges for borrower

- The more the borrowers are able to maintain their financial records better for them to establish credentials better and also their ability to raise resources at reasonable cost.

- Lending against property collateral also has its own disadvantage as generally expected appreciation for property price has come down significantly in recent times creating nervousness among lenders.

- The lower threshold limits for exemption INR 2 Mn against INR 15 Mn for small enterprise have created period of uncertainty in their business model. The readjustment that they had to do is temporary challenge but once they see the benefit of getting credit from formal sector, they would get encouraged. Over the period many of them to would graduate to bigger league.

- The biggest challenge is for informal sector who have not registered their business and therefore have no access to formal credit system. They mostly depend upon the contribution of relative and friends for initial capital and thereafter borrow from money lenders, chit companies and pawn brokers. Typically, when they buy vehicles or machinery, the niche lenders among NBFCs like vehicle financing or Gold loan financing companies who have reach would lend to them, but any other business have to depend upon informal credit only.

The lending institution should make following changes

- Credit appraisal processes should focus on alternative data for assessing capacity and willingness of borrower to repay the loan.

- Many lenders who blindly following the credit score methodology are bound to have more accidents as they only encourage more borrowing to keep the record straight but how long this could be sustained is unknown.

- Focus should be on sector-specific product development rather than universal credit screen

- The NBFCs focused on MSME lending should become extended arm of formal banking system complementing it through its reach, specialisation and skill set for priority sector lending targets

- The reach to informal lenders such as Chit fund companies, moneylenders, pawn brokers and business correspondents may be harnessed to bring them all of them in to formal credit system.

- Collaborations with fin-tech firms focused on MSME lending to build supporting infrastructure

The policy makers and regulators have to

- Expand the scope of assets registered with CERSAI to facilitate movable asset-based lending

- Take remedial measures to enhance the effectiveness of the Credit Guarantee Scheme
- Ensure that regulations are unambiguous and consistent across regulators
- Improve access to funds for NBFCs and MFIs and provide them with regulatory impetus to cater to MSMEs
- Revamp the Negotiable Instruments Act to make it stricter for defaulters, the SARFAESI Act allows banks to auction residential and commercial properties to recover loan above one lac but for NBFCs the limit is above one crore. The NBFCs being more granular lender they should be brought on par with Banks.

We at SHRIRAM have been focusing on individual borrowers and many a times they are first time borrower. We have created very big reach in rural centres and are lending to tractors, local passenger vehicles and commercial vehicles. We have tried to bring fresh approach to lending to our niche segment of commercial vehicle financing. We have added working capital financing products to fund, specific need based funding requirements of customer such as fuel credit, insurance products, buying of tyres, refurbishing the vehicle etc. we have also started funding the adjoining business within transportation industry eco system such as were houses, fuel pumps, garages , shops etc.

We were also earliest to recognise that customer would not be able to pay his full EMI at one go through cheque and have allowed him to pay in parts. We have aggressively gone for digital mode of collection by providing our Shriram app with all digital payment options enabled.

We strongly believe there are potential interventions that can be undertaken to expand the access to MSME finance in India. Thus, proactive steps from credit suppliers, specific interventions in supporting environment, and regulatory impetus can significantly augment the credit flow to the sector.

Our suggestion would be to have greater access to bank finance for NBFCs engaged in priority sector lending should be permitted and bank finance to such NBFCs should automatically be considered as priority sector lending for the banks. This is because such NBFCs are subject to RBI supervision wherein RBI would ensure confirmation of the end use of funds of such NBFCs before according such classification.

Currently, NBFC do not have any window to avail refinance from RBI, however housing finance companies can avail refinance from NHB. This window gives lot of confidence in investor/lender for their lending.

The Public issue of debentures are cumbersome as we need to wait for very long time for the closure and to issue of bonds. The on-tap bond issuance is need of the hour for NBFCs so that we tap the market more regularly and issue the bonds to investors immediately.

Currently, the on lending by banks to NBFC is considered as PSL only till March 31, 2020 and that too restricted to 5% of PSL target that works out to 2% of total lending by banks. We request the restriction to be removed and the policy should be open ended.

Current PSL requirement put cap of base + 8% for PSL classification, we propose no cap as the borrowers who borrow at higher rates are the more needy and unbanked customer. They tend to have no track record and are more eligible for priority sector classification.

MUDRA refinancing should be expanded to all NBFCs, with minimum conditions and no interest rate caps.

6

McKinsey & Company

Authored by

Alok Kshirsagar
Senior Partner

Siddhartha Gupta
Associate Partner

Unlocking the full potential of MSME finance

Finance for micro, small and medium enterprises (MSMEs) has been growing at a healthy pace over the last three years, owing to a combination of enabling policies and financial institutions shifting their focus from corporate to retail and MSME. The share of funding, however, has been disproportionately concentrated among the top end of the segment – the 3 mn to 4 mn enterprises comprising about 60 to 70 percent share of the MSME funding pool. According to estimates, a huge segment of over 50 mn “emerging micro” or “micro” enterprises (annual turnover under INR 30 lakh and INR 1.5 cr respectively) remains under-served.

More than half of these enterprises still struggle to access formal means of finance. While some enterprises have been served by micro-finance players (MFIs), other financial institutions have found them expensive to reach, and they have been able to gather only limited data on their business. This has meant that lenders continue to resort to judgement-based underwriting, which restricts their scale of operations. These enterprises are forced, therefore, to turn to informal sources that charge at least 6 to 10 percent higher interest rates, further squeezing already tight and often negligible margins. Why is this happening?

THE CHALLENGES OF MSME FINANCE

A survey conducted by McKinsey in 2017 points to multiple challenges restricting customers (the MSMEs looking to borrow) and providers (the financial institutions). At the customer level, three constraints bog down their access to formal finance – the lack of adequate collateral to pledge, the excessive documentation and high turnaround times, and inadequate exposure offered given their current debt situation.

Financial institutions struggle too, with the lack of reliable and standardized information to process loan requests, given that MSME bureau penetration is under 30 percent and banking information is scarce. Financial statements are often unreliable and do not accurately indicate business health, making it difficult to assess promoter quality and intent. Financial institutions often lack the talent and credit expertise to accurately underwrite these entities or to be able to reach out to deeper geographies.

AVENUES TO UNLOCK EXISTING POTENTIAL

Unlocking the full potential of MSME finance could offer a triple benefit for the Indian economy – large-scale job creation, formalization of these economic agents, and a rejuvenation of the financial services sector, opening up a vast, new market at healthy and attractive margins.

