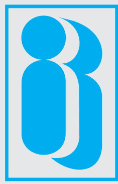

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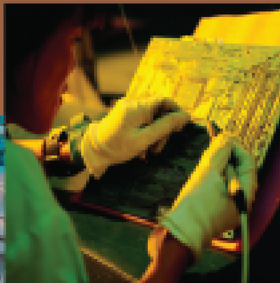

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CONTENTS

From the Editor

Special Features

Risk Capital for MSMEs 5
-- Ravi Tyagi

CART - A Tool for Credit appraisal and rating of MSMEs using IT platform 7
-- Arup Kumar

SIDBI's initiative in lending for Energy Saving Project in MSME Sector 10
-- Pushkar Mishra

FSIA - SIDBI Collateral-Free Equipment Financing Scheme 13

Indian MSME Sector Implementing market linked Business Development Services (BDS) in MSME Clusters - Experiences of SIDBI 16
-- Manoj Mittal

Small Industries Development Bank of India (SIDBI) 22

Promotional and Developmental Activities of SIDBI 26

Report of the Working Group to Review the Credit Guarantee Scheme of the Credit Guarantee Fund Trust for Micro and Small Enterprises 30

Impact of financial crisis on Banks in India and the new 'NORM'al 53
-- R. Bhaskaran

Book Reviews

Banking Risks - Management and Audit 61
-- S. N. Bidani

The Drucker Difference : What the World's Greatest Management Thinker Means to Today's Business Leaders 62
-- Craig L. Pearce, Joseph A. Maciariello and Hideki Yamawaki

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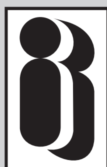

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ध्येय

संस्थान का ध्येय मूलत: शिक्षण, प्रशिक्षण, परीक्षा, परामर्शिता और निरंतर विशेषज्ञता को बढाने वाले कार्यक्रमों के द्वारा सुयोग्य और सक्षम बैंकरों तथा वित्त विशेषज्ञों को विकसित करना है ।

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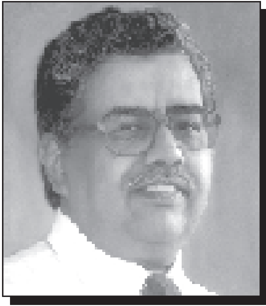


Small and medium enterprises (SMEs) form the backbone of a market economy. They provide most of the employment. A World Bank policy paper shows that SMEs' labour intensity is much higher than other industries. As such SMEs are being seen as a new engine of growth in the coming future and for banks they provide an important business opportunity. However, the sector is unique and has its unique challenges as well. To look at both the challenges and opportunities available in this sector we decided to approach an institution that specializes in SME financing and therefore, we approached the Small Industries Development Bank of India (SIDBI) to help us bring out this issue on SME financing with articles on various aspects of the subject. To our great happiness they agreed and thanks to their co-operation we are able to bring out this issue on SME financing.

As it is difficult for SMEs to raise equity through venture capital or other routes their ability to avail of bank credit also gets limited. It is mainly because of the risk profile of the SMEs that they face such problems. To mitigate this problem SIDBI has set up a risk capital fund which provides risk capital assistance to SMEs. Under this it has launched several products such as subordinated debt, participative mezzanine debt, equity/convertible preference equity and start-up assistance scheme. The article on 'Risk Capital for SMEs' elaborates on the rationale behind setting up the risk capital fund and also explains the various products in detail.

It is difficult to appraise proposals from SMEs for credit particularly because of the difficulties faced by the banks in appraising the creditworthiness of these firms. SIDBI has developed a Lotus Notes application tool Credit Appraisal and Rating Tool (CART) to simplify the appraisal process and also to make it Basel compliant. The article by Arup Kumar on 'CART - A tool for credit appraisal and rating of SMEs using IT' describes SIDBI's experience in using the tool, the new features that they have added and what is the roadmap for the future for this tool.

One of the key features of the SME sector is the existence of clusters which are geographic concentrations of interconnected companies and institutions in a particular field. In his article 'Indian MSME Sector Implementing market linked Business Development Services (BDS) in MSME Clusters - Experiences of SIDBI', Manoj Mittal talks about the GOI's initiative in encouraging cluster development through its MSME Financing and Development Project (MFDP). The Project which started as a pilot in 2007 in 3 clusters has been extended to 15 clusters in 2009 and has met with good response from the entrepreneurs. The article describes in detail the various success stories with regard to this Project.

editorial

Being energy efficient and conserving energy is an imperative across all sectors, SME being no exception. To encourage the small and medium enterprises to save on energy SIDBI has launched an initiative to encourage energy efficient investment in the sector through its 'Assistance for Energy Saving Scheme in MSME Sector'. Pushkar Mishra takes us through the highlights of the Scheme and gives us a lowdown on the various steps taken to encourage energy efficient investment by the SMEs and touched on the response received from the entrepreneurs on this scheme.

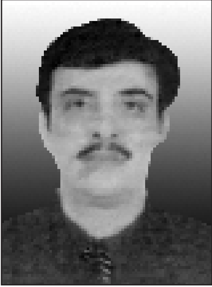
A case study is presented by the Faridabad Small Industries Association (FSIA) with a description of the FSIA-SIDBI Collateral - free Equipment Financing Scheme. This partnership has helped the FSIA mitigate its liquidity constraints through pre-approved loans by SIDBI depending on the strength and creditworthiness of the borrowers under FSIA. The details of how this Scheme works and how it has benefited FSIA and SIDBI is presented in this case study.

It was opportune for us that the report of RBI Working Group set up to review the Credit Guarantee Scheme of the Credit Guarantee Fund Trust for Micro and Small Enterprises was submitted while this issue was under compilation. We have, therefore, been able to carry out good part of the report to give our readers a peek into what could the policy direction with respect to credit guarantee be like. The mandate for the Working Group was to review the working of the credit guarantee scheme, to suggest ways to simplify its procedures and to suggest measures to enhance its usage and increase flow of collateral free loans to the SME sector. One of the recommendations of the Group was to increase the limit of the current level of collateral free loans from Rs.5 lakh to Rs.10 lakh and it be made mandatory for banks. The Group also recommended, with a view to simplification of procedure of filing for claims, initiation of legal proceedings as a pre-condition for invoking guarantees be waived for credit facilities up to Rs.50,000/-. Several other important recommendations are made by the Group and these would be found in the report.

Usually we carry at least one article outside the theme of the issue; this time we are carrying one on 'Impact of Financial Crisis on banks in India and the New Normal'. In this article I have tried to understand the differential impact of the recent global crisis on the different bank groups in India viz., public sector, private sector and foreign banks. I find that while regulation has helped to keep Indian banks insulated from the banking crisis the inherent character of these banks has also affected their profitability in the last couple of years or so. The 'risk for profit' approach of new private sector banks has adversely affected the profitability of some banks as their off balance sheet items were much higher than those of the public sector banks.

In addition to the above articles we are also carrying two book reviews; 'Banking Risks - Management and Audit' by S. N. Bidani, reviewed by A. C. Chug and 'The Drucker Difference: What the World's Greatest Management Thinker Means to Today's Business Leaders' by Craig L. Pearce, et al, reviewed by V. Raghuraman. We hope you will enjoy the current issue on SME Financing and find it useful.

(R. Bhaskaran)



Risk Capital for MSMEs

Ravi Tyagi *

MSMEs are considered one of the most important economic multipliers in any growing economy. However, a major pre-requisite for a vibrant and fast growing MSME sector is adequate availability of risk capital in addition to the two primary sources of finance *viz.,* promoters' resources and secured loans from banks / FIs. Most of the MSMEs are not able to get venture capital/equity assistance due to various issues like valuation, exit options, small ticket deal size, high failure rate, etc., and the fact that equity investments are generally favoured in very innovative and scalable businesses. Further, a large number of MSMEs are partnership / proprietorship firms which do not have the required capital structure to absorb external equity. Thus, a large number of growing MSMEs continue to be dependent on secured debt from banks and personal resources for their growth. However, while promoter capital is always limited, bank credit gets restricted due to norms for collateral security, DER, etc. The MSMEs in new economy and services sector are more affected as generally units in these segments do not create tangible assets at all.

Global scenario

Worldwide, limitation of equity in small companies is well recognized and therefore, alternate risk capital instruments consisting of mezzanine debt are used to meet the requirements of growing companies by complementing the secured lenders and equity investors. Mezzanine debt has features of both debt and equity and it takes more risk, i.e. it is generally not given on the basis of tangible security but on the ability of the unit to generate cash flows. Such mezzanine assistance is more flexible and could also be subordinated in payments to senior lenders which enable the senior lenders treat the assistance as quasi equity. The yield expectation is generally 3-4% higher than secured lenders but less than equity investors who have higher return expectation of 25% IRR or higher. The yield is derived through a fixed coupon rate debt with long moratorium periods and participation structures like royalty, equity warrants / options. Though such mezzanine structures are widely used in developed countries, in India, even basic mezzanine structures like subordinate debt are not available for MSMEs, though the same are used selectively for large corporates and infrastructure projects.

MSMEs are considered one of the most important economic multipliers in any growing economy.

SIDBI's risk capital initiatives

SIDBI has set up a risk capital fund for MSMEs, with an objective of providing risk capital assistance to a larger segment of MSMEs. The fund is being managed by SIDBI Foundation for Risk Capital (SFRC) and apart from providing direct risk capital assistance to MSMEs, it would also provide corpus support to MSME focused venture capital funds, which would invest in equity of innovative MSMEs. One of the key objectives of the fund is to commence mezzanine finance for deserving MSMEs in the country and create awareness about such instruments amongst banks, MSMEs and other stakeholders. As part of the initiative, SIDBI has launched following products :

* *DGM, SIDBI*

Subordinate debt (sub debt) : This product is subordinated in 'payments' and 'security' to all senior lender(s) of MSME and has other features like long moratorium period (upto 5 years), due to which it can be accepted as quasi equity by senior lenders *vis-à-vis* senior loans provided by them. The mechanism for sub-debt has been structured using international best practices. As the assistance is not provided on the basis of asset security, it could be by MSMEs for financing their intangible growth requirements R&D, marketing, technical know how, WC margin, etc. Sub-debt could also be used effectively as a component of the means of finance while financing projects, wherein the exposure of the bank (by way of secured term loan and working capital) could be restricted based on the available security / comfort of the bank. The assets created with the help of sub-debt would be charged to the senior lenders and thus improve their asset coverage. Leading MSME association has also endorsed the sub-debt product of SIDBI.

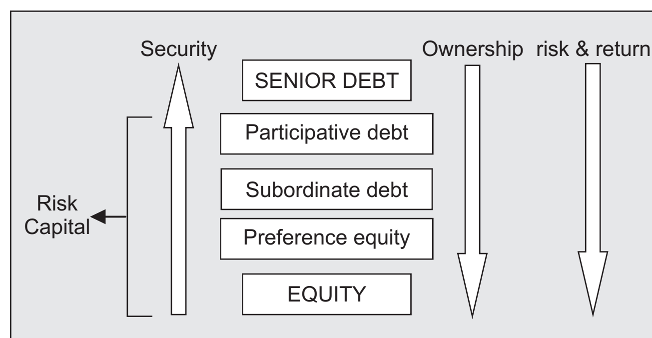
Participative mezzanine debt : While SIDBI follows a standardized approach for dispensing sub-debt, risk capital assistance is also provided in more structured manner where there is greater degree of participation i.e. apart from fixed coupon rate on debt / sub debt, SIDBI also may take royalty on sales, equity warrants / options, etc. which provide a higher return potential in case of better than expected performance of the assisted companies. This assistance is generally targeted at fast growing enterprises in services, technology and other new economy enterprises which have little tangible asset base but good business models and cash flows.

Equity / convertible preference equity : Assistance is selectively provided through equity instruments to innovative MSMEs with scalabale business models and high standards of corporate governance. The assistance is provided after carrying out external due diligence of the companies and through direct equity or convertible preference shares with pre-decided conversion methodology. Exit horizon is generally 5-7 years.

Start up assistance scheme : SIDBI has also implemented a Start up assistance scheme for financing of start ups and early stage companies with focus on innovation. Such enterprises find it very difficult to get assistance under normal bank schemes and are also considered too small for venture capital assistance. SIDBI provides assistance upto Rs.100 lakh through structured debt products with suitable conversion options. Efforts have been made to follow a standardized approach to make the programme scalable. The programme is being run in association with leading incubators in the country (IITs, IIMs, etc.), entrepreneurial bodies like TIE, mentor networks, etc.

Conclusion

The growth of Indian economy is expected to be driven by innovations and business dynamism of a large number of MSMEs, which have increased and diversified funding requirements. SIDBI has always made attempts to introduce innovative financing solutions for MSME sector and the risk capital assistance for MSMEs is another effort in the same direction, aimed at complementing the financing requirements of a large number of MSMEs in both conventional and new economy sectors. The objective is to bring in use wider range of risk capital instruments for MSMEs as under :



It is expected that the risk capital assistance would benefit a large number of growth and early stage MSMEs in different stages of their business cycles.

CART - A Tool for Credit appraisal and rating of MSMEs using IT platform

Arup Kumar *

Background

MSMEs globally have been the backbone of economy; same is true for India as well. Its contribution to the national economy is well acknowledged. However, despite its valuable contribution to the country's economy in terms of sizeable share in production, export, employment generation and GDP, it has not been getting adequate and timely credit - one of the essential ingredients for its optimum operations and key input for its growth. The banks in general have been looking at the MSMEs with skepticism on account of lack of transparency, professional approach, etc., plaguing the sector. However, in view of the significant contribution of the sector, it is not only a responsibility, but also a big opportunity for the banks to extend financial assistance to the MSME sector.

In this backdrop, SIDBI, the apex DFI for MSMEs, decided to develop a tool which would make easy and timely availability of credit for the MSMEs by way of faster processing of loan proposals in a comprehensive yet very simple manner with reduced Turnaround time (TAT). The tool is intended to simplify the appraisal process without compromising on its quality. Keeping in mind the Basel requirement, a simplified Rating Model was also added in the tool. Leveraging the strength of IT, the tool was developed in Lotus Notes Application software and was named as CART (Credit Appraisal and Rating Tool). Special care was taken to make the tool feature rich and yet user-friendly. Moving towards paperless environment, auto workflow feature has been incorporated, enabling the appraisal team to collaborate in soft copy. The tool was initially limited to loan size of upto Rs.50 lakh. The tool was accepted very well by the branch offices; it increased the comfort level of the credit officers in the field so much that there were demands to upwardly revise the loan cap for CART proposals to Rs.100 lakh.

MSMEs globally have been the backbone of economy; same is true for India as well.

External Developments

Appreciating the efforts of SIDBI in moving towards an IT based simplified appraisal and rating tool for faster credit delivery to the much needy SME sector, Reserve Bank of India made a mention of it in its Annual Credit Policy 2005-06, advising the banks to make use of SIDBI's expertise in SME appraisal under SEFC scheme. Hon'ble Union Finance Minister, in his announcement for policy package for SSIs in the parliament in August 2005, made a reference to SIDBI's CART and advised banks to make use of the tool for increased and faster credit delivery to SSIs. This was later followed by an RBI circular on Aug 25, 2005 advising banks to make use of CART for reducing transaction cost (thereby expecting reduction in the cost of lending to the SSIs).

New Initiatives

In view of the internal demand and external developments, it was decided to add more features and migrate CART to an IT platform independent environment to facilitate processing of larger loan size and enable banks / FIs to implement it in their respective systems. Accordingly, CART for Rs.100 lakh was developed in J2EE (Java) and was released in Dec 2006 by the IBA Chairman, amidst an august

* *DGM, Credit, SIDBI*

gathering of senior officials from RBI and Commercial banks. SIDBI decided to give the tool free of cost to all the MoU Banks and SFCs.

The new tool has evolved with experience, the appraisal module has got comprehensive coverage on the critical parameters of loans upto Rs.100 lakh while the rating module has been made 2-dimensional Obligor as well as Facility (in line with the requirements of Basel-II). The flow and the navigation have been made very user-friendly, enabling even a new user to work on it with ease.

Features of CART

CART is a feature rich tool. Some of its salient features are :

- It has been developed in open system architecture enabling the user institutions to use it on any IT platform.
- It has been designed in easy to understand, user-friendly menu driven manner in a tabular setting, with drop down sections.
- It has features to handle proposals
  - below INR 10 lakh and in the range INR 10 lakh - INR 200 lakh
  - for term loan requirement, working capital requirement and composite loans (term loan as well as working capital), and
  - for existing as well as Greenfield projects.
- The software has two modules Appraisal and Rating, and a feature for Automated Document Flow.
- The Appraisal module has sections covering all the relevant aspects of a loan proposal, viz.
  - Promoters & Management
  - Project details
  - Financial projections and Working Capital
  - Industry and Marketing aspects followed by user-defined terms sheet.
- The rating parameters are divided into four sections
  - Management
  - Financial

CART has proven to be a very effective tool in improving the credit delivery process of SIDBI. More than 4000 loan proposals have been processed in this Tool.

  - Business and Operations
  - Industry
- In line with the requirements of Basel-II, besides the Obligor rating (as above), feature for Facility Rating is integrated into the tool, giving Combined Score for the loan proposals.
- Also, in the Appraisal Module, provision for data capture has been made keeping in view the KYC (Know Your Customer) / AML norms, Credit history checks (CIBIL list, etc.)
- The software has the facility to generate various MIS reports which can be used to generate business and knowledge data.
- To take care of Operational Risk, it has got appropriate security features by way of User credential checks. Access is further controlled through different privileges for different users depending upon respective roles and responsibilities. The Tool has got features to capture Audit Trail too.
- CART can work with Oracle as well as MySQL; run with ApacheTomcat or JBoss (open source application server) (Web servers) and may be accessed using any Web browser.
- The tool may be deployed on a stand-alone mode, in LAN / WAN or even on internet.

Outcome

CART has proven to be a very effective tool in improving the credit delivery process of SIDBI. More than 4000 loan proposals have been processed in this tool. The average TAT has come down to 2.30 days. 99.9% of the assets created out of CART are standard.

Some of the banks and SFCs have adopted CART as the tool for processing of smaller loan proposals.

Others are reported to be contemplating the same. With a view to facilitate smoother implementation of CART in those banks and institutions, SIDBI has been providing technical and users trainings to them, besides off-site support on regular basis.

Recent Developments

RBI in May 2009, while communicating the acceptance of major recommendations of Dr. K. C. Chakraborty to a group of banks, advised them to either use SIDBI's CART or develop similar tool for processing of loan application from SMEs. SIDBI has been receiving requests from many banks for sharing the tool, which is being done free of cost as a goodwill gesture.

Further, various international delegations from banks / FIs and Central Banks / Govt. Departments, during their visits to SIDBI have shown interest in CART. Their feedback on CART has been very positive. Some of them have even indicated willingness to implement CART / CART type tool in their organisation / country with our help. In view of the same, an international familiarisation-cum-training programme for the participants of interested banks / FIs is proposed to be organized in association with the Manila based ADFIAP (Association of Development Financing Institutions in Asia and the Pacific).

With our satisfactory experience, and some modifications in the tool, the loan exposure cap for CART has been further upwardly revised to Rs.200 lakh.

Roadmap

With the encouraging feedback from the field level officers of the Bank, as also from other banks / SFCs / international institutions, the following enhancements are being contemplated :

- option to use different rating model (other than that of CART),
- undertaking various types of financial analysis,
- auto generation of post-sanction legal documents, etc.