Riding on the momentum of government initiatives and programs (CRR relief for MSME, restructuring MSME NPAs, procurement mandates from MSMEs, interest subvention for GST registered MSMEs, TReDS, MUDRA and the larger digital payments ecosystem), four sets of imperatives stand out to maximize the power of MSME finance.

Structural enablers that could accelerate growth and access

- Risk-pooling MSME assets for capital market investments: Securitizing MSME advances through capital markets could help nurture growth in an environment of scarce capital. Combining such a market with priority-sector lending linkages and formal ratings can attract large-scale investors. Anchor institutions like SIDBI could orchestrate the development of such a market.

- Facilitating MSME access and demand through marketplaces: This could power their access to markets across the country. As one of the largest procurement powerhouses, the government could continue to take steps to accelerate demand from MSMEs (e.g., along with procurement portals for CPSUs, GeM, and acceleration initiatives like Bharat Craft). Large corporate houses could also consolidate and streamline their MSME procurement through similar marketplaces.

- Activating key digital infrastructure initiatives: This could include enabling all four layers of the IndiaStack (especially the e-sign, digital locker in the “paperless layer” and the “consent layer”). It could also help to accelerate banks' adoption of e-mandates, especially for current/business accounts. State government initiatives to digitize land and title records could be encouraged and even accelerated. This will help banks to assess the required collateral without the associated paperwork that often makes it cumbersome to lend to this segment.

- Enhancing bureaus with alternative sources of data: Utilities and telecommunication companies could report payment flows to the credit bureaus and a "surrogate / proxy" credit report could be formulated.

- Integrating disparate but powerful sources of government data: Integrating data from various government entities could empower financial institutions to transparently and rapidly assess the quality of a business. Such a database could reflect information from entities such as Registrar of Companies (ROC), Income Tax Returns (ITR), Central Repository of Information on Large Credits (CRILC), and the Goods and Services Tax Network (GSTN).

Transforming the operating model of financial institutions

Financial lenders could continue to invest in Digital and Analytics (DnA) to reduce cost-to-serve and enhance access, along with continuously building frontline capability.

- Bring analytics to the core of decision-making: Every lender serves unique markets and customer profiles. Financial institutions could develop their capabilities to build their own customized scoring models to aid credit underwriters. Cashflow-based models (using digital bank statements, GST filings, etc.) and repayment behaviour models (based on bureaus and internal data) deserve higher weightage in the overall decision making compared to the currently heavier reliance on financial statements and self-disclosures by customers.

  Simultaneously, lenders would be well advised to acknowledge that building scoring models in this segment has its own set of challenges given the lack of adequate digital records for most customers. In this context, it could be important to focus on three things:

- Augmenting quantitative models with strong filters and hygiene checks

- Adding qualitative scorecard overlays that capture nuances across business models and sectors

- Actively adopting external data and proxies to estimate income and repayment potential (geospatial data providers, industry insights, utility and telco supply chains). Lenders will need to work with external stakeholders and partner with data providers to develop a framework that helps assess customers while upholding the highest standards of data protection and privacy.

• Emphasize digital enablement and capability building of the field-force and underwriting/portfolio management: To truly enable the analytics framework, lenders need to reengineer manual, paper-centric workflows to support digital workflows. They must understand and assess the current stack's ability to ingest digital data sources (digital bank statements, bureau information), run and score modelling algorithms or rules, handle scanned documentation workflows, and create stage-gates and checks around information points critical to decision making and risk (e.g., collateral values, industry classification).

  Based on their digital assessment, lenders could choose from three options –maintain, augment or upgrade their legacy loan origination system (LOS). The choice to augment it could lead them to additional systems like Business Rule Engines and they could also integrate with bureaus and other external data sources via a stack of APIs.

  In these efforts, an unswerving focus on change management and capability building is critical. This will ensure frontline adoption of digital form-factors (tablets, mobiles) and workflows – an often under-leveraged aspect of digital enablement. The following guiding principles could help:

- Make the frontline a part of the design process: They could structurally enable this through creating a process of working in cross-functional groups and incorporating feedback via CUGs
- Run hands-on bootcamps to train the frontline on the “why” and “how” of the transformation
- Offer continuous training and reinforcement
- Set up and staff technical support infrastructure and helpdesks

• Innovate on product propositions: The unique nature of different customers in the micro and emerging micro segments calls for a micro-segmentation approach. Different sectors and value chains have specific needs (e.g., across crop harvest cycles or seasonal sales). Lenders could develop a suite of products to address the full potential demand of this segment. They could ensure that product development teams, marketing teams and analytics teams work closely with the frontline to develop a systematic approach to product development.

• Build appropriate risk and monitoring guard-rails: Access and reach concerns make monitoring both challenging and expensive in this segment. Lenders could benefit from developing analytically-driven solutions such as the following:

- A holistic early warning system (EWS): It is critical to integrate transaction data, industry trends and negative information, stock statements, etc. in a common framework. This calls for an integrated effort by frontline teams (driving the digitization of stock statements, disciplined collection of financial statements and other statutory requirements), credit underwriters (formulation of exit strategies) and analytics teams (incorporation of external or industry-linked variables). The EWS needs to seamlessly link with other portfolio actions such as renewals and enhancements
- Model governance and performance: Lenders need to recognize that modelling scorecards in these segments need to be closely monitored

and continuously refreshed. They could accordingly incorporate best practices on model validation and risk management into their analytics governance.

Changing the habits of borrowers

A change in the banking habits of borrowers could help banks help them:

- Borrowers should ideally route 100 percent of their cashflows through bank statements, conveying financial health to financial institutions. This could improve the banking scores of MSME entities and help lenders to rapidly and reliably assess creditworthiness.
- Borrowers should try to maintain sole banking relationships, where the MSME promoter, their family all turn to one working capital bank for their financial transactions. Structural challenges encountered in moving relationships across banks must be monitored and proactively disincentivized. The resulting transparency could mitigate the perceived higher risk of MSME lending, and allow the MSME to update the bank whenever they encounter unexpected hurdles in growing their business cash flows. Bank could in turn offer advice based on past experience of what has helped other MSMEs.

Policymakers and regulators continuing to act as catalysts

Policymaking or regulatory bodies could play a powerful role in helping to facilitate the infrastructure shifts discussed earlier. They could also help in the following ways:

- Accelerate and extend execution on policy initiatives: Ensuring that payments from various government departments are monitored and resolved in a timely manner and also following up on deeper penetration of initiatives such as GeM, Bharat Craft, TreDs across the full spectrum of MSMEs
- Build an enabling framework for digital and data innovation: Encouraging the formation of digital ecosystems and facilitating data-sharing protocols that allow access to alternative forms of data

- Consider the following to clear bottlenecks in liquidity and trade finance:
  - Relaxing pricing caps on securitization (via PTC) to make HFC/ NBFCs amenable to pooling; defer recognition of PTCs as on-book exposure under Ind-AS to allow time for adjustment
  - Removing the co-terminal clause of PSL benefit to banks and instituting separate on-lending caps for NBFCs and HFCs to infuse finds
  - Extending credit enhancement for portfolio purchase by PSU banks under securitization from NBFCs beyond two years since the need for credit enhancement is higher in subsequent years
  - Allowing access to pre-shipment finance for Indian exporters from offshore banks in line with global competition
  - Simplifying the DSIR recognition process, relaxing the "export" definition for MSMEs and permitting export credits for entities with exports over INR 100 cr

The opening up of public infrastructure such as account aggregators, public credit registers, etc. is a supportive move by the government, aided by appropriate change of laws and regulations. The imminent launch of invoice discounting and seller finance platforms for MSME financing could go a long way in guiding banks to the digital highway.

Such efforts to reduce cost-to-serve, improving access to growth capital and de-bottlenecking policy, could power up a critical engine of economic development and growth for India, creating a force-multiplier that could deliver and sustain economic outperformance for years to come.

7

Binaifer Jehani
Business Head
SME Solutions
CRISIL

Despite their critical contribution to employment generation and economic growth, majority of MSMEs in the country face huge challenges in accessing formal channels of financing.

- Lack of formal structure – Many MSMEs, especially micro ones, are not formally registered. This makes bankers and other financiers suspicious of their genuineness.
- Information asymmetry – Many do not maintain proper financial and bank account statements. Moreover, they have limited or negligible credit history, which makes their already difficult credit assessment further tedious for lenders.
- Timely access to credit – Most MSMEs need regular and frequent working capital support to sustain their operations. But, as their credit assessment is difficult, they do not get timely access to finance, which adversely affects their business operations and continuity.
- High cost of financing – Since MSMEs generally do not enjoy high credibility with lenders, they are dependent on informal sources of financing which charge high interest rates and are unaffordable. Even for those that enjoy banking relationships, the cost of financing is mostly higher than that of large enterprises and corporates.
- Collateral requirement – Due to high underlying risk, bankers insist on high collateral requirement. Many MSMEs do not own enough assets to produce as collateral and are ineligible to receive finance from many formal channels.

Two key infrastructural constraints of the MSME sector, especially manufacturing units, are availability of labour and electricity. For most urban and semi-urban units, consistent availability of labour is a concern, which hampers smooth manufacturing operations and revenue visibility. The problem of electricity has been adequately solved in urban centres and in areas which have a cluster-based approach. However, in smaller centres and rural areas, continuous availability of electricity and capital required for this are challenges. This impacts the non-agricultural rural economy adversely.

Timely access to finance can be improved by quickening the digitisation of semi-rural and rural economies. Creation of digital footprint in rural areas will help replicate the success of digital lending we are witnessing in urban and semi-urban centres.

Further, the policymakers should make more nuanced efforts to bring supply chain and trade finance completely under the ambit of platform-based settlements. While significant progress has been made through the advent of trade receivable discounting system (TReDS) platforms and the Government e-Marketplace (GeM) portal, they need more committed efforts to ensure higher success rate.

Similarly, a central data repository platform should be created, where lenders can access more details of MSMEs and persons associated with them. For example, in addition to credit history, KYC information and GST filing, availability of other data such as electricity consumption, mobile data and asset ownership will significantly help improve accuracy and reduce turn-around time of credit assessment.

In our opinion, the other measures to be taken by different stakeholders are as below.

a. Borrowers should:

1. Improve their financial understanding and literacy. They should maintain proper financial and bank account statements.

2. Start recording their credit history early, even if it is only of a credit card or a small working capital loan, and maintain a good track record. A good credit score and history can open up multiple options when larger funds are needed.

3. Invest in efforts to create well-defined processes and controls and diversifying customers, suppliers and products to reduce business volatility.

b. Bankers should:

   1. Incorporate more alternative data points and develop more intelligent questionnaires for robust credit assessment methodology.

   2. Create off-banking relationships / provide add-on services to MSME borrowers to increase customer stickiness for future financing requirements and reduce bad loan probability.

   3. Create robust and sophisticated framework and processes to monitor performance and risk of MSME loans.

c. Policymakers should:

   1. Incentivise MSMEs to continuously update and share their financial and non-financial information with key stakeholders involved in lending.

   2. Encourage lenders to lend to the last-mile MSMEs. Support measures include further increasing the corpus for CGTMSE and encouraging proliferation of credit insurance.

   3. Focus more on export-oriented sectors and bring export / trade financing under the ambit of TReDS platforms.

At CRISIL, we have more than a decade of experience in analysing MSME credit and have graded more than 1.4 lakh players till date. By leveraging our core credit expertise and rapid surge in digital footprint, we are attempting to improve MSMEs' access to credit. Our automated assessment solutions such as CRISIL Credit Assessment Score (CCAS) and the exhaustive SME Performance Grading Report act as a bridge between lenders and MSMEs.

Our effort has been to utilise alternative data points now increasingly available digitally and combine them with traditional credit assessment methodology to reduce the cost and time of credit assessment. We have started identifying sales trends from GST and IT filings, cash-flow analysis, credit history, spending pattern and utility consumption in order to get a more accurate picture of the capability and intention of the prospective MSME borrower to repay the lenders' capital. We expect increasing digitisation will help the credit assessment process evolve further. In the long run, this will translate into widespread access to affordable and timely channels of financing for all MSMEs.

The 5 most critical reforms that the system must adopt are as below.

- Enable loan access to rural markets – PSU banks and private lenders, especially new age NBFCs and MFIs, can jointly play a critical role in in making credit easily available in semi-rural and rural markets in a short time span.

- Equity and venture capital funding for MSMEs – Though SME Exchange has been in existence for some time now, the concept of MSMEs raising equity capital is still in its nascent stages. The government and other supporting agencies need to play the role of a facilitator by providing a common platform for venture capital or private equity funds to participate and fund budding MSME enterprises.