Further, more variants are planned to be developed to cater to the following :

- different loan sizes & types (to take care of various sizes of requirement; with project / without project, etc.)
- different user-institutions (banks, SFC, NBFCs, etc.)
- clusters (like Auto, Textile, Energy Efficient, etc.)

With all this, it is expected that CART would emerge as the preferred tool of the banking and financial sector for extending various credit facilities as 'one - stop solution' which would cater to the requirements of appraisal of various types of projects, various types of financial analysis, appropriate rating models, auto-generation of Legal Documents for individual sanctions, disbursement of the sanctioned amount, along with various reports and add-on features. This 'small' intervention has the potential of affecting the MSMEs in a big way. CART would reduce the turnaround time of loan processing considerably, thereby reducing the transaction cost of the banks / FIs. CART would also help the organizations to move towards paper-less environment resulting in further cost-cutting. By automating the entire process, it would reduce the operational risks too. This would ultimately reduce the cost of credit to the MSMEs. This would result in availability of timely and cheaper credit to them in a transparent manner, facilitating their growth and increased contribution to the national economy.

SIDBI's initiative in lending for Energy Saving Project in MSME Sector

Pushkar Mishra *

Micro, Small & Medium Enterprises (MSMEs) have been the backbone of the Indian economy. There are 26.1 million MSMEs as per the 4th MSME quick census (2006-07) which accounts for 40% of industrial production, 35% of exports and provides employment to 59.7 million people. The sector encompasses the wide spectrum of Indian economy from traditional manufacturing sector (i.e. textile, leather, ceramics, forging, foundry, jewellery, handicrafts, etc.) to modern technology & knowledge based sectors (i.e. IT, biotech, KBO, telecom, logistics, etc.). The MSMEs have been the growth driver of the Indian economy as their growth has been higher than overall industrial and then economic growth rate. Thus, sustainable development of MSMEs is critical to the overall economic development of the country.

The traditional MSME sectors are generally functioning in clusters with obsolete technologies / production processes. Different surveys/studies have revealed that traditional MSME clusters are energy inefficient and there is good scope for improving energy efficiency by 10-30% in high energy intensive sectors like, foundry, forging, ceramics, steel re-rolling, leather tanning, textile processing, etc. Investment in energy efficient / clean technologies is key to the survival and growth of MSMEs as it brings down their cost of production which in turn helps them offer competitive rate, expand market and improve top and bottom line.

Sustainable development of MSMEs is critical to the overall economic development of the country.

SIDBI recognized the need for promoting energy efficiency investments in the MSME sector for their sustainable development. There is huge scope for improving the efficiency & productivity of the MSME sector by taking up investment in clean energy efficient technologies / processes, etc. It has been observed that MSMEs are generally reluctant to modernize and upgrade their units as they lack information about energy efficient technologies, cost of such investments, skill upgradation required, benefits from such investment, etc.

To encourage MSMEs to overcome information gap and take up energy efficiency investments, SIDBI has launched "Assistance for Energy Saving Scheme in MSME Sector" at a concessional interest rate along with technical support services under bilateral Lines of Credit from Japan International Co-operation Agency (JICA); KfW, Germany; and AFD, France. The response to the initiatives has been encouraging and there has been greater interest and inclination among MSMEs to take up energy efficiency related investments.

SIDBI's initiative for promoting Energy Saving in MSMEs

SIDBI has taken a multi pronged approach to promote energy saving in MSME sector as it has been felt that providing finance alone will not suffice. The bank first identified the industrial sectors which are high energy intensive and then identified potential clusters having high concentration of MSMEs in the identified industrial sectors for intervention. Some initiatives in this regard are as under :

* *Asst. Gen. Manager in Energy Efficiency Cell at SIDBI*

- **Awareness campaigns in the clusters :** SIDBI in association with JICA and Winrock International India (WII), the technical consultant for the energy saving project, has launched awareness campaigns in identified sectors / clusters. So far 18 awareness campaigns have been organized at Kolhapur (foundry), Rajkot (forging), Morbi (ceramic), Coimbatore (forging), Tirupur (textile), Chennai (leather), Surat (textile), Vapi (paper & chemicals), Kolkata (foundry & leather tanning), Ludhiana (textiles), Jalandhar (hand tools), Indore (Pharma, auto components & oil mills), Gurgaon (textile, auto components & electronics), Faridabad (light engineering), Pune (auto components, engineering & food processing), Bangalore (electricals & electronics), Jaipur (foundry & steel re-rolling) and Mumbai (engineering, electrical, textile and chemicals). The response to the awareness campaigns have been satisfactory and positive. The MSMEs have shown interest in energy saving investment, but due to slowdown in the economy and reduction in off-take of demand, investments were delayed / postponed in first half of the calendar year 2009. However, as the economy started turning around in late 2009, demand has picked up for investment in energy saving projects from MSMEs.
- **Assistance for energy saving projects :** The Bank has been providing assistance at concessional rate, i.e. at fixed interest rate of 9.5-10% p.a. Further, Government subsidy (CLCSS, TUFS, IDLSS, etc.) for the investment is also given as per eligibility. More than 1900 MSMEs in aggregate have availed assistance of Rs.633 crore as on Feb.15, 2010 under the scheme. Major centres where the scheme received good response are Bangalore, Chandigarh, Ludhiana, NCR, Hyderabad, Nasik, Thane, Tirupur, and Pune and Rajkot. Machinery and engineering (metal components, parts, auto components, etc.) has attracted maximum investment under the scheme.

Some of the initiatives for providing energy efficient lending to micro entrepreneurs are :

a) *Taxi Financing :* SIDBI, under a structured arrangement with Mumbai Taxi Drivers' Association have been providing micro assistance of Rs.2 lakh to taxi drivers without collateral security under CGTMSE coverage to phase out their old taxis. More than 700 micro entrepreneurs (taxi drivers) were provided finance under this arrangement with aggregate disbursement of Rs.17 crore. The initiative has helped in promoting clean technology and controlling pollution.

b) *Auto Rickshaw Financing :* 586 CNG fitted auto rickshaws were provided assistance in Chandigarh by Delhi Finance Corporation (DFC). SIDBI supported through refinance to DFC for this clean energy initiative.

c) *Solar lanterns :* Friends of Women's World Banking (FWWB), an MFI was sanctioned assistance of Rs.3 crore for providing assistance to micro entrepreneurs for solar lanterns of 2 watts each. More than 20,000 solar lanterns have been provided to micro entrepreneurs in Manipur for their income generating activities.

- **Publicity to the Scheme :** To disseminate information for energy saving projects multiple forums and channels are used :

a) SIDBI branches have been marketing the Energy Saving Scheme during business development meets / in industry associations, etc.

b) Advertisement of the Energy Saving Scheme is issued in news papers / industrial magazines, etc.

c) SIDBI's Energy Saving Scheme for MSME sector has also been hoisted on the website of the Bureau of Energy Efficiency (BEE).

d) An exclusive website **www.jica.org.in** for promoting energy saving among MSMEs has been created to give updated information on energy saving technologies / equipment, cluster profiles, energy saving potential in the clusters, brochure of the scheme, quarterly magazines, etc. It also has a query mode through which queries may be sent for clarification on eligibility of equipment.

e) Booklets on housekeeping and energy saving in vegetable & food processing industries have been published explaining simple do's and don'ts on energy efficiency measures to enhance awareness about simple, cost effective solutions that would reduce energy, consumption and improve the competitiveness of the fruit and vegetable processing cluster.

f) Three handbooks on house keeping measures were published for improving energy efficiency of MSMEs in Engineering, Foundry and Ceramics sectors at Mohali-Chandigarh (Punjab), Coimbatore (Tamilnadu) and Morbi (Gujurat) respectively.

- **Capacity Building of BDS** (Business Development Services) providers under Cluster Development Initiative : SIDBI has initiated efforts to build the capacity of local BDS providers to enable them to offer their services to MSME sector under its cluster development program.

Conclusion

The above initiatives have generated good response from MSMEs / clusters. The awareness of the scheme is increasing and MSMEs are realizing the advantages of investing in energy saving projects. Feed back from our field offices have been positive and enquiries from different clusters have been coming from across the country. It is expected that by the end of current financial year, we expect to provide assistance to more than 2500 MSMEs for investment in energy saving project.

Difficulties Faced by the Banking Sector in Extending Credit to SMEs

The difficulties faced by the banks in extending credit to SMEs mainly stem from informational opacity and lack of credit history. Unlike large corporations, small businesses are typically much more informationally opaque, because they often do not have certified audited financial statements to yield credible financial information on a regular basis. Also, these firms usually do not have publicly traded equity or debt, yielding no market prices or public ratings that might suggest their quality.

High-risk perception associated with small-scale sector stems from a number of factors such as weak financial strength, inability to provide adequate collateral and other factors. Inability to properly appraise the new projects, new firms and new activities by bankers often results in banks shunning a small borrower. To a greater extent, as the banks are not able to assess the actual or potential risks about the borrower from the SME sector, there is likelihood that banks may arrive at a wrong perception about the borrower.

Asymmetric information about the business prospects of small scale projects and financial standing of the small borrowers arises because small-scale borrowers generally do not have a well-documented credit history. As a result of asymmetric {information and high-risk perception, banks rely heavily upon the collateral-based lending rather than cash-flow analysis while working with small-scale sector borrowers. Although there is a threshold up to which bankers should not insist on collateral, they seldom assume the risk involved in non-collateralised lending. The surveys conducted by the Reserve Bank revealed that many bank branches insisted on collaterals even for loans up to Rs.5 lakh.

Moral hazard problems are associated with the possibility of small scale sector diverting funds to alternative projects or they develop the propensity to take excessive risks. Also, owing to the small amounts of each loan, the aggregate costs of information gathering, due diligence, loan processing and monitoring are much higher than for loans to large corporate borrowers. Therefore, financial institutions charge relatively higher interest rates to small scale sector than to larger companies in order to compensate for the higher costs of information collection, the smaller volume of external financing and perceived greater credit risk.

Other reasons often stated by banks for the weak growth of SME credit are (i) the large number of unregistered enterprises, which require different lending and risk management techniques, processes, and skills; (ii) lack of a secured transactions law to regulate assignment and registry of movables; and (iii) the difficulty and high cost of registering property and enforcing contracts.

Source : RBI's Report on Currency and Finance 2006-08, Volume - II.

FSIA - SIDBI Collateral-Free Equipment Financing Scheme *

A unique step forward

A Memorandum of Understanding (MoU) signed between Small Industries Development Bank of India (SIDBI) and Faridabad Small Industries Association (FSIA) on 20th December, 2008 has been extended further for the year 2010-11. The Special scheme is for collateral-free Equipment Finance scheme upto Rs.50 lacs for FSIA members - a unique scheme formulated specially upon the request of FSIA. This marks the mutual support, cooperation and trust between FSIA and SIDBI and should go a long way in helping the growth and progress of modern Indian MSMEs. FSIA was established in 1977 and has emerged as one of the most active, progressive and largest representative body of MSMEs in north India.

The background :

Most of the MSMEs need to regularly invest in capital assets like dies, jigs, fixtures, testing equipment, machinery, generating sets, transformers, computers, office equipment and other miscellaneous fixed assets throughout the year. Since such needs often emerge suddenly, the units generally have no time to approach their regular bankers for term loan assistance, or sometimes the requirement of documentation and procedure to enhance existing credit limits are too rigorous and time consuming.

Memorandum of Understanding (MoU) signed between Small Industries Development Bank of India (SIDBI) and Faridabad Small Industries Association (FSIA) on 20th December, 2008 has been extended further for the year 2010-11.

To meet with such unplanned, urgent requirements, MSMEs often resort to unsecured loans or loans against property from private lenders at very high interest rates ranging from 18-36% or from the markets at even higher interest rates or use their very limited and precious Working Capital / CC / OD limits. These loans are costly and are also of shorter duration viz., 1-3 years, which further result in liquidity crunch in these small units. By the end of every financial year, lot of working capital and reserves get fixed in these assets and thus cash position remains tight. MSMEs, even though in profit, may thus remain perennially anaemic.

The solution :

In a bid to help MSMEs negate the liquidity crunch in their day to day business and in order to provide a solution to the above and upon the request of FSIA, SIDBI approved a very special Collateral-free Equipment Finance scheme for FSIA Members. This is an ideal example of partnership wherein the redefined roles and responsibilities in the era of interdependence are highlighted as the Association is not only highlighting the problem but also acting as a facilitator by becoming a part of the solution.

The arrangement :

Under this arrangement, SIDBI sanctions pre-approved limits in the range of Rs 10-50 lacs to FSIA Members depending upon their financial strength and requirements, which could be used by such MSMEs for capital expenditure during the year. These limits are intimated to such MSMEs in the form of sanction letters, valid for 1 year so that at the time equipment is to be purchased, the disbursement is made immediately, say, within 24 to 48 hours.

* *The article has been taken from the FSIA Bulletin.*

These loans, as and when availed, are repaid through post dated cheques either in the form of Equated Monthly Installment (EMI) or wherever required, repayment can be staggered / ballooned with gestation period. Credit Linked Capital Subsidy @15% is available wherever applicable.

Proprietorship, Partnership, Pvt. Ltd. and limited companies in Micro, Small and Medium categories, which are minimum 3 years old and in profit for 2 years are eligible. These loans are over and above the existing credit limits with existing bankers which can continue.

The Partnership :

The arrangement has put the hitherto unknown responsibilities upon FSIA. The MSME has to file the Application along with the required documents at the FSIA Office. FSIA has appointed trained professionals to assist the applicants. Preliminary credit appraisal, site visit, personal interview of the entrepreneur are done by FSIA officials and the complete file is forwarded to SIDBI along with FSIA recommendation. SIDBI may ask for additional information, if required, and carries out its appraisal, and sanctions the limit.

At the time when disbursement, whether in full or in part, is required, the unit submits Proforma Invoice or other documents to FSIA which are verified and forwarded to SIDBI with request for disbursal. PDCs are collected for the disbursed amount and unit later submits Invoice, installation certificate etc, to SIDBI through FSIA.

FSIA, thus, is involved right from the first stage when application is made to appraisal, recommendation, disbursement and help in collection of EMIs and installments. To help FSIA meet the additional cost of hiring new personnel to handle the work and build its capacity to perform the role and responsibilities under the arrangement, SIDBI pays upto 1% of the limits sanctioned to FSIA in two phases. A Special Purpose Vehicle (SPV) by the name and in the style of "Integrated Association of Micro, Small and Medium Enterprises of India" (I-am-SME-of-India) was registered under section 25 of The Companies Act which is managing this activity besides various other developmental activities for MSMEs.

Salient Features :

- Loans for plant & machinery, generators, computers, office equipment, HSIIDC Ind. plots & sheds, capital equipment, fixed assets, etc.
- No collateral security
- Up to Rs.50 Lacs
- Prompt and fast processing
- Interest Rate PLR minus 0.5%. (Present 10.5% p.a.)
- PDCs accepted
- Term up to 60 months
- This limit is in addition to present credit facilities from other banks
- Use whenever required, in full or in part to buy assets, machines, etc.
- Repayment in easy instalments upto 5 years, only on the disbursed portion.
- EMI, staggered, ballooning with gestation period of up to 6 months wherever required.
- For all Micro, Small and Medium Enterprises in existence for 3 years and in profit for 2 years.
- Proprietorship, Partnership, Pvt. Ltd. & Limited companies eligible
- Credit linked capital subsidy (15% Subsidy) available wherever applicable.
- Sanction letter valid for up to 6 months for immediate disbursal whenever the need arises.

Future-ready :

There are moments of disappointment too when in some cases the desired limits cannot be recommended due to inherent weaknesses in the financial statements of the MSMEs. FSIA found that many of those who sign these statements have limited knowledge and often do not understand the implications. Since the basic concepts are not clear, the significance of various ratios not known, they fail to attract credit and other resources at best prices.

This has opened new role for FSIA. It has engaged Chartered Accountants and professionals to explain

the reasons for rejection and also train these MSMEs to read, study and analyze their balance-sheets and understand how they can be healthier to become credit-worthy in future.

As FSIA President Rajiv Chawla puts it, “When I was born, my horoscope (Janam Patri) was made by astrologers, based upon three factors, date, time and place of birth. These cannot be changed. Neither had I any control over these three factors as these were not decided by me. So, I cannot change my horoscope (Janam Patri). My destiny, therefore, is fixed… or is it?

I realize that there is one Janam Patri that I write every year. That is in my control. The Janampatri of my Business. It is called Balance-Sheet. It is valid for one year. Based upon this, a banker decides whether to give me loan, at what rate, whether banks or financial institutions will support my business in expansion plans or will I have to face rejections?

I, therefore, spend my time and energy in learning what I can shape for myself instead of worrying about what I can't change.

I believe that every entrepreneur can write his or her own destiny… only if he or she knew how to. Fate is nothing, but what you make.”

Credit Counselling Cell :

FSIA soon realized the need to have an independent, easily accessible, credible credit counseling system / facility that helps consumers in assessing their loan portfolios and advise / guide them properly on their debts' swapping / re-adjustment / re-scheduling and help them sort out the financial trap they might be in.

MSMEs avail of various loan instruments to meet their urgent, unplanned requirements. Whenever the requirements arise suddenly, to save on time, MSMEs resort to unsecured loans, credit card usage, loans against property and even at times to private kitties or chit-funds. Many of these instruments are high interest bearing (16-36%) with hidden costs and silently eat away the precious liquidity, profits and erode the capital & reserves. Over a period of time, MSMEs get busy and don't have even time to realize that they have fallen into credit-traps.

We share the experiences of experts and in order to create a system of well-monitored and independent debt advisory services, FSIA formed a Credit Counselling Cell (CCC) to :

- Study, analyze, rate and assess the loan portfolios of our members
- Advise members on ways and means to improve their liquidity, reduce the loan burdens, etc.
- Advise and / or facilitate in arrangement of funds at reasonable rates from recognized financial institutions to help our members in swapping high interest loans with low interest loans, negotiate better terms with financial institutions, help in re-scheduling wherever required and if possible try to find alternate sources proving better terms, if possible.

This panel consists of learned professionals including senior entrepreneurs, Chartered Accountants and finance experts who help members in getting their loans' portfolios assessed and guide them properly for the better options as and where available & applicable. Many senior FSIA Members, professionals, Financial Consultants volunteer their services to this Credit Counseling Cell (CCC).

“Let no deserving enterprise or project suffer due to non-availability of finance.

Let no promising business idea or innovation or dream die without a try due to lack of finance.

Let no entrepreneur ever say, 'don't know what to do or where to go?'

Indian MSME Sector Implementing market linked Business Development Services (BDS) in MSME Clusters - Experiences of SIDBI

Manoj Mittal *

I. Indian MSME Sector and Clusters

The micro, small and medium enterprises (MSME) sector in India, comprises about 26 million enterprises, accounting for around 95% of all industrial units, 45% of manufacturing sector output, 40% of exports and provides direct employment to about 60 million in the country. A large share of these MSMEs are located in clusters and due to this geographical advantage, MSME clusters present an effective medium of wider reach and greater impact.

According to Michael Porter, "Clusters are geographic concentrations of interconnected companies and institutions in a particular field. Clusters encompass an array of linked industries and other entities important to competition. They include, for example, suppliers of specialized inputs such as components, machinery, and services, and providers of specialized infrastructure."