- Supply-chain financing – Despite the steady growth of TReDS and GeM platforms, delayed payments to MSME suppliers is a cause of concern as it impacts their overall operational health. A regulatory body needs to be formed to ensure maximum payments are routed through such central platforms. Similarly, cross-border trade finance also needs to be brought under the ambit of platform-based settlements.

- Innovative credit assessment tools – Traditional approach to credit appraisal of analysing financial and bank statements is becoming obsolete. This is particularly true for the micro segment, where cash-flow analysis and alternative data sources such as utility bills, asset ownership and customer reviews render making lending decisions easier. PSU banks need to take the lead in incorporating such innovative tools and scorecards to bring the bottom of the chain micro enterprises into the fold of formal financing.

- Encourage public-private collaboration – The new age lending institutions in the private domain have proved to be very nimble and innovative in their approach to credit appraisal, but lack the reach and pull of larger establishments. On the other hand, PSU banks have the reach but lack flexibility in terms of credit policy and target market. By charting out a well thought out blueprint, a collaborative approach can really help reach the unbanked and unbankable borrower in the most rural of markets. Co-origination of loans is a step in the right direction and should be supported with appropriate guidelines and structure.

8

Mahesh Thakkar
Director General
FIDC

Currently, there are many impediments being faced by MSMEs for meeting their funding requirements. Following are the key ones:

- Inadequate appreciation of the special needs of the sector and inability to correctly assess the funding needs on the part of lenders

- Lack of customization in loan offerings – loans should be tailor-made to be compatible to MSME cash flow cycles rather than a templated offering

- Poor governance standards on the part of MSMEs – inadequate financial disclosures; tendency to suppress revenue and income and tendency towards tax avoidance

- Lack of proper guidance and advice to MSMEs on financial discipline leading to mixing of personal funds and business funds and the concomitant tendency for fund diversion

- Focus on the part of banks on the larger corporate sector to meet their business targets

There is a need to create an enabling environment and a supporting infrastructure for improving access to funding for MSMEs. Below are some key infrastructural requirements

- Strengthening of a co-operative mechanism for industry level issues such as effluent processing plants, tool rooms, training facilities which cater to all units in a particular cluster. This will ensure better productivity, waste disposal as well as better compliance since the cost of such initiatives can be shared by all units in a cluster

- Strengthening and deepening of GEM and TReDS mechanisms to ensure greater marketability and smoother cash flows to the MSME sector

- Strong penalties to be enforced on larger entities' delaying/defaulting on payment commitments to MSMEs. Mere statement by Statutory Auditors on the annual report is inadequate - monetary penalty/prohibitive late payment interest should be enforced in case of delayed payments to MSMEs.

- Creation of e-marketplaces for marketing products of MSMEs for private sector as well as the retail consumption market
- Design and offering of special “small business” MBA programmes by IIMs and other management schools to develop management skills among MSME owners
- Ease the process and cost of ISI mark and FSAAI approvals for MSME products

Different measures should be taken by different stakeholders for improving access to MSME funding. According to us, 3 important things:

a. Borrowers should do

   i. Maintain proper and transparent books of account & pay taxes etc. on time

   ii. Do not mix personal finances with business finances – maintain them separately and account for any drawal from business funds

   iii. Develop own skills in managing one’s business

b. Bankers should do

   i. Assess cash flows of MSME customers properly and lend as per cash flow patterns – move away from asset-based lending

   ii. Not to treat MSME lending as a Priority Sector “obligation” but to approach it as a commercially viable business

   iii. Have tie up with and support NBFCs that have developed special MSME lending skills so that more funds can be channelized to the MSME sector

c. Policymakers should do

i. Strengthen GEM and TReDS. Allow NBFCs to participate in TReDS platforms as lenders.

ii. Amend MSME Act to allow definition of MSMEs on the basis of turnover rather than plant & machinery investment; this will encourage development of services sector MSMEs. The policy makers may be advised to keep in mind that more than 50% of India's GDP is contributed by the services sector.

iii. Evolve quick resolution mechanism to deal with MSME loan defaults – creation of fast track mechanism under N.I. Act, IBC and remove the INR 1 crore floor in the SARFAESI Act.

iv. Provide for stringent penalties for delaying any payments to MSME vendors by corporates

d. Regulators should do

i. Allow bank lending to NBFCs for onward lending to MSMEs as priority sector loans without any artificial limitations

ii. Lower the risk weightage in case of NBFC exposure to MSME sector on the lines of housing finance. It would help reduce the cost of funds for lenders

iii. Strengthen the CRILC and CERSAI mechanism to ensure banks and NBFCs get full access to data in respect of borrower details and security details

FIDC has put in a lot of efforts and initiatives or fresh approaches in this regard. They are as below.

- Creating awareness among our members on the opportunity of financing MSMEs

- Joint training programmes with the World Bank Group for promoting "asset-light" lending models

- Help creating new models for: CGTMSE scheme for NBFCs, co-lending with banks and representation on the Standing Advisory Committee for flow of institutional credit to MSME (constituted by the MSME Ministry, Govt. of India)

The 5 most critical reforms, according to us, that the system should adopt, are as below.

a. Harmonisation of data based on single identifier of the MSME (PAN No. could be the one point of identification) so that lenders get transparent data on MSMEs' turnover, tax compliance, bank details etc.

b. Institution of quick and efficient resolution mechanisms in case of MSME defaults (as referred to above)

c. Greater collaboration between banks and NBFCs to cater to the needs of MSME sector. Banks must be encouraged to partner with and treat NBFCs as complementary and not as competitors. Last mile connectivity is best ensured by NBFCs and banks can provide funds to NBFCs for this purpose. Ultimately the benefit of lower cost and better efficiency will flow to the needy MSMEs

d. Overhaul of MSME Act and ensuring that the law does not become a limiting factor for growth in scale. Overhaul of MSME Act and ensuring that the law does not become a limiting factor for growth in scale. Govt should take care to provide incentive rather than disincentivize entities outgrowing MSME status & becoming larger organisations. Concessional treatment (regulatory/tax/other incentives) as promised to an MSME should continue for 3-5 years even after such outgrowing.

e. Educating the Chartered Accountants community to move away from advising MSMEs for "tax avoidance" but to encourage them to look at the advantages of transparent reporting. The greatest advantage of this would not just be easier availability of loans from banks and NBFCs, but also easier ability to attract external equity capital from venture capitalists/investors and easier listing on the SME stock exchanges.