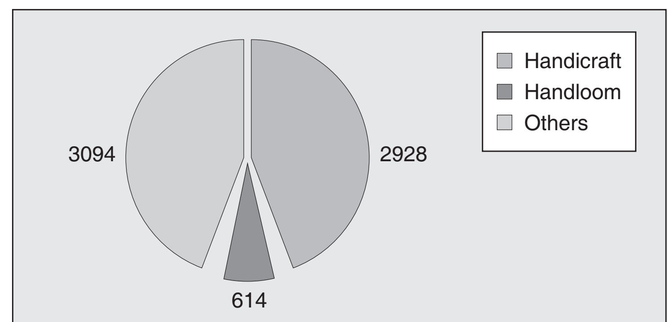
Alfred Marshall in his classical work, Principles of Economics (1890) and, Industry and Trade (1919) offered significant insights into the advantages of industrial districts. He referred to it as "*the concentration of specialized industries in particular localities*". Industrial districts, it was observed, gave rise to external economies that particularly favoured small enterprises through creating opportunities for easy access to pool of skilled labour, subsidiary trades and communications networks.

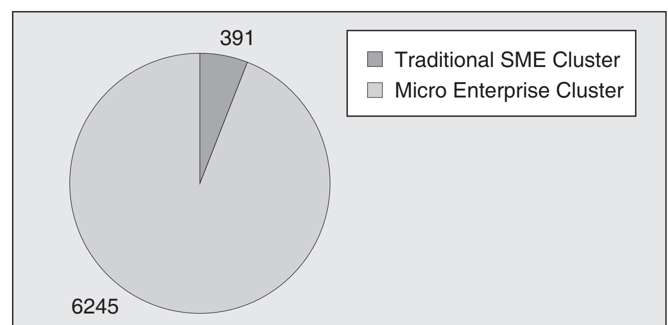
An important factor for cluster development is localization which includes attraction of buyers to places having many sellers. For instance, Indore, a cluster of pharmaceuticals firms in the state of Madhya Pradesh, has a market complex, also known locally as 'Dawa Bazar' comprising about 200 traders dealing in whole sale marketing of pharmaceutical products. This market has attracted buyers from different parts of the country to Indore.

The labour pooling also has a large effect on agglomeration of firms. Workers prefer to stay at locations having concentration for firms to have better job opportunities. This improves the availability of labour and in turn encourages the setting up of more firms.

II. Cluster development in India

Ministry of MSME, Government of India defines clusters as a group of enterprises located within an identifiable and as far as practicable, contiguous area and producing same / similar products / services. However, in India, there exists, no universal / national benchmarks to define the size of cluster. A distribution of various types of clusters in India is provided as below :-

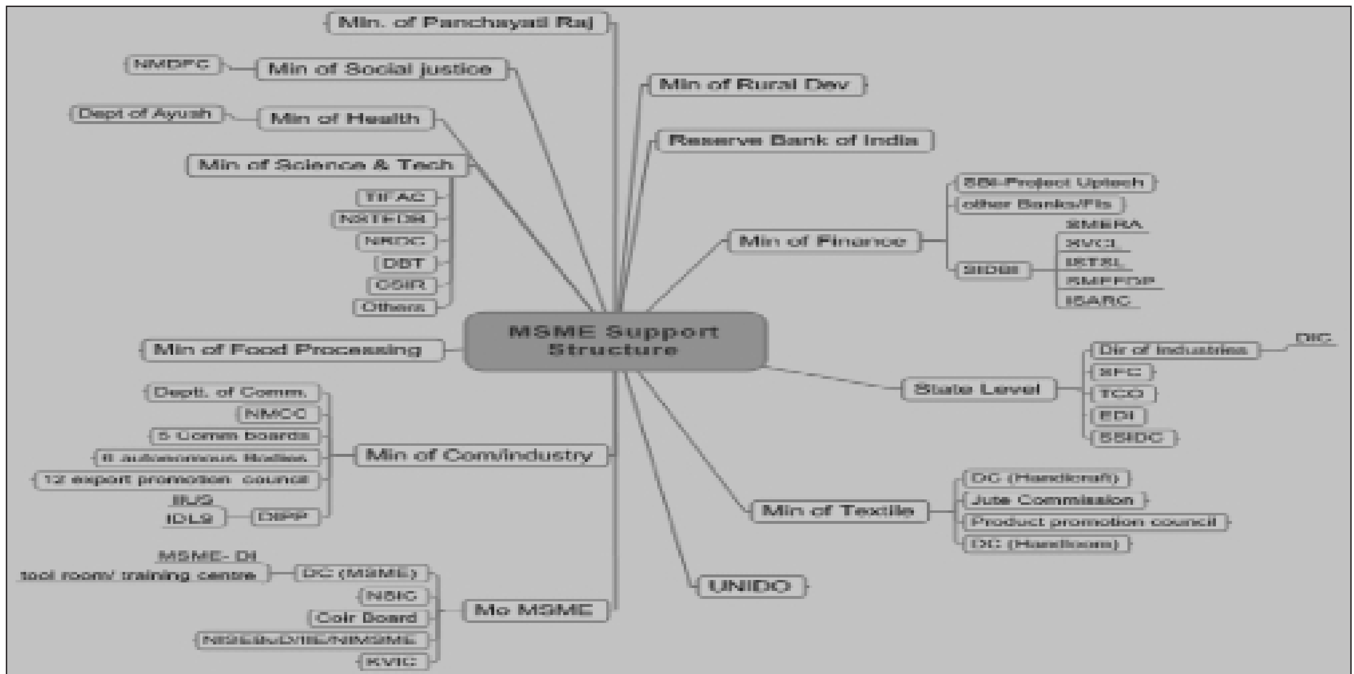




Source : MSME Databse 2010, SIDBI

* *Asst. Gen. Manager in Energy Efficiency Cell at SIDBI*

Besides the MoMSME, several departments of Government / Banks etc., have formed specialized schemes to support cluster-based development of the MSME sector.



crore as on March 31, 2009. SIDBI was set up as a Principal Development Financial Institution for promotion, financing and development of industries in the MSME sector and co-ordinating the functions of other institutions engaged in similar activities for orderly growth of industry in the MSME sector. The activities of SIDBI, as they have evolved over the period of time, now meet nearly all the requirements of the sector. SIDBI has struck a good balance between financing and providing other support services i.e. non financial needs to MSME sector. In its endeavour to provide support services to the MSME sector and related institutions, SIDBI is implementing a multi agency / multi activity Project on Financing and Development of MSMEs namely MSME Financing & Development Project (MSMEFDP).

Recognizing cluster development as a powerful tool for MSME development, during last decade, the Government and development institutions have announced number of promotional schemes / programs that have supported about 1648 clusters. The support has been highly driven by promotion of infrastructure. However, the importance of soft inputs is also reflected in the schemes of the Govt. as indicated in Eleventh Five Year Plan : "…Cluster level support is required for both 'soft' (e.g., marketing, training, network creation, Business Development Services provision, ….) as well as 'hard' (cluster-specific infrastructure) intervention……". Thus, it could be said that process of cluster development requires both the hard infrastructure and soft inputs.

III. Small Industries Development Bank of India (SIDBI)

SIDBI, established in April 2, 1990 is one of the top 30 development banks of the world. It has a net worth of Rs.5342 crore and an asset base of Rs.30886

The World Bank, Department for International Development (DFID) UK, KfW Germany and GTZ Germany are the international partners in the Project.

MSME Financing & Development Project (MSMEFDP)

Noted as perhaps the second largest BDS project in the world, the MSMEFDP is aimed at making MSME lending

an attractive and viable financing option as also facilitate increased turnover and employment in the sector.

While the MSMEFDP covers a comprehensive set of need-based interventions for MSMEs viz., technical assistance, risk sharing and credit facility, implementing market linked Business Development Services (BDS) for MSMEs is the cornerstone of the project. This is designed to strengthen MSMEs' access to market driven BDS, to facilitate designing and implementing strategies to foster BDS market development in select MSME clusters and develop them as "Role Models" with a strong demonstration effect.

The BDS project started, in July 2007, on a pilot basis in 3 clusters viz., Alleppey coir cluster, Pune fruit & vegetable processing cluster and Kanpur leather cluster and also made certain specific interventions in the forging cluster at Ludhiana and brass component cluster at Jamnagar.

Buoyed by the success of the pilot interventions, the project, in April 2009, was expanded in 15 additional clusters across the country. Currently, the project reach has totaled a number of 21 MSME clusters (Box).

Box

These 21 clusters broadly represent 7 sub sectors viz., Engineering, Pharma, Floor Covering, Fruit & Vegetable processing, Leather, Dyes & Chemicals & Knitwear. It is estimated that there is scope for taking the learning of these 21 clusters to over 150 other clusters which belong to similar sub-sectors. The intervention has produced some path breaking results and created new models for delivery of Business Development Services in these clusters. The project has facilitated around 300 activities with participation from more than 10000 MSME units / BDS providers. These initiatives ranged from skill upgradation to testing facilities to technology upgradation to marketing initiatives etc., some of which are discussed as under -

Skill Development

a. Training rural unemployed youth from BPL families for gainful employment

It was estimated that footwear units at Kanpur need more than 10,000 shop floor workers during the next five years with no proper institutional mechanism to meet this demand. Thus the strategy adopted by the project was to involve a local intermediary institution that already had some trust with the firms, work out a professional course through a reputed institution and with the involvement of the intermediary ensure that placement takes place in the end. Apart from the project, assistance was also utilized from the Ministry of Rural Development. Beginning with the first batch of 20 trainees in March 2008, the project has trained 1100 persons and 1070 of them have been employed by around 42 units. The candidates trained belong to BPL families and have reported increase in the income after the training. Interestingly, starting with one centre, the project has increased to 3 more centres with two of these centres belonging to private sector.

b. Training local women to tackle shortage of migratory labour

Severe shortage of skilled labour was one of the most common problems of Ludhiana knitwear cluster identified under this project. It is difficult to meet the production requirement without the availability of skilled

labour. According to reports, there is an immediate shortage of more than 50,000 skilled workers in the industry.

The Ludhiana BDS programme sought out to tap the untapped labour pool of local and rural women and decided to train them for working in the factories with the help of BDS programme. The factory provided the training infrastructure and raw material required for training. These women who were unemployed or worked as household labour till only a month back were able to secure jobs at an average salary of Rs.3500 per month + transportation and perks. Of the 270 trained women, almost 90% have received confirmed employment in professional working environment and are extremely satisfied with their new found financial freedom and improved status. The programme has found wide acceptance and is getting replicated at fast pace.

Similar programmes are being conducted by SIDBI under the project in different MSME clusters.

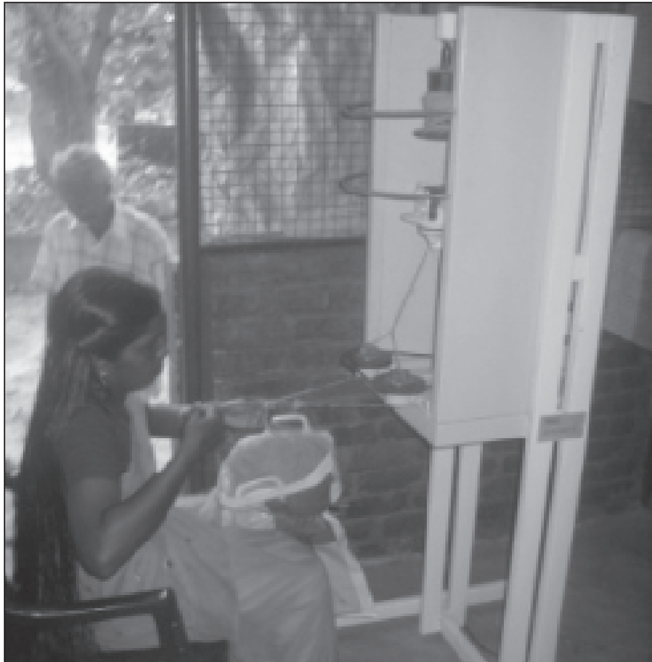
Technological Changes

Every cluster, although belonging to same sub sector, has a different level of technology. Most of the time, obsolete technology constrains the productivity and processing capacity of the firms in the cluster. The project has taken several initiatives in different clusters targeted not only at improving the productivity but also at improving the working conditions of the labour.

Development of a mechanized spinning ratt in Alleppey Coir Cluster

Spinning of coir yarn employs around 45,000 individuals, mostly women, operating predominantly as household units. The traditional spinning ratt requires 3 women, while a slightly more mechanized design requires 2 women. Daily yield is 12-15 Kg yarn (spun @ 270-280 meters / hour) of short length yarn which are then manually “spooled (yarn attaching)”, for weaving. This requires a fifty feet shed space worth around Rs.80,000. The drudgery and low productivity was seeing lesser youth turnout for this activity. Capital cost involved is also a deterrent for the poor.

A BDS provider was engaged by SIDBI under the project. The provider, after several experiments created 'table-top' design which requires minimal space and no infrastructure. It needs only one worker to feed the raw fibre into the machine in place of two thus increasing the productivity by two folds.

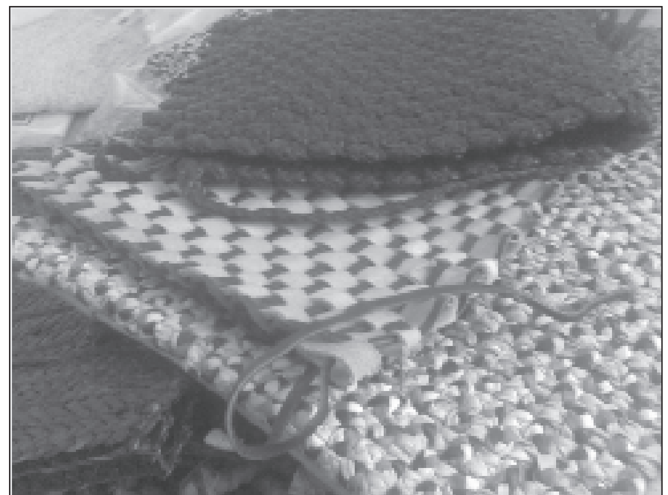


The compact design will not require outdoor shed space which will allow the spinning operators to be employed around the year despite adverse weather conditions. Productivity of the new model is over 320m / hr. Besides, the yarn obtained is in continuous length and manual attachment of yarn (spooling) is no longer required. The proto-type is functional. It will minimize the drudgery involved of walking 10 to 15 kms everyday by the women workers. It would cost about Rs 7500 in the beginning. The new design is gradually gaining acceptance in the cluster with the help of stakeholders.

Design of a new loom for producing value added products

On a related note, in Kanpur, while working out marketing related issues, it was found that creation of new products face quality issues when cut leather pieces were hand woven. Here the BDS provider who was brought in by SIDBI from outside the cluster, innovated a small hand operated loom for leather. The artisans were given intensive training which resulted in further sharpening of their skills while working out a test order. The loom has got wider acceptance and has made a significant contribution in the product quality and made possible a product upgradation from hunter rope making to rope making for fancy leather purses for women, thus creating scope for promoting economic independence to the otherwise high level of low return economic dependence of the artisans to the traders.

Product before project intervention



Value added Products project intervention

Mechanisation of Carpet tufting process

One of the major problems faced by the Panipat Floor Coverings Cluster is low productivity as more than 90% of the tufting and composite manufacturing firms are

using manual tufting guns. Some of these firms, though, purchased electrical tufting guns, but were unable to utlise them due to unwillingness of manpower and also due to non availability of local maintenance facilities. SIDBI facilitated the training of workers on operations and also maintenance of the gun with the help of machinery suppliers. After realizing the importance of electrical tufting guns, 20 tufting firms have placed orders to the tune of 300 tufting guns leading to total increase in carpet production by about 15%. Due to increase in orders and implementation of Electrical Tufting Guns the average earning of the weavers has started increasing significantly while the machine mechanics are witnessing a hike in earning ranging from 10% to 20%. Now, additional 50 Tufting and Composite Manufacturing firms have come forward to get associated with the project.

Marketing

Besides supporting firms in their individual firm level marketing plans, the project of SIDBI has endeavoured to position the marketing efforts at the cluster level. This includes giving a new identity to cluster product, bringing the MSMEs together to have a cohesive marketing initiative.

The United Nations had declared 2009 as "The Year of Natural Fibre". SIDBI led project in the Alleppy coir cluster registered its initiative on the UN website and organized a series of events including new design awards, etc. The project also supported the making of biggest doormat of the world of the size of 101.6 X 1.2 meters. This doormat has also found an entry into the World Record Academy. All these events were well captured nationally and internationally creating a large brand identity for Alleppey coir cluster.

The project has been supporting use of ICT in marketing efforts of the cluster firms. An initiative to link a group of 50 firms in Kanpur leather cluster with a BDS provider for their online marketing initiative was started. The arrangement included focused web based marketing campaign, search optimization, enquiry management, etc. The project has also supported design and operations of 19 cluster level websites (cumulative hits so far : 1.75 lakh) which also provide marketing support to firms. A dedicated website ***www.punefoodhub.com*** has been started with the support of the project to facilitate the marketing of MSME firms in Pune cluster.

The project has also been supporting small firms to link up with organized retail chains. These chains require a certain level of preparedness of the firms before starting the outsourcing. The project has helped the mechanisms in the clusters for establishing these linkages and results are encouraging.

Besides, the project has been carrying out various other initiatives in the areas of common testing facilities, financing, capacity building of industry associations, energy efficiency & environment, ICT etc., under BDS component. The project would come to an end in October 2011 and SIDBI has created a specialized Project Management Division to implement the project. This division is working with the support of 7 BDS facilitator agencies having around 55 full time cluster experts and with a comprehensive framework for monitoring of activities and impact evaluation. For further details on these initiatives and other components of the project, please visit SIDBI website ***www.sidbi.in*** and also project's website ***www.msmefdp.net***.

Small Industries Development Bank of India (SIDBI)

Background

Small Industries Development Bank of India (SIDBI) set up on April 02, 1990 under an Act of the Parliament, functions as the principal financial institution for the promotion, financing and development of the Micro, Small, and Medium Enterprise (MSME) Sector and co-ordinate the functions of the Institutions engaged in similar activities. The authorised capital of SIDBI is Rs.1000 crore. The paid-up capital is Rs.450 crore, which is held by 35 financial institutions / public sector banks / insurance companies owned or controlled by Government of India. SIDBI completed 20 years service to the MSME sector on April 02, 2010. Financial year 2008-09 had been an eventful year for SIDBI with the achievement of a number of operational milestones. The Bank achieved highest ever operational performance with credit sanctions increasing by 80.6 percent and disbursements by 87.6 percent during financial year 09 in spite of the economic slowdown witnessed globally. The aggregate outstanding portfolio of SIDBI crossed Rs.300 billion for the first time and stood at Rs.30,886 crore, as on March 31, 2009, recording an increase of 53 percent over the portfolio as at the end of previous financial year. The cumulative credit disbursements of SIDBI since inception, up to March 31, 2009 stood at Rs.1,32,412 crore.