9

L. Guru Raghavendran
Vice President & Global Head -
Products, Pre-sales & Marketing
(Banking Practice)
3i-Infotech

The International Finance Corporation (IFC) estimates that 65 million firms, or 40% of formal micro, small and medium enterprises (MSMEs) in developing countries, have an unmet financing need of $5.2 trillion every year, which is equivalent to 1.4 times the current level of the global MSME lending. The impediments as I would like to describe are 3 Cs that are Capability, Capacity and Convenience.

- Capability: In order to obtain funding, relevant understanding of the requirements is a necessity. Today, there is a lack of knowledge of the available schemes. Awareness is missing regarding the options in the market today. Once there is an effort to understand the options, the required documentation in order to obtain the finance, also needs to be understood. In case there is an insistence on a collateral, the alternative that can be offered depends on the capability of the entrepreneurs and their skills.

- Capacity: In the absence of relevant mandatory documents, the interest rates are high due to the risk involved. This stems from the fact that MSMEs require to showcase their repayment capability. If they do not have a proper accounting system or tax payment history, then financial institutions are unwilling to provide the finance at a reasonable rate.

- Convenience: MSMEs may willingly pay a few basis points higher to secure a quick finance with basic documentation. But, one of the major impediments is the time taken for processing a finance application. Even if an MSME has the capability and capacity, the very fact that the funding process is long drawn, is discouraging. The other aspect of convenience is the location – how far do they have to go to obtain the finance?

With the focus on these 3 Cs, one should be able to structure the right financing instrument and ensure timely credit to MSMEs.

Broadly, the key infrastructural requirements can be classified as follows:

- Physical infrastructure - There are basic hygiene related needs like power, water, roads, transportation, and communication. These are essential factors of production which have a direct impact on output, cost and productivity.

- Knowledge Infrastructure - How many of them are aware of the two major centrally sponsored schemes? – Micro and Small Enterprise Cluster Development Programme (MSE-CDP) of Ministry of MSME and Industrial Infrastructure Upgradation Scheme of the Department of Industrial Policy and Promotion (DIPP). Also, how many are active on TreDS (Trade Receivables Discounting System) – a digital platform launched by the Reserve Bank of India.
- Environmental Infrastructure - To ensure competitiveness of MSMEs, it is essential that infrastructure is in tune with the global trends and it compensates for small scale operations through provision of common facilities.
- Marketing Infrastructure - Marketing is one of the biggest expenses that MSMEs need to incur, hence a supporting infrastructure is required without impacting the bottom-line. A necessary platform needs to be created for MSMEs to promote and capitalize on having focused marketing approaches like cluster specific marketing, guerilla marketing and relationship marketing. This is critical for creating greater acceptance locally and strengthening them to compete globally.
- Information Technology Infrastructure - Technology is a key for the success of the MSME sector in India. The right use of technology would help address all areas of other infrastructural requirements, such as knowledge or marketing. It is important that they understand the cloud based option to utilize the technology which is not capital intensive but highly productive if appropriately utilized.

Different measures that should be taken by different stakeholders are as below

a. Borrowers should do

   i. Invest: Invest in knowledge/skill based resources

   ii. Enhance: Make better use of the eco-system that is around the entire process

iii. Innovate: Understand from counterparts across the globe and focus on innovation as a theme across the process

b. Bankers should do

i. Risk Assessment: Banks should take into consideration different risk assessment models acknowledging the fact that the MSME sector will not have certain data/documents available.

ii. Alternate Data: Alternate data needs to be considered for credit assessments that can prove worthy for understanding the repayment behavior

iii. Partnership: Banks should work together with FinTechs to ensure quicker processing of loans required and focus on digitization.

c. Policymakers should do

i. Execution: There should be focused measurement of the effectiveness of the policies rolled out.

ii. Continuous improvement: There should be a process of continuous improvement of policies considering the quickly developing markets as well as global conditions that need to be taken into consideration

iii. Global benchmarking: There should be a separate committee of policymakers which regularly studies and reviews policies and plays an advisory role.

d. Regulators should do

i. Awareness: Regulators should conduct road-shows to create awareness of the schemes that are being rolled out.

ii. Forums: Participate directly in various forums to hear the views of the MSME sector as well as be transparent and proactively work on promoting innovations.

iii. Eco-system: Regulators should work closely with ministries such as Finance, to see how the MSMEs growth can be furthered.

As a leading technology player, we are focused on enabling MSMEs by providing them with access to relevant technologies such as:

- Digitization - We have created a digital lending platform with the following key objectives:
    - Shorter turnaround time for approvals and disbursement
    - Ensure different customer journeys defined on the basis of their risk appetite
    - Alternate data scoring models embedded as a part of the customer journey
    - Application Programming Interface (API) Box that enables data driven decisions
- Mobility
    - A seamless journey using a mobile application
    - Integration right from KYC check till the time when the money is disbursed through eNACH to customer's account
    - Enhanced and easy to use intuitive interface
- Advanced Technology tools
    - Artificial Intelligence: AI can help in better decision making such as:
        - Credit evaluation by assessing behavior patterns and evaluating associated risks.
        - Ensure identification of discrepancy in unstructured documents and thereby, identify fraudulent documents
    - Machine Learning (ML): ML is applicable at varied data points in the transaction life cycle. Some of them are late payment charges, credit history, payment patterns and behavior. These kinds of data with ML algorithms can help in better assessment of credit for MSMEs on a real-time basis. We have created inbuilt analytical models that focus on deepening the knowledge on customer behavior

Other than enabling MSMEs, our focus is also to help the sector to have the relevant tools that will help them innovate in their areas of operation. We plan to conduct User Forums where what we do is practical and the impact is visible within a shorter period.

The five most critical reforms that I think need to be adopted and which would be successful only if they are done across the eco-system by involving the relevant stakeholders:

1. Awareness Campaigns - There should be planned awareness campaigns that are conducted along with the required stakeholders in the required cities. The objective of these campaigns should be to enable MSMEs to understand what schemes are available, the required documentation and the benefits that they would derive.

2. Promoting Innovations - With the new emerging technologies, there should be multiple ways where MSMEs should focus on innovating ways of growing in a competitive market

3. Enable Infrastructure reforms - MSMEs can take all the required initiatives; this should be equally backed by the necessary infrastructure that is required for them to succeed

4. Provide Marketing Support - David Ogilvy, says, "On the average, five times as many people read the headline as read the body copy. When you have written your headline, you have spent eighty cents out of your dollar." MSMEs need to be provided focused marketing support to ensure that the marketing spend is worthy.