Activities

SIDBI started as refinancing institution, emerged as complete financial institution meeting all needs of MSME sector for financial and support services :

- *Indirect Finance :* The indirect financial assistance is extended in the form of refinance support to more than 900 PLIs, comprising banks, SFCs, SIDCs etc., having a network of over 82,000 branches and Microfinance support to over 140 microfinance institutions (MFIs) all over the country. Apart from PLIs, SIDBI also provides resource support to non banking finance companies (NBFCs) to reach out to MSMEs not covered by the formal banking system. SIDBI also provides financial assistance to MFIs for onward lending microfinance services to the poor, especially women.
- *Direct Finance :* SIDBI started its direct finance with the objective that no bankable project in MSME sector should languish for the want of resources. Accordingly, direct finance is provided to fill in the credit gaps by way of supplementing and complementing the efforts of the banks / SFCs / MFIs to meet adequate credit needs of MSMEs at affordable rates. Over the years, SIDBI has evolved itself as a one-stop institution to meet the various types of credit requirements of the MSME sector by directly offering tailor-made fund based and non-fund based financial products and services. Direct Finance is channelised through its present network of 103 branches all over the country covering more than 600 MSME clusters.

NEW INITIATIVES

- *Poorest States Inclusive Growth (PSIG) Programme :* The Department for International Development (DFID), UK has awarded the contract for "Design and Implementation of Poorest States Inclusive Growth (PSIG) programme" to the consortium led by SIDBI and comprising NABARD, ITC e-choupal, ACCESS Development Services and IFMR Foundation. The PSIG programme aims to enhance the income and employment opportunities of poor women and men in the four poorest States of India viz., Uttar Pradesh, Madhya Pradesh, Bihar and Orissa, by enabling them

to participate and benefit from wider economic growth in India.

- *MSME Mentor :* SIDBI alongwith NSE and Prime Database have prepared an e-platform called ***www.msmementor.in*** which is an online platform, for MSME service providers / consultants to submit their profiles in a simple format and for MSMEs to identify and reach out to required experts they need, through a refined search mechanism.
- *Promotional and Developmental Activities :* The credit operations of SIDBI are well supplemented with promotional and developmental activities, which are designed to achieve prime objectives of National importance such as enterprise creation in the MSME sector, thereby generating employment and alleviating poverty through Rural Industries Programme (RIP), Entrepreneurship Development Programme (EDPs), vocational training, etc., and strengthening of the existing MSMEs to face the emerging challenges of globalization and increasing competition through select intervention, such as skill cum technology upgradation programme, Small Industries Management Programme, Cluster Development Programme, Marketing Assistance, etc.
- *Nodal Agency :* SIDBI acts as the Nodal Agency for various Government of India Schemes, viz., Credit Linked Capital Subsidy Scheme (CLCSS), Technology Upgradation Fund Scheme for Textile Industry (TUFS), Integrated Development of Leather Sector Scheme (IDLSS), Scheme of Technology Upgradation / Seeting up / Modernization / Expansion of Food Processing Industry.
- *MSME Development & Financing Project :* SIDBI is implementing a multiactivity, multi-agency, MSME Financing and Development Project (MSMEFDP) aimed at making MSME lending an attractive and viable financing option as also to facilitate increased turnover and employment in the MSME sector. The objective of the Project is to attend to demand and supply side issues of MSME sector through financial and non- financial services. Principal partners / donors for the project are World Bank; Department for International Development, UK; KfW and GTZ, Germany. While Department of Financial Services, Ministry of Finance, Government of India is the Nodal Agency, SIDBI is the Implementing Agency of the Project.
- *Support to North Eastern Region :* The Bank accords priority to the development of North Eastern Region (NER) through its activities under micro finance, rural industrialisation, handicraft cluster development, entrepreneurship development, marketing support, etc. Cumulatively, the Bank has provided financial assistance of more than Rs.383 crore to the region. The Bank has undertaken various development measures in the region such as published compendium of 100 project profiles for tiny / micro enterprises, set up a "Counselling Centre for Micro and Small Enterprises" at Guwahati, started a special 'Small Loans Scheme for North Eastern Region', sharing CGTMSE charges with the partner banks etc.
- *Policy Advocacy :* SIDBI has been actively involved in playing an effective policy advocacy role towards framing sound MSME related policies and frameworks by the Government of India (GoI), Planning Commission, Reserve Bank of India etc. SIDBI is represented on the apex Board set up by GoI for policy formulation and also associated with various key GoI appointed committees and expert groups.

Institution Building

Looking at non-credit needs of the MSME sector SIDBI created network of institutions to provide support services to the Sector. SIDBI has worked on building up institutional network to cater to the emerging needs of the sector.

- *SIDBI Venture Capital Ltd. :* Set up as a wholly owned subsidiary of SIDBI in 1999, is an asset management company for providing venture capital assistance to knowledge based MSMEs, especially in the areas of IT, auto components, life sciences, clean technologies, light engineering, etc. As on February 28, 2010 SVCL has committed total assistance of more than Rs.550 crore to the MSME sector.

- *Credit Guarantee Fund Trust for Micro and Small Enterprise (CGTMSE) :* In order to provide collateral free lending to Micro and Small Enterprises (MSEs), Govt. of India and SIDBI set up the CGTMSE in 2000. Before CGTMSE, there was total absence of credit guarantee in MSME domestic financial support. CGTMSE provides credit guarantee support for loans upto Rs.100 lakh extended by banks and lending institutions to MSME sector. As on February 28, 2010 guarantee approvals were extended to 2,77,968 proposals covering credit assistance of Rs.10,550 crore by the CGTMSE.
- *SME Rating Agency of India Ltd. (SMERA) :* SIDBI, alongwith few public sector banks and Dun & Bradstreet has set up the SME Rating Agency (SMERA) in 2005, as a dedicated third-party rating agency to provide comprehensive, transparent and reliable rating to MSMEs. In a short span of time, SMERA has achieved market leader position in MSME rating by evaluating around 6000 MSMEs by February 28, 2010. SMERA has also initiated ratings of Micro Finance Institutions and Risk Model Mapping / Validation. SMERA has achieved another milestone by launching Green Rating first time in the country.
- *Indian SME Technology Services Ltd. (ISTSL) :* ISTSL, set up in 2005, provides a platform for MSME to tap opportunities at the global level for acquiring modern technologies. ISTSL has identified Clean Development Mechanism (CDM) and Carbon Credit in MSME Sector as its thrust areas and has been working actively in these areas in select MSME clusters, organizing awareness campaigns, seminars and guiding MSMEs to take advantage of the opportunities existing in the CER markets.
- *India SME Asset Reconstruction Company Ltd. (ISARC) :* India SME Asset Reconstruction Company Ltd. (ISARC) was set up in April 2008 to acquire non performing assets (NPAs), with a focus on MSME NPAs, from banks/FIs and would strive to maximize recovery value through its innovative resolution methods thereby facilitating in revival of the MSME sector. SIDBI, in collaboration with SIDBI Venture Capital Ltd., 12 public sector banks, 4 FIs and LIC have agreed to contribute to the share capital of ISARC. The present paid-up capital of the company is Rs.10 crore which will soon be raised to the level of its authorized capital of Rs.100 crore. Some of the activities of ISARC are as follows:

International Awards

SIDBI has received several awards over the last few years. The major awards received by SIDBI are given below :

- "Asian Banking Awards 1999" by ADFIAP for its Micro Credit Scheme in the Development Finance products / programme category - The Awards are instituted by Asian Banking Association and the Association of Development Financing Institutions in Asia & Pacific.
- "ADFIAP Development Award 2003" for RIP Interventions.
- SIDBI was adjudged winner for its project entry on "SME Rating" under ADFIAP's Institutional Outstanding Development Project Category on SMEs 2007.
- "Plaque of Merit" for Establishment of Role Model Fund for Equity Assistance to SMEs in the area of Software and Information Technology (NFSIT) by ADFIAP - 2008.
- ADFIAP award in 2009 for :
  - SIDBI's initiative towards setting up of India SME Asset Reconstruction Company Limited (ISARC),
  - SIDBI's website (***www.sidbi.in***) as the best website and
  - Shri R. M. Malla, CMD, SIDBI for the 'Outstanding CEO of the year 2009'.

Outlook :

Considering SIDBI's apex role in promotion, financing and development of MSME sector, the Bank would continue to play a proactive role of a change agent and engage in such policy advocacy, as aligned to government's national priorities as also Millennium Development Goals. There will be

increasing emphasis on promotional activities in clusters to foster soft infrastructure support leading to sustainable development of Indian MSMEs. The activities will also be aligned more with the emerging lines of credit, e.g., in the areas of energy efficiency / climate change / CDM / carbon credits, as also those which result in improving the competitiveness of the sector, e.g., bench-marking, lean manufacturing, etc.

SIDBI is committed to contributing towards the national goal of attaining 'inclusive' Growth by promoting the great spirit of MSME entrepreneurship as well as reaching out to those at the bottom-of-the-pyramid by extending developmental and financial support through the network of banks, FIs and microfinance Institutions. As a part of our philosophy of responsible banking, SIDBI envisions sustainable development of the MSME sector across its social, economic and environmental spheres.

Initiatives to Improve the Credit Flow to SMEs

Recognising the importance of the SME sector, the Government of India and the Reserve Bank had constituted several committees and working groups, viz., Nayak Committee (1992), Kapoor Committee (1992), S. P. Gupta Working Group (2000), Ganguly Committee (2004) and Murthy Group (2005). These Committees / Groups have made several recommendations for improving the credit flow to the SME sector. On the recommendations of these Groups, several policy actions were taken.

In 2006, the Parliament enacted Micro, Small and Medium Enterprises Development (MSMED) Act, 2006. The Act lays down definition and framework for SMEs in India. The Act has removed distortions which create perverse incentive for small business to remain small and not move / graduate to medium sized firms, reaping economies of scale and contributing growth and employment.

The past approach based on preferential treatment of SSIs and targeted loan at subsidised interest rates is being changed. The artificial barriers to entry and regulated credit market are not suitable for optimal size and efficiency of SSIs. The Government has pruned a number of items from the list of products reserved for SSIs to infuse competition and provide incentive to small firms to grow organically and reap benefits of scale.

To strengthen the framework for tackling loan defaults and contract enforcement, the Parliament enacted the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002.

As better information can directly increase the financing for SMEs by reducing the cost and risk arising from information asymmetries, the Parliament also enacted Credit Information Companies (Regulation) Act, 2005. The Act has strengthened the legal mechanism. The credit information companies can also be set up to collect, process and share credit information on the borrowers of the banks and financial institutions.

A debt restructuring mechanism for nursing of sick units in the SME sector and a one-time settlement (OTS) scheme for SME accounts in the books of banks as on March 31, 2004 were formulated and advised to all commercial banks and public sector banks, respectively, for implementation.

The Reserve Bank has constituted empowered committees at the Regional Offices to review the progress in SME financing and rehabilitation of sick SSI and SME units, and coordinate with other banks / financial institutions and the State Governments in removing bottlenecks, if any, to ensure smooth flow of credit to the sector. These regional level committees may decide the need to have similar committees at cluster / district levels.

Source : RBI's Report on Currency and Finance 2006-08, Volume - II.

Promotional and Developmental Activities of SIDBI

- The promotional and developmental (P&D) support to the MSME sector has always been an integral part of the Bank's activities.
- As per the mandate given to SIDBI, besides financing, the Bank plays a pioneering role for promotion and development of the MSME sector as a whole and rural / cottage and micro enterprises in particular.
- The Promotional and Developmental (P&D) activities of the Bank are designed to achieve the twin objectives of promotion and development of MSMEs which are of national importance.
- Promotional activities include enterprise promotion resulting in self employment and creation of additional employment through its select programmes, such as Rural Industries Programme (RIP), Entrepreneurship Development Programme (EDP), Vocational Training Programmes, etc. and
- Developmental activities include strengthening the MSME sector to face the emerging challenges of globalisation and growing competition through select interventions such as Skill-cum-Technology Upgradation Programme (STUP), Small Industries Management Programme (SIMAP), Cluster Development Programme (CDP), Marketing Assistance, etc.

Highlights of various P&D programmes are given below :

Rural Industries Programme (RIP)

- RIP, the flagship programme of the Bank, is a comprehensive enterprise support service programme for the benefit of rural entrepreneurs.
- It aims at promoting viable rural enterprises leading to employment generation in rural areas with the use of local resources. RIP, thus, addresses problems of rural unemployment, urban migration, under utilisation of know-how and latent rural resources and marketing of rural products.
- Cumulatively, up to March 31, 2009, the RIP has been implemented in more than 120 districts in 24 States over the years.
- More than 32,600 enterprises have been promoted, including about 3000 units during FY 2008-09.
- These enterprises have generated employment opportunities for over one lakh persons.

Modified Rural Industries Programme (MRIP)

- Recently, the Bank has launched a modified RIP in December 2009 in select underserved areas with a focus on setting up of new micro enterprises either with Bank linkages or through self financing.
- MRIP aims at promoting viable rural enterprises leading to employment generation in rural India by facilitating availability of business services. It would create mechanism to provide help in identifying, motivating and guiding rural entrepreneurs in setting up industrial ventures. It also aims at better commercial exploitation of local resources.

Entrepreneurship Development Programme

- The Bank's Entrepreneurship Development Programmes (EDPs) aim at promotion of self-employed ventures capable of generating employment opportunities, especially in rural areas targeting less privileged sections of the society like women and Scheduled Castes / Scheduled Tribes.
- As on March 31, 2009, the total number of EDPs supported by the Bank since inception for various

target groups was 2,661 covering about 66,000 participants.

Strengthening MSME Sector

- With a view to strengthening the technical and managerial capacities of the MSME entrepreneurs, the Bank supports reputed management / technology institutions to offer management / skill development programmes, viz. "Skill-cum-Technology Upgradation Programme" [STUP] and "Small Industries Management Programme" [SIMAP].
- STUP aims at enhancing technology profile of MSME units and SIMAP targets qualified unemployed as well as industry-sponsored candidates with the overall objective of providing competent managers to the MSME sector.
- Besides extending assistance in the form of corpus fund, the Bank also encourages new institutions, which can take up such specialised programmes and has been extending support for stand-alone STUPs and SIMAPs.
- These management / technology institutions have been provided with corpus support for conducting STUP / SIMAP on an ongoing and regular basis.
- The Bank has supported 18 leading institutions with a corpus support of Rs.356.38 lakh.
- As on March 31, 2009, the total number of STUPs and SIMAPs supported by the Bank since inception reached 1460 and 284, respectively benefiting more than 37,700 participants.

Cluster Development

- The paradigm shift in the cluster development programme during last few years is basically from technology centric to a more comprehensive cluster development approach which includes management practices, establishment of marketing linkages, product / design development, skill upgradation, etc.
- SIDBI has so far intervened in more than 50 small industry clusters for structured intervention.
- In addition to this, 7 cluster level programmes have been taken up in association with UNIDO, industry neutral cluster development support to CII, and 16 clusters have been undertaken under the National Programme of Rural Industrialisation (NPRI), a Central Government sponsored programme.
- The product groups covered include locks, textile processing, bicycle / bicycle parts, scientific instruments, salt and salt based chemicals, power looms, machine tools, rubber products, sea food products, glassware, gem & jewellery, brass & bell metal, blacksmith, leather & leather products, foundries, hand tools, mango jelly, stone carving, hand block printing, zari work, dhokra art etc.
- During financial year 2009-10 cluster development programmes (expected to benefit more than 1000 artisans) have been sanctioned in the North Eastern Region. These clusters are basically handicraft, handloom and traditional industries dependent on local skills / resources. Besides, one Brass and German Silver Utensil cluster in Eastern Zone and one Foundry cluster in Southern Zone were also sanctioned.

Marketing Initiatives

- Under the marketing activities, the Bank supports participation of MSME units in select trade fairs / exhibitions at national and international levels; organising trade fair / exhibitions / buyer-seller meets etc., setting up of retail outlets, development of website / brochure / catalogue etc., and market promotion and exploration trips.
- Some of the important events supported by the Bank during the last year include 4 RUDSETI Bazaars.
- These were organised by RUDSETI, Karnataka at 4 locations for the benefit of more than 55 entrepreneurs, with a view to encouraging and supporting the marketing efforts of micro entrepreneurs.
- As a part of developmental initiative, the Bank has supported Karnataka Small Scale Industries Association (KASSIA) to create a permanent infrastructure for holding exhibitions, setting up a display centre for MSME units, etc., at Bangalore, with a development loan of Rs.200 lakh.

- On becoming functional, a successful vendor development meet / exhibition was organised in February 2009, which was attended by over 200 units.

Promotional and Developmental Initiatives in NER

- SIDBI has put greater emphasis on the promotional and developmental (P&D) needs of the MSMEs in NER for their capacity building and holistic development.
- It may be noted that the Committee on Financial Sector Plan for the North Eastern Region under Smt. Usha Thorat, Dy. Governor, RBI has made certain recommendations for SIDBI to implement its developmental programmes, viz. Cluster Development Programmes and Rural Industries Programme in all the States of North East.
- SIDBI has geared up to deepen its support in the recommended areas. The support of the Bank under various promotional and developmental programmes in the NER, is as under :
  - Under RIP, the Bank has promoted around 1780 units in 22 districts of the NER till December 31, 2009.
  - The Bank has conducted around 453 EDPs benefiting around 14488 participants till December 31, 2009.
  - The Bank has so far intervened in 30 clusters benefiting around 2603 beneficiaries in the entire NER covering handloom weaving, cane & bamboo mat weaving, carpet weaving, agarbatti making, muga silk, blacksmith, shoe making, terracota pottery, brass & bell metal etc.
  - The Bank has so far conducted over 105 STUPs benefiting over around 3950 participants in the entire NER.

Institution Building

- **North Eastern Development Finance Corporation Ltd. (NEDFi)**
  - SIDBI is one of the co-promoters of NEDFi, which is set up at Guwahati as the Development Finance Corporation for the North East.
  - SIDBI has contributed a sum of Rs.10 crore towards the paid-up capital of the agency.
  - NEDFi aims at catalysing the economic development of the region by extending assistance for the efficient formation of fixed assets through identification, financing and nurturing of eco-friendly and commercially viable industrial and infrastructure projects in the Region.
- **Indian Institute of Entrepreneurship (IIE), Guwahati**
  - SIDBI is one of the founder member of IIE set up at Guwahati.
  - An amount of Rs.25 lakh has been extended towards corpus fund for setting up the Institute.
  - IIE is undertaking entrepreneurial training activities in the Region.

Other Initiatives :

- Assistance was sanctioned to North Eastern Industrial & Technical Consultancy Organisation Ltd. (NEITCO) for preparation of 100 project profiles of Tiny Sector Projects for the North Eastern Region. The profiles were released recently.
- SIDBI, in association with Exim Bank, also conducted a workshop on Export Oriented Fruit Processing Industry for entrepreneurs having fruit processing units in North Eastern Region.
- The Bank has supported various vocational training programmes and marketing / seminars / exhibitions covering over 3500 participants from MSME sector in the NER.
- A Counselling Centre for Micro & Small Enterprises has been setup jointly by SIDBI and United Bank of India for providing counselling services to budding entrepreneurs. The Centre is located at RGVN Office, Rajgarh Road, Guwahati. The Centre was operationalised on March 31, 2009. Till December 31, 2009, the centre has rendered its service to about 566 prospective entrepreneurs.
- Project profiles have been prepared for 100 micro sector projects having potential in North Eastern

Region and was released by Shri P. Chidambaram, Hon'ble Finance Minister, Govt. of India in the presence of Hon'ble Prime Minister on October 04, 2008.