5. Skills and Information Development – All of the above are possible only if there are skilled people. It is important to have specific focus led programs to train the required MSMEs to perform better. Today the FinTechs which have entered the market, have identified this need and they aim to provide end to end services to MSMEs, including the required skill development.

Article by NeSL

A New Initiative for Speedy Disposal of MSMEs' Unpaid Dues

The significant role that Micro, Small and Medium Enterprises (MSMEs) play in job creation and wealth generation is indisputable. Employing around 120 million people, the MSME sector is the second-largest job creator after agriculture and contributes approximately 30% to India's GDP.

It goes without saying that to help achieve the Hon. Prime Minister Shri Narendra Modi's vision of making India a $5 trillion economy by 2025, MSMEs will have to play an increasingly catalyzing role in nation-building. Shri Nitin Gadkari, the Hon. Union Minister for MSMEs, recently reasserted this when he shared his vision of doing everything that is needed to increase the MSME sector's contribution to India's GDP to over 50% in the next five years.

Acknowledging the myriad set of challenges that MSMEs face in rapidly scaling up their businesses, a slew of policy measures have been introduced over the last few years. Notable initiatives like Skill India, Startup India, Digital India and Make in India have rejuvenated the MSME sector, while incentivizing measures like Business Loan Within 59 Minutes, Interest Subvention Schemes, Trade Receivables e-Discounting System (TReDS), Government e-Marketplace (GeM) Portal, Credit Linked Capital Subsidy Scheme (CLCSS), etc. have given new aspirations to fledgling MSMEs.

Despite such productivity-enhancing initiatives and credit-boosting schemes, a major challenge that MSMEs still face is repeated delayed payments from their clients, especially large organizations, that take unfair advantage of MSMEs' low bargaining power and deliberately delay their payments. This results in working capital deficits for the MSMEs which in-turn results in delay in payments to their own employees and vendors.

To curb this vicious cycle of delayed payments to MSMEs, Chapter 5 of the MSMED Act mandates buyers to pay their MSME vendors within 45 days of the acceptance of goods or services or face a penalty of paying compound interest on the unpaid amount at three times of the bank rate notified by RBI.

With a view to enforce compliance to timely payments, in October 2017, the government launched a dedicated online redressal mechanism, titled ‘Delayed Payment Monitoring Portal - MSME Samadhaan’ that empowers MSMEs to easily launch an online complaint of delayed payments against their buyers.

Upon meticulous scrutiny of each complaint registered through Samadhaan, the concerned state’s Micro and Small Enterprise Facilitation Council (MSEFC) then issues an “award” that mandates the buyer to pay the outstanding amount along with the penal interest to the concerned MSME. However, despite the “award” in favour of the aggrieved MSME, buyers continue defaulting on their obligatory dues.

What is new?

In a new development, in late 2019, the MSME Ministry interlinked the Samadhaan portal with NeSL IU that now empowers unpaid MSMEs to file insolvency proceedings against their defaulting buyer.

Registered with the Insolvency and Bankruptcy Board of India (IBBI) that operates under the aegis of the Insolvency and Bankruptcy Code (IBC), 2016, National E-Governance Services Ltd. (NeSL) - a Union Government Company, is India’s first Information Utility (IU) that provides verified information (that does not require any further authentication) to adjudicating authorities of National Company Law Tribunal (NCLT) about a debt/claim.

With the interlinking of Samadhaan and NeSL IU, the authenticity of an MSME’s claim of unpaid dues is validated through the IU platform of NeSL by obtaining the response of the defaulting buyer. Now, when an MSME registers its complaint on Samadhaan, its consent to share its details with NeSL IU is taken. Upon receiving these details, NeSL’s team reaches out to the concerned MSME and guides it to upload all unpaid invoices on the NeSL IU portal.

A ‘Demand Notice’ is then automatically generated by NeSL IU and sent to the defaulting buyer on behalf of the aggrieved MSME. To ensure confirmed delivery of the ‘Demand Notice’, NeSL IU sends three reminders to the buyer to accept or dispute the claim.

If the buyer fails to respond to the Demand Notice within 14 days of receiving the 'Demand Notice Authentication Request', NeSL IU automatically generates a 'Record of Default' and disseminates it in the form of a 'Default Alert' to all registered Financial Institutions and Operational Creditors who have provided credit to the buyer.

In the event the defaulting buyer still refuses to clear the dues of his MSME vendor, the aggrieved MSME can use the 'Record of Default' generated by NeSL IU as a piece of legal evidence to make an application to the NCLT against the buyer under IBC, 2016.

At NeSL, we are confident that the process of public naming and shaming, loss of face and creditworthiness in front of lenders, and the loss of management control in the case of admission of application for insolvency proceedings, will deter buyers from defaulting on timely payments to their MSME vendors.

Article by
Primus Partners Private Limited

MSMEs: Revving up the engine of India's US$5 trillion journey

MSMEs are widely considered the growth engines of the Indian economy and expected to play a vital role in India's journey of becoming a US$5 trillion economy.

In the last few years, the Government has focussed on improving the ease of doing business in the country and enhancing its global competitiveness. The Government has launched various reforms and initiatives to support the MSMEs, such as 59-minute loan approval, lower interest rates for GST registered MSMEs, decriminalisation of small and inadvertent mistakes, assured procurement by Government entities, reducing the number of filings, etc.

Growth of the MSME segment has been hindered by various factors such as GST and demonetization, but the severe liquidity crunch has been an overarching concern. The current headwinds in the domestic and global economy, have added to the pressure faced by the MSME segment. Already strapped for financing, such organisations are also adding to the NPA problem that India is facing. However, NPAs of such firms are often the result if delayed payments from large firms.

While the government has undertaken various initiatives in recent times, to support the MSME sector, more structural reforms are needed to make them future-ready.

The Mudra Scheme is designed for micro-entrepreneurs providing them financing with ease and low cost. However, more than 90% of MSMEs are estimated not to have access to institutional financing options. In June 2019, the credit exposure to MSMEs was INR15.7 trillion up 12% from the previous year, though it was considerably short of the credit requirements of the segment. Since formal avenues of credit are not readily available to MSME organisations, they often turn to informal channels of credit, which lead to a much higher cost of capital. Benefits of various Government-run financing schemes are underutilised owing to the corruption and tedious procedures.