Other Major Initiatives :

- The Bank has been extending assistance in the form of loan for developmental initiatives under the Development Loan Scheme with a reduced interest rate. The same could also have a grant component of upto 15% of the loan amount. The same policy is proposed to be continued for which no specific budget is proposed.
- National Innovation Foundation, Ahmedabad was supported to set up Micro Venture Innovation Fund (MVIF) with a view to identify and commercialise grassroots innovations all over the country. SIDBI's contribution to the Fund is Rs.5 crore. So far, the Fund has supported 125 innovations including 13 innovations during 2008-09.
- SIDBI Innovation and Incubation Centre (SIIC) was set up at Indian Institute of Technology, Kanpur in January 2002 with support of Rs.424.28 lakh including Rs.200 lakh towards corpus support with the objective of fostering successful entrepreneurs and develop industry in the knowledge and technology based areas, particularly for small enterprises.
- With a view to enhancing the share of Indian cottage sector in the world market from 2% at present to 4% in coming years, SIDBI has decided to become an active shareholder in a Special Purpose Vehicle [SPV] being jointly promoted by EXIM Bank, NEDFI and Export Promotion Council for handicrafts [EPCH]. The SPV will implement special project for development and promotion of cottage industry focussing on handicrafts, handlooms, silk, jute, carpet and other employment generating sectors, particularly in handicraft / artisan clusters. It has been ascertained from EPCH that the formation of SPV is in an advanced stage and will be set up shortly.

Lending to SMEs - Recent Initiatives taken by Banks in India - A Brief Survey

State Bank of India has adopted a cluster financing approach through its Project Uptech, where the units from similar industry are identified for process improvement. This means that units, which come forward to adopt innovations, get financial assistance for upgradation costs. ICICI Bank has introduced a simplified loan product, an unsecured loan up to Rs.25 lakh for the SME sector. This is ideal for promoters with big ideas and little collateral security. SMEs can also apply for loans through the bank's website now. Another service in the pipeline is the roping in of legal and taxation experts as channel partners whose services SME units could utilise.

Oriental Bank of Commerce (OBC) is in the process of setting up a specialised cell for the SME sector. Apart from processing and imparting loans for this sector, the cell would carry out marketing activity and follow up loan cases for customers of SMEs. The cells would be set up at all the 29 OBC regional centres across the country. Standard Chartered Bank has a separate business unit called Standard Chartered Investment & Loans Ltd. (SCILL) operating currently in 16 cities. The bank has drawn up a road map to extend SCILL's network to 60 cities. HSBC is offering mass-banking service through its 21 branches in 16 cities across the country. The minimum income level required for getting a loan from HSBC is just Rs.3,500 per month for salaried employees and Rs.10,000 per year for the self-employed. Understandably, risk management for this sector is a huge issue with banks. Credit Rating Information Services of India Ltd. (CRISIL) has stepped in to provide a rating service for the SME sector. According to this rating programme, SMEs would be rated on a scale of one to eight, with scale one indicating the highest credit quality and the scale eight, hinting at default possibilities. The ratings assigned to SMEs would also function as a self-improvement tool for them. SBI, ICICI Bank and Standard Chartered Bank have joined hands with the Small Industries Development Bank of India (SIDBI) and have floated a rating agency for the SME segment. The rating agency, Small and Medium Enterprises Rating Agency of India Limited (SMERA), will rate the company's overall strength; unlike most rating agencies whose core business are to rate debt instruments.

Source : RBI's Report on Currency and Finance 2006-08, Volume - II.

Report of the Working Group to Review the Credit Guarantee Scheme of the Credit Guarantee Fund Trust for Micro and Small Enterprises*

Introduction

The critical role and place of the MSE sector in the Indian economy cannot be overemphasised in employment generation, exports and economic empowerment of a vast section of the population. As per data released by the Ministry of Micro, Small and Medium Enterprises (MSME), there are about 2.6 crore enterprises in this sector. The sector accounts for 45 per cent of manufactured output and 8 per cent of the Gross Domestic Product (GDP). MSMEs contributed close to 40 per cent of all exports from the country and employed nearly 6 crore people which is next only to the agricultural sector.

It was, therefore, only appropriate that the Government of India enacted the Micro, Small and Medium Enterprises Development Act, 2006. Public Policy has rightly accorded high priority to this sector in order to achieve balanced, sustainable, more equitable and inclusive growth in the country. Advances extended to the MSE sector are treated as priority sector advances and as per the extant Reserve Bank guidelines, banks are required to extend at least 60% of their advances to the MSE sector to Micro Enterprises.

An increasingly globalised world, marked by competition and innovation, is posing newer and varied challenges to the MSEs. Because of their small size, individual MSEs are handicapped in achieving economies of scale in procuring equipment, raw materials, finance and consulting services. Often they are unable to identify potential markets to take advantage of market opportunities, which require large volumes, consistent quality, homogenous standards and assured supply. In today's globalised economy, improvements in product, processes, technology and organizational functions such as design, logistics and marketing have become key drivers in delivering competitiveness, including for MSEs.

MSEs primarily rely on bank finance for a variety of purposes including purchase of land, building, plant and machinery as also for working capital and exports receivables financing, etc. Ensuring timely and adequate flow of credit to MSEs has been an overriding public policy objective, and as a result, over the years there has been a significant increase in credit extended to this sector by banks. As at the end of March 2009, the total outstanding credit provided by all Scheduled Commercial Banks (SCBs) to the MSE sector was Rs.2,57,361 crore, constituting 11.4 percent of the Net Bank Credit. The outstanding credit to the sector by Scheduled Commercial Banks (SCBs) for the last three years is furnished below :

Table-1 : Bank credit to MSEs (Amount in Rs. crore)

Year ended March	Public Sector Banks	Private Sector Banks	Foreign Banks	All SCBs	% of MSE Credit to Adjusted Net Bank Credit for SCBs
2007	1,02,550	13,136	11,637	1,27,323	7.2
2008	1,51,137	46,912	15,489	2,13,538	11.6
2009*	1,91,307	47,916	18,138	2,57,361	11.4

provisional

Source : RBI

However, not withstanding various measures taken by the Government of India and Reserve Bank of India for facilitating the growth of the MSE sector, there have been widespread complaints from the MSE sector that many of them, particularly technocrats and first generation entrepreneurs in the Micro and Small enterprises sector, find themselves handicapped in accessing credit from

* ***Reserve Bank of India Report, March 2010***

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*Conditions Apply

the banking system primarily for want of secondary collateral and / or third party guarantee. Banks generally insist on secondary collateral, particularly in the form of immovable property as also third party guarantee, in order to hedge against default in the small loan segment. As availability of timely and adequate bank credit without the hassles of collateral and third party guarantees is of essence to small first generation entrepreneurs to realise their dream of setting up their own MSEs, the Reserve Bank of India had enjoined upon banks not to take secondary collateral from MSE units with credit limits upto Rs.5 lakh.

The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) was set up by the Ministry of Micro, Small & Medium Enterprises (MSME), Government of India (GOI) and Small Industries Development Bank of India (SIDBI) in August 2000. The GOI and SIDBI as settlors of the Trust have committed a corpus of Rs.2,500 crore in the ratio of 4:1 to the CGTMSE, out of which Rs.1,906 crore has been contributed till date. CGTMSE operates the "Credit Guarantee Scheme" (CGS) which guarantees grant of collateral-free and / or third party guarantee-free credit facilities to Micro and Small Enterprises by Member Lending Institutions (MLIs). It thus encourages MLIs to appraise credit proposals on the basis of viability of projects rather than merely on the basis of availability of adequate collateral.

Although the CGS became operational in 2000-01, the trends in its operations indicate that during the initial years, the cover was low. From the year 2005-06 onwards, there has been a steady growth in guarantee cover and as of January 31, 2010, cumulatively 2,61,987 guarantee approvals have been accorded involving an amount of Rs.9,822.50 crore. However, the present cover is still much below the desired level as the MLIs have not opted for guarantee cover in large number of cases. Having regard to the imperative of accelerating the flow of timely and adequate credit to the MSEs sector, so critical for inclusive and equitable growth and a broad-based economic empowerment, it was announced in the paragraph 114 of the Annual Policy statement for 2009-10 "to ask the Standing Advisory Committee on MSEs to review the Credit Guarantee Scheme so as to make it more effective."

As a sequel to this announcement, a Working Group was constituted under the Chairmanship of Shri V. K. Sharma, Executive Director, Reserve Bank of India with the following terms of reference :

- To review the working of the Credit Guarantee Scheme and suggest measures to enhance the usage and facilitate increased flow of collateral free loans to MSEs
- To make suggestions to simplify the existing procedures and requirements for obtaining cover and lodging / invoking guarantee claims under CGTMSE Scheme
- To examine the feasibility of a whole turnover guarantee for the MSE portfolio and
- Any other issues.

The Working Group comprised the following :

Shri V. K. Sharma Executive Director Reserve Bank of India	Chairman
Shri R. M. Malla Chairman and Managing Director Small Industries Development Bank of India	Member
Shri. Praveen Mahto Additional Economic Adviser, Ministry of Micro, Small and Medium Enterprises, Government of India	Member
Shri B. S. Bhasin Chief General Manager State Bank of India	Member
Shri V. H. Thatte General Manager (SME) Bank of Baroda	Member
Shri K. Unnikrishnan Dy. Chief Executive Officer Indian Banks' Association	Member
Shri S. Sen Chief General Manager Department of Banking Supervision Reserve Bank of India	Member
Shri H. N. Prasad Chief Executive Officer Deposit Insurance and Credit Guarantee Corporation	Special Invitee
Shri R. C. Sarangi Chief General Manager Rural Planning and Credit Department Reserve Bank of India	Member Secretary

The Working Group met on four occasions i.e. on June 23, 2009; November 6, 2009; February 9, 2010 and February 25, 2010 and reviewed the working of the Credit Guarantee Scheme. The Chairman and Managing Director, SIDBI made a detailed presentation on the Scheme and various steps taken by CGTMSE to popularise it. He mentioned that the loans covered under the CGS had increased sharply during the last two years and the trend is expected to continue in the future. The two banker members of the Working Group shared their sense and took on the reasons for low level of guarantee cover availed of under the CGS, as also the low number of guarantees invoked. Views on working of the Scheme, difficulties faced by them in taking the guarantee cover and invoking guarantees and suggestions for improving the Scheme were elicited from all public sector banks and select private sector banks. Responses were received from 19 public sector banks and 5 private sector banks. The Group also took into account the suggestions and views received from various MSME Associations.

The Report is organized as follows :

Chapter-II reviews the performance of the CGS of CGTMSE and provides a backdrop to the subsequent Chapters.

Chapter-III discusses the various issues relating to the Scheme and

Chapter-IV contains the Summary of Observations and Recommendations of the Working Group.

CREDIT GUARANTEE SCHEME OF CGTMSE

Objective

Credit Guarantee Schemes are globally treated as instruments of credit enhancement for targeted sections. A snapshot of the international practices and experience in CGS for SMEs is given in the Appendix. As internationally, so also in India, the main public policy purpose of the CGS for MSEs is to catalyse flow of bank credit to first generation entrepreneurs for setting up their MSE units without the hassles of secondary collateral / third party guarantee. The Scheme is intended to encourage Member Lending Institutions to rely in their appraisal essentially on the viability of the project and the security of primary collateral of assets financed. The other objective is to encourage lenders availing of guarantee facility to extend composite credit facilities to borrowers comprising both working capital and term loans. The CGS seeks to reassure lenders that, in the event of a default by MSE unit covered by the guarantee, the Guarantee Trust would meet the loss incurred by the lender upto 85 per cent of the outstanding amount in default.

Eligible MLIs

The CGTMSE operates the CGS through Member Lending Institutions (MLIs). All commercial banks included in the Second Schedule to the RBI Act, 1934, and such other institution(s) as may be notified by the Government of India from time to time are eligible to become MLIs. As of January 31, 2010, there were 110 MLIs registered with CGTMSE. Of this, 27 are Public Sector Banks, 16 Private Sector Banks, 59 Regional Rural Banks, 6 financial institutions and 2 foreign banks.

Eligible Borrowers

All new and existing MSEs, which have been extended credit facilities by MLIs without any collateral security and / or third party guarantees, are eligible for guarantee cover under the Scheme.

The MSEs are enterprises as defined under the MSMED Act, 2006, as given below :

Sector	Micro Enterprises	Small Enterprises
Manufacturing or Production	Investment in plant and machinery does not exceed Rs.25 lakh	Investment in plant and machinery is more than Rs.25 lakh but does not exceed Rs.5 crore
Services	Investment in equipment does not exceed Rs.10 lakh	Investment in equipment is more than Rs.10 lakh but does not exceed Rs.2 crore

Extent of Guarantee Cover

Any secondary collateral / third party guarantee free credit facility (both fund and non-fund based) extended by MLIs, to new as well as existing MSEs with a maximum credit limit of Rs.100 lakh are eligible for cover. The extent of the guarantee cover admissible is shown below :

Borrower Category	Maximum extent of Guarantee where credit facility is		
	upto Rs.5 lakh	above Rs.5 lakh upto Rs.50 lakh	above Rs.50 lakh upto Rs.100 lakh
Micro Enterprises	85% of the amount in default subject to a maximum of Rs.4.25 lakh	75% of the amount in default subject to maximum of Rs.37.50 lakh	Rs.37.50 lakh plus 50% of amount in default above Rs.50 lakh subject to overall ceiling of Rs.62.50 lakh
Women entrepreneurs / Units located in North East Region (including Sikkim) other than credit facility upto Rs.5 lakh to micro enterprises	80% of the amount in default subject to a maximum of Rs.40 lakh		Rs.40 lakh plus 50% of amount in default above Rs.50 lakh subject to overall ceiling of Rs.65 lakh
All other category of borrowers	75% of the amount in default subject to maximum of Rs.37.50 lakh		Rs.37.50 lakh plus 50% of amount in default above Rs.50 lakh subject to overall ceiling of Rs.62.50 lakh

Tenure of Guarantee

The guarantee cover commences from the date of payment of guarantee fee and runs through the agreed tenure in respect of term credit. In case of working capital, the guarantee cover is available for a period of 5 years or a block of 5 years or for such period as may be specified by the Trust in this behalf. Units covered under CGTMSE and becoming sick due to factors beyond the control of management, assistance for rehabilitation extended by the MLIs is also covered under the scheme provided the overall assistance is within the credit cap of Rs.100 lakh.

Guarantee Fee and Annual Service Fee

A one-time Guarantee fee at the rate of 1% of the credit limit for credit facility upto Rs. 5 lakh and 1.5% in the case of credit facility above Rs.5 lakh is charged. In case of credit facilities upto Rs.50 lakh sanctioned to units in North Eastern Region (including State of Sikkim) the Guarantee fee is 0.75% of the credit facility sanctioned. The guarantee fee is to be paid upfront to the Trust by the lending institution.

An annual service fee at specified rate (currently 0.50% in the case of credit facility upto Rs.5 Lakh and 0.75% in the case of credit facility above Rs.5 Lakh) of the credit facility sanctioned (comprising term loan and / or working capital facility) is charged to the MLIs. The rates of guarantee and annual fees charged on the basis of the credit facility sanctioned are furnished in the Table-2 below :

Table-2 : CGS - Cost of Cover

Credit facility	Upfront one time guarantee fee		Annual Service Fee
	North East Region (including Sikkim)	Others	
Upto Rs.5 lakh	0.75%	1.00%	0.50%
Above Rs.5 lakh to Rs.50 lakh	0.75%	1.50%	0.75%
Above Rs.50 lakh to Rs.100 lakh	1.50%	1.50%	0.75%

The existing procedure for Invocation of Guarantee and Settlement of claims :

i) The MLIs can invoke the guarantee within a maximum period of one year from date of account becoming NPA, if the date of classification as NPA is after the lock-in period of 18 months from the date of guarantee, or within one year after lock-in period, if date of classification as NPA is within lock-in period, if the following conditions are satisfied :

   a. The guarantee in respect of that credit facility was in force at the time of account turning NPA;

b. The lock-in period of 18 months from either the date of last disbursement of the loan to the borrower or the date of payment of the guarantee fee in respect of credit facility to the borrower, whichever is later, has elapsed;

c. The amount due and payable to the lending institution in respect of the credit facility has not been paid and the dues have been classified by the lending institution as Non Performing Assets. The lending institution shall not make or be entitled to make any claim on the Trust in respect of the credit facility, if the loss in respect of the said credit facility had occurred owing to actions / decisions taken contrary to or in contravention of the guidelines issued by the Trust;

d. The credit facility has been recalled and the recovery proceedings have been initiated under due process of law. Mere issuance of recall notice under SARFAESI Act 2002 cannot be construed as initiation of legal proceedings for the purpose of preferment of claim under CGS. MLIs are advised to take further action as contained in Section 13 (4) of the said Act wherein a secured creditor can take recourse to any one or more of the recovery measures out of the four measures indicated therein before submitting claims for first installment of guaranteed amount. In case the MLI is not in a position to take any of the actions indicated in Section 13(4) of the aforesaid Act, it may initiate fresh recovery proceeding under any other applicable law and seek the claim for first installment from the Trust.

ii) The Trust shall pay 75 per cent of the guaranteed amount on preferring of eligible claim by the lending institution, within 30 days, subject to the claim being otherwise found in order and complete in all respects. The Trust shall pay to the lending institution interest on the eligible claim amount at the prevailing Bank Rate for the period of delay beyond 30 days. The balance 25 per cent of the guaranteed amount will be paid on conclusion of recovery proceedings by the lending institution. On a claim being paid, the Trust shall be deemed to have been discharged from all its liabilities on account of the guarantee in force in respect of the borrower concerned.

iii) In the event of default, the lending institution shall exercise its rights, if any, to take over the assets of the borrowers and the amount realised, if any, from the sale of such assets or otherwise shall first be credited in full by the MLI to the Trust before it claims the remaining 25 per cent of the guaranteed amount.

iv) The lending institution shall be liable to refund the claim released by the Trust together with penal interest at the rate of 4% above the prevailing Bank Rate, if such a recall is made by the Trust in the event of serious deficiencies having existed in the matter of appraisal / renewal / follow-up / conduct of the credit facility or where lodgement of the claim was more than once or where there existed suppression of any material information on the part of the MLIs for the settlement of claims. The lending institution shall pay such penal interest, when demanded by the Trust, from the date of the initial release of the claim by the Trust to the date of refund of the claim.

v) The Guarantee Claim received directly from the branches or offices other than respective operating offices of MLIs will not be entertained.

Subrogation of rights and recoveries on account of claims paid

i) The Member Lending Institution shall furnish to the Trust, the details of its efforts for recovery, realisations and such other information as may be demanded, or required, from time to time. The Member Lending Institution will hold lien on assets created out of the credit facility extended to the borrower, on its own behalf and on behalf of the Trust. The Trust shall not exercise any subrogation rights and that the responsibility of the recovery of dues including take over of assets, sale of assets, etc., shall rest with the Member Lending Institution.

ii) In the event of a borrower owing several distinct and separate debts to the Member Lending Institution and

making payments towards any one or more of the same, whether the account towards which the payment is made is covered by the guarantee of the Trust or not, such payments shall, for the purpose of this clause, be deemed to have been appropriated by the MLI to the debt covered by the guarantee and in respect of which a claim has been preferred and paid, irrespective of the manner of appropriation indicated by such borrower, or, the manner in which such payments are actually appropriated.

iii) Every amount recovered and due to be paid to the Trust shall be paid without delay, and if any amount due to the Trust remains unpaid beyond a period of 30 days from the date on which it was first recovered, interest shall be payable to the Trust by the lending institution at 4% above Bank Rate for the period for which payment remains outstanding after the expiry of the said period of 30 days.