MSME's are the primary job creators in India, which often struggle to scale up, due to lack of essential infrastructure support, such as electricity, water, and connectivity. Government support is inconsistent and often leads to regional imbalances across the country. The infrastructural bottlenecks faced by MSMEs restrict regular business operations and hinder future growth prospects. Improving infrastructure, especially connectivity, can help bring down the cost of logistics and provide much-needed respite to the cost pressures faced by these firms. India needs to evaluate the creation of multi-modal corridors which can go a long way in improving connectivity concerns for organisations across the country.

Skill development is a key focus area to boost the growth of MSMEs, which often struggle to attract and retain the right talent. Cost pressures make it difficult for such organisations to invest significantly in up-skilling their staff. Lack of skill development and training often impacts the quantity and quality of output of such firms. The Government's efforts towards promoting skill development should also focus also encompass schemes that help address the skilling issues of MSME's. Given the lack of formal management implemented in various micro and small firms, it would benefit, if the Industrial Training Institutes are equipped to train people on financial markets, management, procurement and marketing skills.

Technological developments have been advancing at an unprecedented pace, and are contributing to improved efficiency levels across the world. While the Indian consumer has been adept at embracing technology, the Indian MSME segment is restricted in its access and adoption of emerging technologies of production. While embracing technology can help reduce cost and improve quality of output, the initial investment required and skilling efforts associated with such adoption often deters MSMEs from venturing too far from traditional methods. Technology is also opening various avenues for organisations for marketing their products in the global arena. However, Indian MSMEs, due to lack of funds and professional knowledge, often lack the zeal towards embracing these channels. Therefore, for the holistic development of the Indian economy, the Government should also focus on improving the linkage between large industries and MSMEs to foster the exchange of technological know-how.

To achieve its economic aspirations and to embed itself in global value chains, India needs to make focused efforts to support the growth of MSMEs. Intense competition from imports and other factors are impacting the level-paying field for these organisations. Sustained momentum of structural reforms is hence the need of the hour to support equitable growth in the country.

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About ASSOCHAM

The Knowledge Architect of Corporate India

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.

Today, ASSOCHAM has emerged as the fountainhead of Knowledge for Indian industry, which is all set to redefine the dynamics of growth and development in the technology driven cyber age of 'Knowledge Based Economy'.

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

Empower Indian enterprise by inculcating knowledge that will be the catalyst of growth in the barrierless technology driven global market and help them upscale, align and emerge as formidable player in respective business segments.

MISSION

As a representative organ of Corporate India, ASSOCHAM articulates the genuine, legitimate needs and interests of its members. Its mission is to impact the policy and legislative environment so as to foster balanced economic, industrial and social development. We believe education, IT, BT, Health, Corporate Social responsibility and environment to be the critical success factors.

MEMBERS – OUR STRENGTH

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 a44 Chamber with a difference.

Currently, ASSOCHAM has more than 100 National Councils covering the entire gamut of economic activities in India. It has been especially acknowledged as a significant voice of Indian industry in the field of Aerospace and Defence, Auto and Auto Ancillaries, Arbitration & Legal Affairs, Corporate Social Responsibility, Environment & Safety, HR & Labour Affairs, Corporate Governance, Information Technology, Luxury and Lifestyle, Biotechnology, Telecom, Banking & Finance, Company Law, Corporate Finance, Economic and International Affairs, Tourism, MSMEs, Textiles, Civil Aviation, Infrastructure, Energy & Power, Education, Legal Reforms, Real Estate and Rural Development, Startups & Skill Development to Mention a few.

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ASSOCHAM has been a significant contributory factor in the emergence of new-age Indian Corporates, characterized by a new mindset and global ambition for dominating the international business. The Chamber has addressed itself to the key areas like India as Investment Destination, Achieving International Competitiveness, Promoting International Trade, Corporate Strategies for Enhancing Stakeholders Value, Government Policies in sustaining India's Development, Infrastructure Development for enhancing India's Competitiveness, Building Indian MNCs, Role of Financial Sector the Catalyst for India's Transformation.

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.

Deepak Sood
Secretary General, ASSOCHAM
sg@assocham.com

The Associated Chambers of Commerce and Industry of India
Corporate Office: 5, Sardar Patel Marg, Chanakyapuri, New Delhi-110 021
Tel: 011-46550555 (Hunting Line) • Fax: 011-23017008, 23017009
Website: www.assocham.org

ASSOCHAM'S REGIONAL & OVERSEAS OFFICES

ASSOCHAM REGIONAL OFFICES

SOUTHERN Regional Office
#F1, First Floor, Richmond Plaza
No. 10 & 10/1, Raja Ram Mohan Roy Road,
Bangalore – 560 025
Phone : 080-4113 2467/4113 1891/4113 4838
Mobile : 9036333975
E-mail : umasnair@assocham.com

EASTERN Regional Office
18, Ballygunge Circular Road, Kolkata– 700019
Phone : 91-33-4005 3845/41
Fax : 91-33-40001149
Mobile : 9674312234
E-mail : perminder.kaur@assocham.com
kolkata@assocham.com

ASSOCHAM Regional Office, Tamil Nadu
International Law Centre,
61-63, Dr. Radhakrishnan Salai
Mylapore, Chennai– 600 004
Phone : 044-28120000
E-mail : vs@lawindia.com
intellect@lawindia.com

ASSOCHAM North Eastern Regional Office
Global Express Group, House No.7
Bye No. 2, Chandan Nagar
Survey, Beltola, Guwahati – 700 028
Phone : 09957999367
E-mail : ner@assocham.com

ASSOCHAM Western Regional Office
608, 6th Floor, SAKAR III, Opposite Old High Court,
Income Tax Cross Road, Ashram Road
Ahmedabad– 380014, Gujarat
Phone : 079-27541728-29
Fax : 079-27546352
Mobile : 9810825894
E-mail : vipul.bg@assocham.com

ASSOCHAM Regional Office, Ranchi
503/D, Mandir Marg-C
Ashok Nagar, Ranchi – 834 002
Phone : 0651-6555601/6555801
Mobile : 9971047550
E-mail : bharat.jaiswal@assocham.com

ASSOCHAM North Region Office, Chandigarh
SCO: 55, 56, 57, II Floor, Sector-8,
Madhya Marg, Chandigarh– 160008
Phone : 0172-4800855
Mobile : 9815025552
E-mail : ravinder.chandla@assocham.com