Operational Highlights of CGTMSE

CGTMSE has adopted multi-channel approach for creating awareness about the Credit Guarantee Scheme (CGS) amongst all the stake holders including banks, Industry Associations, Entrepreneurs, etc., through various fora like print and electronic media, conducting workshops / seminars etc. CGTMSE's website has been reconstructed to make it more user-friendly and informative with hyperlink to websites of its Member Lending Institutions / other development institutions / agencies. Cumulatively, by January 31, 2010, more than 1,010 workshops and seminars had been conducted on Credit Guarantee Scheme. Recently, CGTMSE has launched advertisement campaign in Hindi, English, and regional languages. These advertisements are issued in newspapers across the country at periodic intervals as also in leading magazines and periodicals.

Of the 110 MLIs registered with the Trust as of January 31, 2010, 82 MLIs availed of the guarantee cover. The trend in availment of guarantee cover under the CGS since inception is given in Table-3 and the Chart-I below :

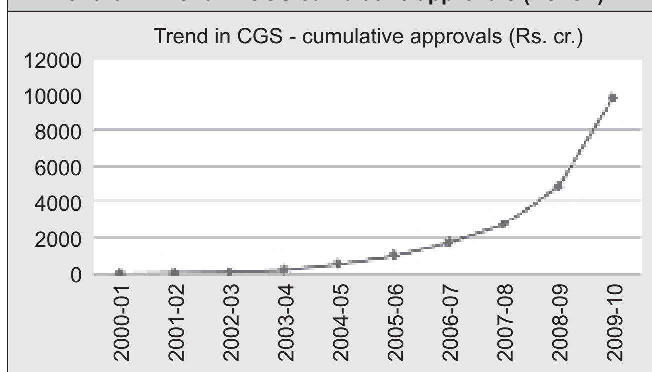
Table-3 : Trend in availment of cover under CGS since inception

Period	No. of Active MLIs	No. of Credit Facilities Approved	Amount of Guarantees Approved (Rs. Crore)	Cumulative Guarantees Approved (Rs. Crore)
FY 2000-01	9	951	6.06	6.00
FY 2001-02	16	2,296	29.52	35.00
FY 2002-03	22	4,955	58.67	94.00
FY 2003-04	29	6,603	117.60	212.00
FY 2004-05	32	8,451	267.46	538.00
FY 2005-06	36	16,284	461.91	1,000.00
FY 2006-07	40	27,457	704.53	1,705.00
FY 2007-08	47	30,285	1,055.84	2,701.00
FY 2008-09	57	53,708	2,199.40	4,824.00
FY 2009-10*	82	1,13,029	5,110.09	9,822.50

*Data Source : CGTMSE * Till January 31, 2010*

N.B.: Actuals may vary due to intervening cancellations / modifications

Chart-1 : Trend in CGS cumulative approvals (Rs. Cr.)



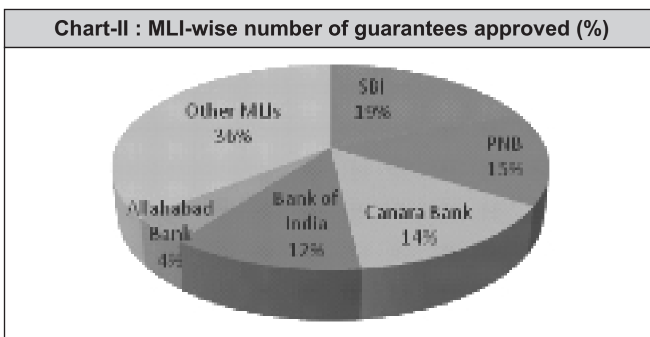
Data Source : CGTMSE (Status as of January 31, 2010)

The Scheme was slow in taking off in the initial years and the cover availed of remained below 10,000 proposals during the first five years. However, since 2005-06, there has been a steady growth in the issue of guarantees and the same has increased exponentially from 16,284 proposals involving Rs.461.91 crore in the year 2005-06 to 53,708 proposals involving Rs.2,199.40 crore in the year 2008-09. During the ten month period ending on January 31, 2010, 1,13,029 guarantee proposals for Rs.5,110.09 crore were approved. Cumulatively, as of January 31, 2010, 2,61,987 guarantee proposals have been approved involving an aggregate amount of Rs.9,822.50 crore.

The MLI-wise classification of CGS cover

As of January 31, 2010, State Bank of India topped the list in terms of number of proposals covered with 49,594 proposals involving guarantee amount of Rs.1,517.65 crore accounting for 18.93% of the total proposals in terms of number and 15.45% of the guaranteed amount approved cumulatively as of January 31, 2010. Punjab National Bank (38,517 proposals involving Rs.1,062.65 crore), Canara Bank (35,892 proposals involving Rs.881.04 crore), Bank of India (31,614 proposals involving Rs.1,694.64 crore) and Allahabad Bank (10,785 proposals involving Rs.288.67 crore) were the other leading MLIs as shown in Chart-II below :

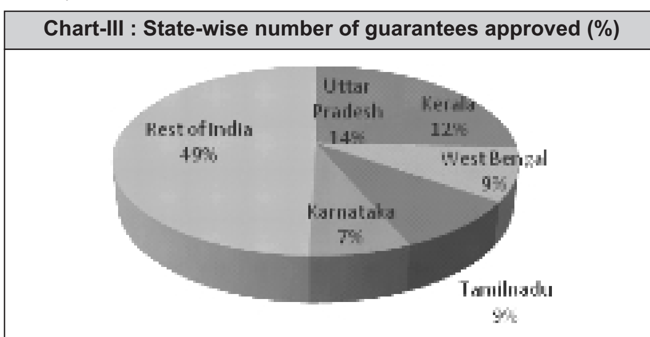
Chart-II : MLI-wise number of guarantees approved (%)



Data Source : CGTMSE (Status as of January 31, 2010)

State-wise classification of the cumulative cover under CGS as of January 31, 2010 indicates that Uttar Pradesh was the leading beneficiary with guarantee cover for 36,583 proposals involving an aggregate credit of Rs.877.66 crore, followed by Kerala (30,250 proposals involving Rs.577.52 crore), West Bengal (24,272 proposals involving Rs.898.93 crore), Tamilnadu (22,832 proposals involving Rs.917.20 crore) and Karnataka (17,642 proposals involving Rs.969.70 crore) as shown in Chart-III below.

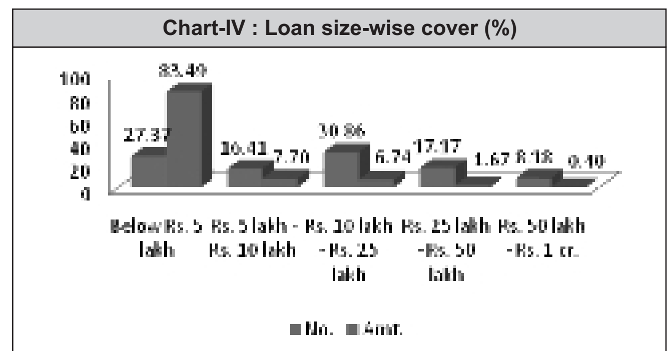
Chart-III : State-wise number of guarantees approved (%)



Data Source : CGTMSE (Status as of January 31, 2010)

Loan size-wise analysis of the cumulative guarantees approved as of January 31, 2010 reveals that 27.37% of the amount guaranteed pertains to loan size below Rs.5 lakh (by numbers 83.49%), 16.41% of the amount guaranteed belongs to loan size between Rs.5 lakh to Rs.10 lakh (by numbers 7.70%), 30.86% of loans belongs to loan size between Rs.10 lakh to Rs.25 lakh (by numbers 6.74%), 17.17% of loans belongs to loan size between Rs.25 lakh to Rs.50 lakh (by numbers 1.67%), 8.18% in terms of amount guaranteed belongs to loan size between Rs.50 lakh to Rs.100 lakh (by numbers 0.40%) as shown in Chart-IV below.

Chart-IV : Loan size-wise cover (%)



Data Source : CGTMSE (Status as of January 31, 2010)

ISSUES FOR CONSIDERATION

Extent of Cover

Any secondary collateral / third party guarantee free credit facility extended by MLIs to MSEs upto the credit limit of Rs.1 crore are eligible for guarantee cover by CGTMSE. An analysis of the data on collateral free loans upto credit limit of Rs.25 lakh each extended by all public sector banks as indicated in the Table 4 below was carried out as a sample and the data revealed that only 8.46% of such accounts were covered under the CGS as at the end of March 2008. In terms of the amount outstanding, 13.95% of the total loans were covered under the CGS. The position improved in the year 2008-09 and as at the end of March 2009, 9.77% of such accounts and 21.97% of the total amount was covered under CGS as shown in Table-4 and Charts-V and VI below :

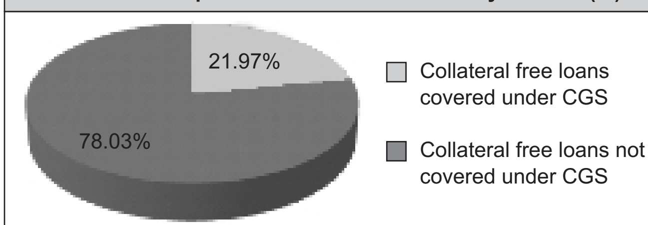
Table-4 : Extent of cover of collateral free loans of Public Sector Banks under CGTMSE				
As on March 31	Position of collateral free loans upto Rs.25 lakh		Collateral free loans covered under CGTMSE	
	No. of accounts	Amount O/s (in Rs. in crore)	No. of accounts	Amount O/s (in Rs. lakh)
2008	12,04,478	17,336.97	1,01,902 (8.46%)	2,419.21 (13.95%)
2009	13,13,247	18,136.30	1,28,305 (9.77%)	3,985.57 (21.97%)

Note : Figs. in parenthesis show percentage of cover under CGTMSE of the total collateral free loans upto Rs. 25 lakh.

Source : Data as reported by banks to RBI

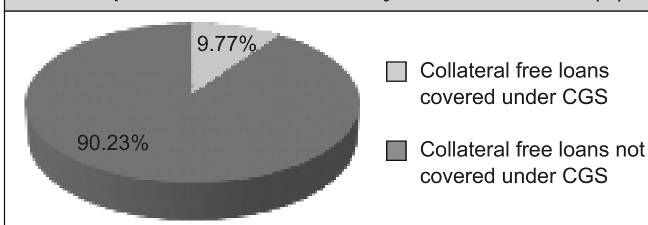
The collateral free loan accounts increased by 1,08,769 in number from the year 2007-08 to 2008-09 for credit limits upto Rs.25 lakh extended by public sector banks. Significantly, of these incremental accounts, 26,403 (24.7%) were covered under the CGS.

Chart-V : The share of cover of collateral free loans of Public Sector Banks upto Rs.25 lakhs under CGS by amount (%)



Source : Data reported by banks (Status as of March 31, 2009)

Chart-VI : The share of cover of collateral free loans of Public Sector Banks upto Rs.25 lakhs under CGS by number of accounts (%)



Source : Data reported by banks (Status as of March 31, 2009)

Data on total loans to MSE sector, extent of guarantee cover taken, claims lodged and settled received from 19 public sector banks and five private sector banks is furnished in Annex-I. The data revealed that the guarantee cover taken by banks for their MSE advances was very low. As at the end of March, 2009, out of 21.8 lakh MSE borrowal accounts, only 57,552 accounts, constituting 2.64% of total accounts, were covered under the CGS. In terms of the amount outstanding, guarantee cover was taken only for 3.01% of the total advances to MSEs. Further, of the approximately 17.5 lakh accounts with credit limit of up to Rs.5 lakh each, only 46,280 (2.64%) accounts were covered under the guarantee scheme. In terms of amount outstanding, guarantee cover taken in respect of accounts with credit facility up to Rs.5 lakh constituted 2.75% of the total advances to such borrowers.

The above analysis clearly illustrates that the CGS has not been attractive enough to MLIs.

Invocation of Guarantee and Settlement of Claims

As may be seen from Annex-I, the claims lodged were very low. Only 470 claims with aggregate amount of Rs.39.15 crore were lodged during 2008-09. The position in respect of major public sector banks which lodged higher number of claims were analysed (Table-5). The data revealed that by June 30, 2009, of the total number of 4116 NPA accounts, claims were lodged only in 649 accounts which constituted 15.8% of these accounts. The reasons cited by banks for low level of invocation of guarantees were procedural hassle of filing suit in all cases as a precondition for lodging claims and due to the prescription of lock-in period of 18 months.

Table-5 : Extent of claims lodged

Bank	No. of accounts covered under CGTMSE	No. of NPA accounts (of col. 2)	Claims lodged (of the NPA accounts) (in col. 3)	No. of accounts of Col. 3 where claims were not lodged (col. 3 - col. 4)
1	2	3	4	5
State Bank of India	25649	1668	99	1569
Bank of Baroda	2616	93	16	77
Canara Bank	21085	1983	425	1558
Bank of India	18400	372	109	263
Total	**67750**	**4116**	**649**	**3467**

(Cumulative up to June 30, 2009)
(Source : CGTMSE)

Issues raised by various stakeholders

The effectiveness of the CGS was reviewed by the Standing Advisory Committee (SAC) on credit flow to Micro and Small enterprises in its meeting held on February 3, 2009. Various MSE Associations in their representations and submissions to Reserve Bank of India had also expressed concern over the unsatisfactory performance of CGS mainly due to the reluctance of banks to avail of guarantee cover under the Scheme and the guarantee fee being high. The Working Group also received comments from a number of banks on the working of the Scheme and suggestions for further improvement. The issues raised by various stakeholders are summarised below :

Scope of Cover under the Scheme

a. Loans to all service activities as specified in the MSMED Act, 2006 (such as loans granted to educational institutions, SHGs, Retail Trade) should be eligible for cover under CGS. The CGS may be amended suitably to align it with the MSMED Act, 2006.

b. More often than not, the branch level functionaries prefer to lend against secondary collaterals rather than take guarantee cover from CGTMSE on the assumption that it would be easier for them to recover the dues by liquidation of collaterals. Further, the branch managers were not delegated powers to take the CGTMSE cover for the loans sanctioned by them. The power is normally given to the Controlling Offices. This policy delays taking of guarantee cover. The eligible accounts which the branch fails to report to the controlling offices remain uncovered and there is no monitoring mechanism in this regard. These deficiencies needed to be removed. At present, non-obtention of secondary collateral in all loans upto Rs.5 lakh to the MSE sector is mandatory. This limit may be enhanced for the first generation entrepreneurs for establishing industries in industrially backward areas to Rs.10 lakh as recommended by the Working Group on Rehabilitation of Sick SMEs (Chairman : Dr. K. C. Chakrabarty).

c. Mandatory cover under the Credit Guarantee Scheme be considered for loans upto a limit of say, Rs.25 lakh, and the guarantee fee / Annual Service Fees (ASF) may be borne by the Government. This would have the effect of bringing under guarantee cover the entire Micro enterprises segment. The reduction in cost due to economy of scale should enable CGTMSE to bring down the guarantee fee to 0.5%.

d. Guarantee cover for loans with limits higher than Rs.100 lakh to the extent of the unsecured portion of these loans with a ceiling of Rs.100 lakh may be provided.

e. The extent of guarantee cover should be made uniform at 75% of the amount in default for all credit facilities upto Rs.1 crore.

f. Borrowers having credit facility under multiple banking arrangements may also be brought under the ambit of CGTMSE scheme.

g. Existing loans (both term loans and working capital) backed by secondary collateral / third party guarantee may be covered under CGS if lending institution releases collaterals at any time during the currency of the loan.

h. CGTMSE should assign reasons for rejection of the applications for guarantee cover under the scheme. This will enable the branches for correct submission of applications, or re-submission of the proposals.

i. A whole turnover policy could be considered, where the entire MSE portfolio of the bank may be covered as against the present system of covering each borrowal account individually.

j. The following two clauses of the Scheme are major hurdles in the implementation of the scheme and need to be removed :

- The Credit Guarantee Trust reserves the discretion to accept or reject any proposal referred to it by MLIs which otherwise satisfies the norms of the Scheme.
- Credit facility with interest rate of more than 3 per cent over Prime Lending Rate, is not eligible for being guaranteed under the scheme.

Guarantee fee

a. The upfront guarantee fee may be charged at uniform rate of 0.75% of the sanctioned amount. Risk-based guarantee fee may be introduced

according to the risk factor in the industrial / service sector.

b. As the cost of credit to MSE sector is already very high, the rate of guarantee fee and annual service charge should be reduced by at least 50 percent across the board.

Annual service fees (ASF)

a. Once the account turns Non Performing Asset (NPA), the borrower stops servicing the account. However, ASF is paid by the bank even after the account becomes NPA till settlement of the claim. It would be appropriate to discontinue collection of ASF from the date the account turns NPA.

b. At present, the ASF is charged on the sanctioned limit. The ASF may be charged on the outstanding amount rather than on the sanctioned limit.

c. ASF should not be collected for the accounts closed during the year.

d. In case of working capital loans, only ASF should be charged, instead of one-time guarantee fee and ASF.

e. The MSEs enjoying credit limit upto Rs.5 lakh may be exempted from payment of ASF and Guarantee fee. Appropriate Corpus may be created by CGTMSE to bear the charges for the small borrowers.

The Procedure for Invoking Guarantees

a. The mandatory provision of filing of legal suit before lodgement of claim may be waived for loan amount up to Rs.50.00 lakh. Alternatively, a system of sharing legal expenses between MLIs and the Trust may be devised. Issue of legal notice recalling the loan amount should be sufficient for invoking claims instead of filing of legal suit.

b. The lock-in period for lodging of claims may be reduced to 12 months from 18 months as at present. Further, in case of small business loans under the Government sponsored schemes, normally there is no realizable value of assets. In such cases there should not be any lock-in period for lodging claim.

Settlement of claims

a. Some MLIs felt that there is a need to ensure prompt settlement of claims under the CGTMSE scheme to foster confidence amongst bankers.

b. As per the extant guidelines, final instalment of claim is paid by the Trust only after the decree of recovery becomes time barred i.e. 12 years after the decree is passed by the courts. This provision of the scheme poses serious difficulty for banks.

c. MLIs are required to take the permission of the Trust before adjusting the claim amount to the account of the borrower. This may be done away with as MLIs furnish an undertaking that they would take all possible steps for recovery including legal action. The MLIs should be permitted to adjust the settled amount to the borrower's account without seeking permission from CGTMSE.

d. In the claims settled accounts, the MLI is required to remit the full amount to the CGTMSE in case of recoveries. The Trust then appropriates 75% of the recovered amount and refund the balance amount to the MLI. This procedure is cumbersome and the MLIs should be allowed to remit the proportionate share of the recovery to the Trust.

e. Existing software put in place by CGTMSE for covering / claiming under the CGS may be improved further to make it more user friendly.

Summary of Observations and Recommendations

One of the terms of reference of the Working Group was to review the working of the CGTMSE Scheme and recommend measures which would result in its enhanced usage and consequential increased flow of collateral free loans to the MSE sector. The Working Group noted that the year-wise performance of the CGS has exhibited steady improvement since 2006-07. While 27,457 accounts with aggregate amount of Rs.704.53 crore were approved for guarantee cover in 2006-07, 53,708 accounts with aggregate amount of Rs.2,199.40 crore were approved in 2008-09 which has further improved to 1,13,029 approvals amounting to Rs.5,110.09 crore by January 31, 2010 during the current year 2009-10. However, the extent of guarantee cover of

the credit facilities to MSE sector remained far below its potential. As per the data furnished by 24 banks (public sector and private sector banks), out of total number of MSE accounts at 21,80,036 as on March 31, 2009, the accounts covered under the CGS of CGTMSE were 57,552 which constituted only 2.64% of total accounts as shown in the Annex-I. Further, only about 10% accounts representing collateral free loans upto Rs.25 lakh extended by public sector banks were covered under Credit Guarantee Scheme as shown in Table-4. In terms of amount outstanding, 22% of credit limits upto Rs.25 lakh each were covered under the guarantee scheme. With a view to encouraging MLIs to avail themselves of guarantee cover under the CGS of CGTMSE for most of the collateral free loans to MSE sector with credit limit upto Rs.1 crore, the Working Group makes the following recommendations duly supported by rationale :

Collateral free loans

As per the extant Reserve Bank guidelines, banks must not obtain collateral security in the case of loans upto Rs.5 lakh extended to all units in the MSE sector. The Working Group on Rehabilitation of Sick SMEs (Chairman : Dr. K. C. Chakrabarty) had recommended that the present limit of Rs.5 lakh for collateral free lending to SMEs be enhanced to Rs.10 lakh for first generation entrepreneurs for setting up units in industrially backward areas. As the analysis of the extent of the present cover indicates, majority of the loans continue to be in the below Rs.5 lakh category, and, therefore, it would be only appropriate, and reasonable, to enhance the existing mandatory limit for collateral free loans by banks from Rs.5 lakh to Rs.10 lakh, so as to benefit larger number of MSE units. In accordance with the recommendations of the S. L. Kapur Committee, the exemption limit for obtention of collateral security / third party guarantee was raised from Rs.25,000 to Rs.1 lakh in October 1999. Banks were advised in January 2002, to extend the benefit of collateral-free loans upto Rs.5 lakh to all SSI units, (now described as MSEs) so as to ensure flow of adequate and timely credit to this sector. As over seven years have elapsed since the limit was fixed at Rs.5 lakh, there is a strong case for enhancing the said credit limit from Rs.5 lakh to Rs.10 lakh, as incidentally, also recommended by the Chakrabarty Committee.

The Group, therefore, recommends that the limit for collateral free loans to the MSE sector be increased from the present level of Rs.5 lakh to Rs.10 lakh and it be made mandatory for banks. Banks, in turn, can take cover for the collateral free credit facilities under CGS. In order to upscale the CGS, it is necessary to create widespread awareness about the key features and benefits of the Scheme. As the branch level functionaries have a predilection to lend against collaterals, the Group recommends that the Chief Executive Officers (CEOs) of banks assume complete and total ownership in the matter of strongly encouraging the branch level functionaries to avail of the CGS cover, including making performance in this regard a criterion in the evaluation of their field staff.

Guarantee Fee

a) Risk- based guarantee fee

The matter of introduction of risk-based guarantee fee was deliberated by the Group. It was suggested that instead of the uniform rate of fee presently charged to cover the MSE loans under CGTMSE, the guarantee fees could be charged based on the risk profile of the loan portfolio of the bank concerned. For a risk-based fee, it was suggested that an audit by a third party of the portfolio by sampling could be taken for each bank in order to decide the risk level of the portfolio and appropriate guarantee fee. The other alternative is to get the portfolio rated by an external agency which would however be a time consuming and costly process. Another suggestion was to decide the guarantee fee on the basis of gross NPAs in that portfolio. However, the Group was of the opinion that this could result in a higher guarantee fee for MLIs with larger MSE loan portfolio. More so, a differentiated risk-based fee structure would be inconsistent with the public policy purpose of providing CGS cover to the MSE sector which is considered more risky but contributes significantly to employment generation, exports and inclusive growth. The feedback of the member banks was also such that banks were not very favourably disposed to differentiated rates of guarantee fee. Besides, the case for risk based guarantee fee is typically sought to be made out on the analogy of similar case for deposit insurance globally.

But the Group noted that there is a need to carefully nuance between risk-based premium for deposit insurance and risk-based guarantee fee under CGTMSE because in the former case, deposits insured of different banks are subjected to individually voluntarily differing risk profiles of banks' assets, whereas in the latter, MSE loans are conferred a priority status by public policy and, therefore, individual banks have no control over generic risk inherent in MSE loan portfolios i.e. the risks assumed in MSE lending are involuntary. The Group, therefore, recommends that a uniform guarantee fee would be most appropriate as being levied hitherto.

b) Recovery of Guarantee Fee

i) Fair Value of Guarantee Fee

On the issue of fair value of guarantee fee charged by the Trust, the Group noted that as of today there is no conceptually rigorous and technically robust methodology adopted by CGTMSE to compute the fair value of guarantee fee to be charged to MLIs. Accordingly, in order to add conceptual and technical rigour to determination of fair value of annual guarantee fee, the Group recommends a conceptually rigorous and technically robust methodology for computing fair value of annual guarantee fee which simulates / models the dynamically evolving distribution of claims settled such that if the model-generated fair value guarantee fee per annum is charged, there will be, at 99.9% one-tailed confidence interval, only 0.1% probability that the claims settled will exceed the guarantee fees collected. In other words, there will be only 0.1% chance that the corpus / fund will be touched.

Based on the above methodology, in working out the most realistic and reliable annual guarantee fee, the potential claims likely to devolve during the year 2010-11 were also simulated by assuming the worst case scenario of the entire unclaimed portion of NPAs devolving. This is deemed to be likely scenario what with the implementation of the Group's recommendations for rationalisation / simplification of procedures, if accepted. To simulate this, the data shown in Table-5 was made use of. It will be observed that of the total number of NPA accounts covered under CGTMSE which stood at 4116, claims were lodged only for 649 accounts. This meant that potential devolvement on the Trust could theoretically be for the balance 3467 accounts, in the worst case scenario, which is approximately 5 times the claims actually lodged.

Furthermore, the provision for claims made by the Trust in its Balance Sheet for the year ended 31, March 2009, based on the actuarial valuation of liability of the Trust for the year 2008-09 was Rs.32.53 crore against claims paid to the extent of Rs.8.38 crore for the same year. Thus the provision for claims was approximately 4 times the actual claims settled. The Group, therefore, considered the worst case scenario of all the potential claims devolving on the Trust and it was worked out that the potential pay-out could be approximately Rs.195 crore (5.34 times the claims which have devolved on the Trust till date as shown in Table-5). From this the net surplus of Rs.123 crore which the Trust has accumulated (GF / ASF received from 2000-01 to 2009-10 till January 31, 2010 net of tax at 33% but including interest income earned @ say 8% p.a. minus the cumulative claims settled. cf Annex-II), was subtracted as this amount is already available with the Trust as a cushion for any pay outs in 2010-11. Based on this worst case assumption, the fair value of guarantee fee worked out to 1.14% per annum at 99.9% one-tailed confidence level as shown below :

Calculation of Fair Value of Guarantee Fee				
Year	Claims settled	Cumulative guarantees approved	Claims settled to cumulative guarantees outstanding (%)	
2000-01	0	6.06	0.00%	
2001-02	0	35.58	0.00%	
2002-03	0	94.25	0.00%	
2003-04	0.03	211.85	0.01%	
2004-05	0.52	479.31	0.11%	
2005-06	1.10	941.22	0.12%	
2006-07	1.40	1645.75	0.09%	
2007-08	7.15	2701.59	0.26%	
2008-09	8.38	4900.99	0.17%	
2009-10	17.85	10011.08	0.18%	
2010-11	108	10011.08	1.08%	
				fair price
		average	0.18%	
		standard deviation	0.31%	
		value at 99.9% confidence one-tailed	0.96%	1.14%
		value at 99% confidence one-tailed	0.72%	0.90%
		value at 95% level one-tailed	0.51%	0.69%

Currently, the Trust also charges Annual Service Fee, ranging from 0.50% to 0.75% p.a., in addition to the normal one-time upfront guarantee fee of 1.0 % to 1.5% of the amount of guaranteed MSE loans. Generally, the average period of cover is about 5 years and, therefore, the per annum guarantee fee for say, credit facility above Rs.5 lakh, works out to 0.30% (1.5% divided by 5) which gives a composite all-in fee of roughly 1.05% per annum (0.30% plus 0.75%). This is very close to the more rigorously worked out annual guarantee fee of 1.14% p.a. The Group, therefore, recommends that the CGTMSE may charge composite, all-in guarantee fee of 1% p.a. which is almost the same as the composite annual fee now being charged by CGTMSE and appropriately realign downwards the guarantee fees chargeable to women entrepreneurs, Micro enterprises and units located in NE Region including Sikkim. Further, as discussed above, the Trust may each year review the Guarantee Fee to be charged on the basis of the model of dynamically evolving distribution of claims.

ii) Exemption from Income Tax

As CGTMSE is a not-for-profit organisation, it was exempted from payment of Income-Tax for the first five years of its operations and its income has since been subject to tax thereafter. DICGC, which used to provide Credit Guarantee earlier, was exempt from tax for 15 years, and subsequently exemption period was extended by the Government for another 5 years. The Working Group felt that the Ministry of Finance may also consider exempting the Trust from Income Tax as was done in the case of DICGC. The Trust was established with the explicit high public policy priority of providing impetus to the MSE sector. Thus, the case for exemption from income tax of the guarantee fee and income on investment of any surplus is not only justified by the underlying high public policy purpose but equally by the fact that the guarantee fee is not ‘income’ in the first place as it is in the nature of ‘revenue’ and meant to cover existing and potential claims as indeed so is income on investment of any surplus as ultimately that income will also be potentially used for meeting potential guarantee claims. Besides, the income on investment of corpus of the Trust increases the size of the Trust Fund and only furthers the public policy purpose of guaranteeing more MSE loans and/or reducing the guarantee fees thus ultimately benefiting only the MSE sector. So, it is only appropriate that fee income and income on investments may be exempted from Income Tax as indeed is the practice internationally vide page 33 of cross-country practices. More so, as the Government is the major contributor to the corpus, in the extreme case of shortfall, the Government may have to replenish the same. Hence, it may not be appropriate to levy income tax on its own income. In view of the rationale stated above, the Group strongly recommends that the Government consider exempting both guarantee fee and the income on investments of the Trust from Income Tax.

iii)Guarantee fee for credit limits upto Rs.10 lakh

As regards, the practice of recovery of the guarantee fee / ASF from the MSE customers under the Scheme, the Working Group noted that there were divergent practices amongst banks. In some cases, banks and borrowers share the fee equally. While some banks recover the entire fee from borrowers, in some cases banks refund the fees to borrowers at the time of final repayment of loans by the latter. The decision to charge fees to borrowers, or otherwise, is left to individual banks. In the erstwhile Credit Guarantee Scheme of DICGC, banks had the discretion to recover the guarantee fee from the borrowers, other than those belonging to the ‘weaker sections’. Since the guarantee scheme is primarily a safety net for MSEs, the Group was of the opinion that the small borrowers should not be burdened with the cost of the guarantee and Government should bear the same. Micro enterprises generally have a weak financial structure and banks are generally reluctant to finance them for this reason. The need for credit enhancement either by secondary collateral security or by a third party guarantee gets accentuated in these accounts. However, most such entrepreneurs, being very small, have little or no secondary collateral security to offer. In this context, the Working Group on Rehabilitation of sick SMEs (Chairman : Dr. K. C. Chakrabarty), had also suggested that the government might bear the entire credit guarantee fees for micro enterprises in order to encourage financial inclusion in the sector. In this context, the Group noted that Government of India had made initial contribution to the

Guarantee Fund. Thus, the Government has already taken the burden for the MSE borrowers. The Group is of the opinion that it may not be appropriate to ask banks, which are commercial entities, to bear the guarantee fee as any scheme for banks has to be a reasonable business proposition for it to be readily acceptable. Further, the Working Group felt that if banks were made to bear the fee, they would somehow either discourage lending to MSEs, especially Micro Enterprises, or somehow indirectly load the same on the customer by charging a higher rate of interest on the facility provided thereby defeating the very purpose of fostering and developing the MSE sector. Considering the special dispensation of collateral free loans to Micro Enterprises upto the limit of Rs.10 lakhs recommended both by the K. C. Chakrabarty Committee and this Group, the Group strongly recommends that the guarantee fee for collateral free loans upto Rs.10 lakh to Micro Enterprises be borne / absorbed by the CGTMSE subject to the proviso that the Trust be free to adjust Guarantee Fee both downwards and upwards, based on the modelling of the dynamically evolving distribution of claims. This will ensure that while the stakeholders like MLIs and their MSE clients benefit from the potentially lower guarantee fee, the CGTMSE also remains self-financing and self-sustaining in the longterm. Besides, asking MLIs to bear the guarantee fee, might be counterproductive.

The Extent of the Guarantee Cover

At present, taking guarantee cover under CGS is not mandatory and MLIs have the freedom to take, or not to take, guarantee cover for MSE advances extended by them. The Group felt that the decision to take cover under the Guarantee Scheme should be left to the MLIs and no compulsion should be made in this regard. As the Working Group has recommended enhancement of the limit of collateral free loans from the present limit of Rs.5 lakh to Rs.10 lakh for Micro enterprises and payment of guarantee fees by the Trust in these cases, it is expected that MLIs would be incentivised enough to take guarantee cover at least for all the accounts with credit limits upto Rs.10 lakh. At present, the extent of guarantee cover for Micro enterprises is 85% of the amount in default for credit limits upto Rs.5 lakh. For credit limits above Rs.5 lakh, the guarantee cover is 50% to 80 % of the amount in default. As a logical sequel to the recommendation of the Group to increase the credit limit from Rs.5 lakh to Rs.10 lakh for collateral free lending by banks to Micro enterprises, the Group recognised that there was also a need to enhance the extent of cover of 85% for credit facilities now available upto Rs.5 lakh to Rs.10 lakh for Micro enterprises. This would help both small entrepreneurs as well as lenders. The Group, therefore, recommends that guarantee cover upto 85% of the amount in default be made applicable to credit facilities to Micro Enterprises upto Rs. 10 lakh.

Whole Turnover Guarantee

The issue of providing cover on a whole turnover basis was examined by the Group. The Group noted that the Export Credit Guarantee Corporation (ECGC) provided Whole Turnover guarantee to banks on an annual basis for packing credit / post shipment credit extended to all exporters. Such guarantee stipulates a minimum number of 25 accounts and minimum assured premium of Rs.5 lakh per annum per bank as a precondition for issue of Whole Turnover Cover for Pre and Postshipment credit. The extent of cover is a certain percentage of the loss depending on the average claim to premium ratio of the bank for preceding five years in respect of packing credit. The maximum liability of ECGC under Packing credit is fixed for each bank on the basis of aggregate outstanding as at the end of March each year and for Post-shipment credit an overall limit is fixed for banks up to which claims can be paid. A differential rate of premium is charged under whole turnover policy of ECGC for Packing credit. For a new bank, the premium rate for packing credit is different from that for a bank that is already holding ECGC whole turnover cover. The premium rate for member banks is decided on the basis of claim to premium Ratio for the preceding 5 years. The Group made a comparative study of the ECGC Scheme with the extant CGTMSE Scheme. On a comparative assessment, the Group felt that the CGS of CGTMSE has not yet become popular and covering of all the eligible accounts would take few more years. Introduction of Whole Turnover Guarantee (WTG) for the MSE sector may complicate the Scheme and is not

appropriate at this stage. The CGTMSE Scheme provides cover for both Working capital and Term loans to the MSE sector and tenure of the cover is for the full term of the credit and block of 5 years respectively which is more suited for this sector than an annual cover prescribed under the ECGC Scheme. The extent of cover may also have to be varied depending on the track record of a bank. However, under the CGTMSE Scheme, there is uniform cover for all banks. As the Scheme is yet to gain acceptability by banks and it needs to attain critical mass of traction, and stabilize, the Group recommends that introduction of Whole Turnover guarantee can wait until later.

Corpus of the Guarantee Fund

If the CGTMSE uses the conceptually rigorous, and technically robust, Model suggested by the Group, there is only 0.1% i.e. only 1 in 1000 chance that the CGTMSE fund will be touched. In other words, this is as close as it can get to capturing a 'black swan' event! However, as and when required, the Government of India may contribute to the Fund's corpus.

Simplification of the Procedures

a) Filing of suit for Invocation of Guarantees

One of the terms of reference of the Working Group was to offer suggestions to simplify the existing procedures and requirements for obtaining cover and invoking claims under the CGS of CGTMSE. The data on invocation of guarantees in respect of four major public sector banks has been analysed in this regard.

The data in respect of major banks revealed that claims were lodged in respect of only 649 accounts against the total number of NPA accounts at 4116 (15.8%). The main reasons, as cited by MLIs, for claims filed being low were (i) non-completion of lock-in-period, (ii) non-initiation of legal proceedings against borrowers and (iii) that classifi cation of accounts as NPA was done recently. A number of banks had suggested that the pre-condition of filing of suit for invocation of guarantee should be either removed, or at least, a suitable threshold may be fixed upto which the precondition of taking legal action could be waived. They felt that filing of suits in small accounts was not economical to the banks in view of adverse cost-benefit trade-off involved. It was clarified that under the CGS, suit could be fi led with any authority such as a civil court, Debt Recovery Tribunal, Lok Adalat etc., by the banks without engaging the services of lawyers. The rationale for filing suit was that it was the last resort / option available to banks to recover dues. The issue of filing suit as a precondition to lodging claims was deliberated by the Working Group. The Group felt that as the guarantee fees would be borne by the Trust in all the cases with credit limit of Rs.10 lakh (as recommended by the Group), the burden on banks to bear the guarantee fee would be affordable. As such, banks could file a suit for the loan account covered for lodging their claims. However, with a view to simplifying the procedures, the Group felt that there was a case for prescribing a threshold upto which the condition could be waived. While considering the threshold upto which the precondition of filing suit could be waived, the CGTMSE informed that cumulatively as on January 31, 2010 the guarantee proposals approved by CGTMSE stood at 2,61,987 of which 98,131 proposals were for an amount less than Rs.50,000 constituting approximately 37.5 per cent of the proposals approved by the Trust. Therefore, the Group suggested that to begin with, a threshold of Rs.50,000/- could be fixed upto which the banks need not file legal proceedings before invoking guarantee. Some members felt that this limit was too low and should be raised to a minimum of Rs.1 lakh. But it was felt that to begin with, it would be appropriate to fix the limit at Rs.50,000/- initially and based on the experience gained it could be reviewed after a year. The Group, therefore, recommends that with a view to simplifying the procedure for filing claims in respect of small loan accounts, initiation of legal proceedings as a pre-condition for invoking of guarantees could be waived for credit facilities upto Rs.50,000/-. The Group also recommends that for all such cases, where the filing of legal proceedings is waived, an Executive Committee of the lending institution headed by an Officer not below the rank of General Manager should examine all such accounts and take a decision for not initiating legal action and filing claim under the Scheme.

b) Time period for invocation of Guarantees

Under the Scheme, there is a lock-in period of 18 months from either the date of last disbursement of the loan, or the date of guarantee fee, whichever is later, during which guarantee cannot be invoked. MLIs can invoke the guarantee within a maximum period of one year from the date of account becoming NPA, if this date is after lock-in period, or within one year after the lock-in period, if the loan becomes non-performing within the lock-in period. There are suggestions from banks that the lock-in period may be reduced from the present 18 months to 12 months. The Group was of the opinion that the provision of a lock-in period of 18 months is reasonable as it is expected that MLIs should conduct proper due diligence in sanctioning of loans so that the credit facility does not become non-performing within a short period of sanction. Moreover, the Group was of the opinion that the Fund should be dipped into only when the account is considered reasonably doubtful of recovery. Even if a borrower defaults from the first month of sanction of the loan, it takes 16 months for the account to become a doubtful asset. The Group, therefore, recommends that the present requirement of a lock-in period of 18 months is reasonable and may continue. However, the Group felt that the provision of filing claim within a period of one year from the date of classification of the asset as NPA is a very short period to judge the loan as irrecoverable as there is always a chance of upgradation of the status of the account within first one year. The present position only compels MLIs to initiate premature legal action simply to meet the deadline for invoking guarantee. The Group, therefore, recommends that MLIs may be allowed to invoke guarantee within a period of two years from the date of classification of the account as NPA.

c) Release of final claim

As per the extant guidelines, final instalment of claim (25% of the total eligible amount) is paid by the Trust only after the decree of recovery becomes time barred i.e. approximately 12 years after the decree is passed by courts. The feedback received from the banks revealed that this provision of the Scheme poses serious difficulty for banks as they had to wait for a very long period for the final claim to be settled. The Group also felt that the period was too long which resulted in 25% of the remaining dues of banks with the Trust almost perpetually. The Group felt that the final claim should be paid once the lender has obtained a decree from the court. However, SIDBI opined that MLIs should take steps to execute the decree and needed some time for the same. The Group, therefore, recommends that the final claim should be paid by the Trust after three years of the obtention of decree of recovery.