ASSOCHAM Regional Office, Uttarakhand
Plot No. 152, Nand Nagar Industrial Estate, Phase II,
Mahua Khera Ganj,
Kashipur– 244 713
Dist. Udhamsingh Nagar, Uttarakhand
Phone : 05947-226146
E-mail : assocham.uttarakhand@gmail.com

ASSOCHAM OVERSEAS 28 OFFICES

ASSOCHAM CORPORATE OFFICES

5, Sardar Patel Marg, Chanakyapuri, New Delhi-110 021
Tel: 011 -46550555 (Hunting Line) • Fax: 011-23017008, 23017009
Email: assocham@nic.in • Website: www.assocham.org

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About APAS

Ashvin Parekh Advisory Services LLP (APAS) was founded in June 2013 and is headquartered in Mumbai, the finance capital of India. APAS is a leading financial advisory firm, providing a wide range of consulting services to a diversified client base, including financial conglomerates, business houses, banking companies, life, general and health insurers, financial institutions, regulators and the government.

Our focus is primarily on business development through advisory services in strategy, processes and people areas. In strategy areas, we focus on diversification, strategic alliances, mergers and acquisitions and business restructuring. We also offer services in the areas of transformation and value creation. In the operation strategy areas, we also render services in product and product design, intermediation and distribution areas, business risk management and governance aspects of the management.

In keeping with the services we offer, we have experts in business and transaction advisory areas. We have teams drawn from the industry to offer services to our clients in business and operational areas in the financial services space.

We have teams focusing on the new banking reforms, including the formation of the new banking companies arising out of the new licenses. We offer operational support in the areas of financial inclusion, holding company structures and project management services. We also focus on the new reforms in the areas of subsidiarisation of foreign banks. In addition, we also conduct high level diagnostic studies for public sector and private sector banks.

Team

- Ashvin Parekh, Managing Partner

  Previously, Ashvin was senior partner in EY and heading the financial services division until June 2013. Prior to that, he held the position of Executive Director of Deloitte, India from July 2002 to June 2005. He has also served at senior positions in Arthur Anderson, PwC, KPMG and

Hindustan Lever Ltd. in UK, Dubai, Australia, Germany and the US on Partner Secondment programs.

Experience in Financial Services: During his tenure, he has successfully completed more than 700 projects in the course of 38 years. Ashvin's work has been focused on the areas of business strategy and capital expansion, with more than 45 transactions in the areas of JV and M&A. He was involved in the formation of 4 new banks in India.

At APAS: He assists entry of multiple foreign banks and re-insurance companies in India. He also advises clients in formation of non-banking finance companies and differentiated banking entities.

Eminence: Ashvin is registered as an expert in financial services sector with the World Bank and the Asian Development Bank and works closely with the Government of India. In the past 5 years, he has been on 9 committees set up by the Ministry of Finance.

He has been a member of several committees set up by the RBI, IRDAI and SEBI and is instrumental in bringing about reforms in the financial sector. He is frequently invited by top media houses to share his insights on current developments in the industry.

- Sujana Hari, Director

Sujana comes with more than 12 years of experience in financial advisory. Before joining APAS, she worked with Deloitte Financial Advisory Services (India) and a boutique consulting firm. Over the years, she gained experience in financial and business consulting, transaction advisory and syndication services. She served clients across the spectrum from Fortune 500 companies to Small and Medium Enterprises in various sectors and markets as diverse as India and the United States. Sujana holds Bachelors in Technology from JNTU, Hyderabad and a Post Graduate Degree in Business Management from Bharathidasan Institute of Management, Trichy.

At APAS: Sujana has been with the firm since its inception and handled various business and transaction advisory assignments for banking, insurance and other financial services firms across various subjects including technology, payments, governance and regulatory aspects. She assisted clients in setting up of foreign bank branches, reinsurance branches, and supported clients with advisory on differentiated banking license applications, regulatory advisory, business due-diligence, growth strategies, business and strategic consulting projects in the areas of technology, payments, governance etc.

- Kalpesh Mantri, Manager

  Kalpesh focuses on banking domain and has been instrumental in successful completion of various banking and related projects at APAS. He assists banking clients on various areas including business expansion, regulatory licensing, transaction advisory, regulatory advisory, business plan formulation, policies and processes documents preparation. He completed Master of Management Studies in Finance from Sydenham Institute of Management Studies and Bachelor of Technology in Production Engineering from VJTI, Mumbai.

- Harsh Mirpuri, Manager

  Harsh has worked on projects in the BFSI domain and provided strategic advisory and transaction advisory to the clients. At APAS, he focuses on technology and works closely with clients in Non-Banking Financial Services. Previously, Harsh has worked with ICICI Prudential Life Insurance Company Ltd. and Bank of America Continuum India Pvt. Ltd. He completed Post Graduate Diploma in Business Management (PGDBM) in Finance from Sydenham Institute of Management Studies and Bachelor of Management Studies (BMS) in Finance from MMK College, University of Mumbai.

- Ankita Narnaware, Manager

  Ankita specializes in the area of insurance along with banking business. At APAS, she assists various clients including private equity funds, health insurance companies, life and general insurance companies, foreign banks and co-operative banks in the area of M&A and was involved in business due-diligence and transaction advisory projects. She has assisted insurance and insurance distribution firms with their strategic expansion plans. She completed Master of Management Studies in Finance from Sydenham Institute of Management Studies and Bachelor of Technology in Chemical Technology from Nagpur University.

- Rishank Dabra, Senior Consultant

  Rishank has around 6 years of work experience in research and consulting. Currently, at APAS, he has been involved in the projects covering banking and insurance domains. His core strength lies in research and analysis. Previously, he worked with Gerson Lehrman Group (GLG) as a Senior Analyst. He completed Master of Business Administration in Finance from NMIMS, Mumbai and Bachelor of Arts in Economics from Delhi University.

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Assocham Corporate Office
5, Sardar Patel Marg,
Chanakyapuri, New Delhi – 110 021.
Tel: 011 46550555 | Fax: 011 23017008, 23017009
Email: assocham@nic.in | Website: www.assocham.org

Ashvin Parekh Advisory Services Llp
7th Floor, The Ruby, Senapati Bapat Marg,
Dadar – (W). Mumbai – 400028.
Tel: 022 67891000 | Fax: 022 49743828
Email: info@ap-as.com | Website: www.ap-as.com