Factoring Services without recourse

Though not within the terms of reference, the Working Group deliberated the issue of bringing factoring services without recourse under the purview of the guarantee scheme. The Group observed that there were few entities which provided factoring services without recourse to the MSE sector. Such service providers were not lenders and did not come under the definition of MLIs. The Group discussed the issue of bringing the factoring companies within the purview of CGS as these institutions provide liquidity to MSE sector against the receivables of the latter. After deliberations, the Group felt that as most buyers of the goods from MSE units are large corporates, extending guarantee to factors will effectively lead to guaranteeing the defaults of large corporates and CGS of CGTMSE is not meant for that purpose. There may be few cases where both the sellers and buyers are MSE units. However, as the loans extended to both the MSE units are covered under CGS, the Group does not recommend bringing factors under the guarantee scheme of CGTMSE as it would encourage another level of intermediation and resultant additional costs to MSEs.

Cover of loans under the CGS with partial secondary collateral

During the deliberations, the Working Group considered the suggestions of some banks that loans with partial secondary collateral could also be made eligible for the guarantee cover. It was suggested that the Group may consider recommending to cover the credit facilities above Rs.1 crore and upto Rs.2 crore with partial secondary collateral under CGS. The Group was of the opinion that the 'raison d'être' of the CGTMSE Scheme is to encourage collateral free lending and helping the small entrepreneurs. The Group, therefore, recommends that

the issue of covering advances with partial collateral by enhancing the limit to Rs.2 crore may not be considered.

Definition of Collateral

The CGTMSE Scheme provides guarantee cover for collateral-free and third-party guarantee free credit facilities extended by MLIs to MSE borrowers. As per the definition provided in the CGTMSE Scheme, 'Primary security' means the assets created out of credit facility so extended and / or which are directly associated with the project, or business, for which credit facility is extended. This definition was not in sync with the international banking practice. Internationally, an asset which is acquired by utilising the bank finance is treated as the 'primary collateral' for the lender and any other additional security offered whether belonging to the borrower, or to a third party, is treated as secondary or supplementary collateral'. However, it was felt that the CGTMSE Scheme had been working satisfactorily and borrowers had no difficulty in offering the assets belonging to the unit as additional security to banks. The Group, therefore, does not recommend change in the present definition of the Scheme. The Scheme may cover the credit facilities which are secured by primary collateral as well as secondary collateral which belongs to the unit and are directly connected to the business activity of the unit.

Appendix

Credit Guarantee Schemes for the SMEs - Cross-country Practices

The market failure in the credit markets for SMEs has led to the formulation of more than 2,250 credit guarantee schemes in almost 100 countries internationally (ADB, 2007). The credit guarantee schemes serve the larger public policy objectives of promoting entrepreneurship in the country and to provide credit to the SMEs which commonly lack the kind of collaterals required by the banks and simultaneously reducing the credit risk of the lenders. According to Asian Development Bank (ADB,2007), "it is also argued that well-designed, well-funded and well-implemented credit guarantee schemes can improve SME access to credit and their integration into formal financial markets, assist SMEs to obtain finance for working capital, fixed assets and investment at reasonable conditions, and enable smaller firms to improve their competitiveness and extend their economic activity. This will ultimately translate into improved business performance and job creation". In some countries, a high proportion of SMEs are serviced by guaranteed loans e.g. Japan 38%, South Korea 20%, and Taiwan 20%. Most national credit guarantee schemes internationally, however, have little impact on the SME sector (they service only 1-2% of SMEs).

The schemes in existence internationally are organised in various corporate or legal forms, ranging from state-operated financial institutions, state-funded companies and government-guaranteed SME loan programs and in some cases independent private corporate entities, credit guarantee foundations or associations, mutual guarantee associations etc. (ADB, 2007). One of the largest funds globally, the Korean Credit Guarantee Fund (KODIT) is owned 60% by the national government and 40% stake is owned by the financial institutions. In Taiwan, the government owns 99% stake in the Small & Medium Enterprise Credit Fund (SMEG) and the remaining 1% is owned by the financial institutions. In the Philippines, however, the Small Business Guarantee & Finance Corp (national fund) the stakeholders are - National Government 45%; 55% by 5 state banks & insurance company. In UK, the Small Firms Loan Guarantee Scheme (SFLG) - National fund is financed 100% by UK Govt. In case of France, SOFARIS (Societe Francaise de Garantie des Financements des petites et Moyennes Entreprises), BDPME Bank (French Development Bank) is the main equity holder and other stakeholders include CDC & French Government.

As for the fee arrangements, most of the schemes have fixed guarantee fee arrangements in the range of 1.5 - 2 per cent per annum on the outstanding guarantee whereas some of the schemes have adopted risk-based guarantee fees where the fee structure is based on a sliding scale (e.g. Korea and Taiwan).

It is also observed that almost all international major credit guarantee institutions and programs have been granted non-profit status and enjoy exemptions from paying income tax and Value-Added Tax.

In most of the countries, the SME credit guarantee institutions are subject to mandated maximum credit multiplier levels (measured as a ratio between outstanding guarantees at the end of the year and capital funds), either through legislation or by directives, in order to maintain financial discipline and manage risks.

Japan's 52 institutions have the highest (varying between 35 and 60), and Korean, Taiwan and German institutions have designated a maximum multiplier of 20. The Philippines and Thailand, both small programs with weak management, have imposed levels as low as 3 and 5 respectively (ADB, 2007).

The loss-sharing ratio is generally in the range of 70-90 per cent and the remaining 10-30 per cent risk is borne by the lending institution. However, in certain programs, 100 per cent risk sharing is undertaken as in the case of Taiwan and Thailand. On the other end of the spectrum, risk sharing can also be as low as 20-50% as in Italy, and 45-70% as in France.

In a recent survey by Beck et. al. (2009) of 76 Partial Credit Guarantee Schemes (PCGs) globally, the main findings were :

- 40% of the schemes are for-profit, while the remaining 60% are non-profit; 52% are subject to corporate income tax, while 48% have tax-exempt status.
- 72% of PCGs use a loan or "selective" basis, while 14% use a portfolio or "lump screening" approach and 9% use a combination of the two approaches.
- Around 40% of all schemes in the sample offer guarantees of up to 100%.
- Most PCGs guarantee at least the loan principal (74%), while fewer guarantee only interest (34%) or other costs (13%); almost 30% guarantee both principal and interest.
- In 56% of the sample, the fees are paid directly by the borrower and in 21% by the financial institution receiving the guarantee (although this cost might be passed on to the customer). 63% of schemes in the sample (48) have a per-loan fee, while 30% of the schemes levy an annual fee; 15% charge a membership fee.
- There is also variation in the basis that schemes use to compute fees : 57% base the fee on the amount guaranteed, while 26% base it on the loan amount. Further, 25% of the schemes that charge on a per-loan basis take into account the maturity of the guaranteed loan when computing the fee, while 25% adapt the fee according to the risk of the loan or the borrower. Only 7% of the PCGs use a risk-based pricing structure and only 10% impose penalty rates for financial institutions with below-average loan performance.
- In 34% of the schemes in the sample, payouts are made after the borrower defaults. In 42% of the schemes, payout happens after the bank initiates recovery, while in 3% it happens after the PCG initiates recovery. In only 14% of all cases, payout has to wait until the bank writes off the loan. Schemes in more developed countries are more likely to pay out after default or after write-off, while schemes in developing countries are more likely to pay out after the bank initiates legal action.

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ANNEX- I

Amt.(Rs. in crore)

Data on coverage of the Credit Gurantee Scheme for MSEs for the year March ended 2009														
Total Loans to the MSE sector	No of A/Cs (in actual)	Amt O/s	Accounts covered under CGS		% Col 4 to Col 2	% Col 5 to Col 3	Claims lodged by banks during the Year		Claims settled by CGTMSE during the year		Percent-age of total coverage limit-wise (Number)	Percentage of total coverage limit-wise (Amount-wise)	Percent-age of claims lodged out of the covered (Number)	Percentage of claims lodged out of the covered (Amount)
1	2	3	4	5	6	7	8	9	10	11				
Particulars			No of A/Cs (in actual)	Amt (o/s)			No of A/Cs	Amt.	No of A/Cs	Amt.				
(Credit Limit)														
Upto Rs 5.lakh	1750025	21498.23	46280	590.25	2.64	2.75	247	2.24	56	0.85	80.41	25.93	0.53	0.38
Above 5 lakh upto Rs15 lakh	234661	14667.05	7448	679.67	3.17	4.63	39	3.48	26	1.86	12.94	29.86	0.52	0.51
Above 15 lakh upto Rs 25 lakh	103202	11503.32	2570	521.21	2.49	4.53	14	2.64	9	1.5	4.47	22.90	0.54	0.51
Above 25 lakh upto Rs1 Crore	92148	27863.84	1254	485.1	1.36	1.74	9	30.79	3	0.39	2.18	21.31	0.72	6.35
Total	**2180036**	**75532.44**	**57552**	**2276.23**	**2.64**	**3.01**	**470**	**39.15**	**284**	**65.79**	**100.00**	**100.00**	**2.32**	**7.75**

Note: A few banks have not provided the amount-wise break-up of the claims lodged and settled and hence the column total may not tally with the individual row totals

Annex- I *(Contd.)*

Amt (Rs. in crore)

Data on coverage of the Credit Guarantee Scheme for MSEs for the year ended March 2008

Data in respect of 24 banks

Total Loans to the MSE sector	No of A/Cs (in actual)	Amt Out-standing	Accounts covered under CGS		% Col 4 to Col 2	% Col 5 to Col 3	Claims lodged by banks during the year		Claims settled by CGTMSE during the year		Per-cent-age of total cover-age limit-wise (Number)	Percent-age of total coverage limit-wise (Amount-wise)	Percent-age of claims lodged out of the covered (Number)	Percent-age of claims lodged out of the covered (Amount)
1	2	3	4	5	6	7	8	9	10	11				
Particulars (Credit Limit)			No of A/Cs (in actual)	Amt. O/s			No of A/Cs	Amt.	No of A/Cs	Amt.				
Upto Rs 5.lakh	1156966	15590.7	21328	258.32	1.84	1.66	136	1.31	73	0.56	80.26	27.90	0.64	0.51
Above 5 lakh upto Rs15 lakh	166496	9771.99	3493	305.17	2.10	3.12	11	0.84	10	0.18	13.14	32.96	0.31	0.28
Above 15 lakh upto Rs 25 lakh	67791	6448.69	1368	268.62	2.02	4.17	13	3.27	14	3.41	5.15	29.01	0.95	1.22
Above 25 lakh upto Rs1 Crore	59079	16520.16	386	93.85	0.65	0.57	11	1.28	11	1.2	1.45	10.14	2.85	1.36
Total	1450332	48331.54	26575	925.96	1.83	1.92	70	4.79	40	4.12	100.00	100.00	4.75	3.36

Note: A few banks have not provided the amount-wise break-up of the claims lodged and settled and hence the column total may not tally with the individual row totals

Annex- I *(Contd.)*

Amt. (Rs. in crore)

Data on Coverage of the Credit Guarantee Scheme for MSEs for the year ended March 2007

(Data in respect of 24 banks)

Total Loans to the MSE sector	No of A/Cs (in actual)	Amt O/s	Accounts covered under CGS		% Col 4 to Col 2	% Col 5 to Col 3	Claims lodged by banks during the year		Claims settled by CGTMSE during the year		Per-cent-age of total cover-age limit-wise (Num-ber)	Percent-age of total coverage limit-wise (Amount-wise)	Per-cent-age of claims lodged out of the cov-ered (Num-ber)	Percent-age of claims lodged out of the covered (Amount)
1	2	3	4	5	6	7	8	9	10	11				
Particulars (Credit Limit)			No of A/Cs (in actual)	Amt O/s			No of A/Cs	Amt.	No of A/Cs	Amt.				
Upto Rs 5.lakh	602715	10774.95	23220	244.39	3.85	2.27	111	0.407	86	3.23	87.53	38.14	0.48	0.17
Above 5 lakh upto Rs15 lakh	74670	5972.66	2384	218	3.19	3.65	15	1.41	3	0.18	8.99	34.02	0.63	0.65
Above 15 lakh upto Rs 25 lakh	21191	3930.84	764	157.39	3.61	4.00	2	0.4	0	0	2.88	24.56	0.26	0.25
Above 25 lakh upto Rs1 Crore	30064	10712.93	159	21.03	0.53	0.20	7	1.45	5	0.78	0.60	3.28	4.40	6.89
Total	728640	31391.38	26527	640.81	3.64	2.04	45	2.077	6	3.28	100.00	100.00	5.77	7.96

Note: A few banks have not provided the amount-wise break-up of the claims lodged and settled and hence the column total may not tally with the individual row totals

ANNEX - II

Details of CGS operations of CGTMSE

1. Details of Year-wise Guarantee Approvals

Period	No. of Active MLIs	No. of Credit Facilities Approved	Amount of Guarantees Approved (Rs. Crore)	Cumulative No. of Credit Facilities Approved (Rs. Crore)	Cumulative Amount of Guarantees Approved (Rs. Crore)
FY 2000-01	9	951	6.06	951	6.06
FY 2001-02	16	2296	29.52	3247	35.58
FY 2002-03	22	4955	58.67	8202	94.25
FY 2003-04	29	6603	117.60	14805	211.85
FY 2004-05	32	8451	267.46	24321	538.62
FY 2005-06	36	16284	461.91	40605	1000.53
FY 2006-07	40	27457	704.53	68062	1705.06
FY 2007-08	47	30285	1055.84	97282	2701.59
FY 2008-09	57	53708	2199.40	150034	4824.34
FY 2009-10*	82	113029	5110.09	261987	9822.50

** As at January 31, 2010*

N.B.: Actuals may vary due to intervening cancellations / modifications

2. Details of Year-wise Claims Settled

Year	No. of Claims Settled	Amt settled (1st instalment)	Average size
FY 2005	47	54.00	1.14
FY 2006	113	110.35	0.98
FY 2007	111	144.66	1.30
FY 2008	238	714.45	3.00
FY 2009	275	853.54	3.10
FY 2010 (till January 31, 2010)	567	1785.83	3.14
Total	**1351**	**3662.83**	**2.71**

3. Details of Year-wise Income (Guarantee Fee / Annual Service Fee) *(Rs. lakh)*

Year	Guarantee Fee	Annual Service Fee	Total
2000-01	5.57	0.00	5.57
2001-02	74.48	8.08	82.56
2002-03	126.79	37.18	163.97
2003-04	233.03	87.54	320.57
2004-05	657.85	204.81	862.65
2005-06	900.21	403.04	1303.25
2006-07	953.96	0.00	953.96
2007-08	1257.75	665.99	1923.74
2008-09	2465.85	1055.82	3521.68
2009-10	6240.00	1724.00	7964.00
Total	**12915.49**	**4186.46**	**17101.95**

Impact of financial crisis on Banks in India and the new 'NORM'al

R. Bhaskaran [1]

Introduction

The seeds of the financial crisis were laid much before the year 2007-08 when the impact of the crisis began visible. More than two years and a massive dose of stimulus later, today opinion is divided on whether or not the worst of the crisis is over. The crisis has shaken the belief that organizations are too big to fail and put a question mark on the capital adequacy driven regulation of financial sector. Post crisis Governments world over came to the rescue of banks by infusing capital. India has had Government owned banks as a strategy for quite sometime now. Even in the case of troubled private banks the country has witnessed regulator driven takeover of banks by PSU banks. The Government had supported the banking system by infusing capital when the IRAC norms were introduced in the late nineties. It can be argued that interest rate subventions and waivers are nothing but credit risk management in a different way. These measures, to a large extent helped the banks to set right their credit portfolio and no cash flow was intended to reach the borrowers. In the past this policy was advocated and defended on account of developmental needs and poor capital formation. Banks had to play a proactive role in the modernization and industrialization of the country. The stimulus that the banks in USA, European countries, Middle East and other places has received is mainly woven around capital infusion by the Government and certain prescriptions of control by the Government agencies. Even as risk policies are being redrawn it is seen that the business design and geographies of some of the banks are being reworked. In some cases the ownership of the Government is much higher than 51% and it appears that "Government Ownership" may as well be the new **NORM**al.

Before going into the impact of the crisis on Indian banking it must be said that the Indian banking and financial sector is stable. Authorities in RBI and GOI have already made it amply clear that the sole reason why Indian banks were not affected as much as their U.S. or European counterparts is conservative / strong regulation. This coupled with the fact that majority of the PSU banks did not indulge in the concept of "taking risk[2]" but were content in 'complying' with risk guidelines kept the system financially stable.

Financial Crisis and Indian Banking System

Though the crisis started in 2007-08, the Indian banks felt the impact, albeit a rather late. Also not all the banks were impacted on an even scale. However, during the last two years, as the economy felt the impact of the crisis, corporate performance suffered and commodity and property prices became volatile, banks had to battle hard to cope with the crisis and by now, unlike the world banking scene, possibly the worst is over as far as India is concerned. The markets have started looking up and barring inflation things seem to be under control. Once again the cellphones have started ringing offering retail loans. The plethora of real estate advertisements seem to say that things are back to normal. In this background it would be interesting to see how were the banks impacted.

1. The views and opinions are personal and do not bind nor represents the views of the organization for which the author works.

2. Taking risk can be defined as investing in risk management products and instruments for the purpose of making profit without underlying risk exposure of the customer.

Indian banking is known for its four groups of banks namely PSU banks, including SBI group, private sector banks consisting of Old and New generation banks, foreign banks and cooperative banks. The characteristic of each group is distinct in terms of business mix, technology in use, HR practices etc. Managing a crisis calls for strategies. Strategies could differ according to the impact of crisis and management styles. Strategies could be in terms of business mix (off balance sheet exposures, exposure to sensitive sector, ratio of retail portfolio, investment loan mix etc.), ALM positions[3], rate of interest, risk management policies, etc. How did the crisis impact the banks and what were the strategies of the banks in managing the crisis?

Overall business

RBI in its report on Trend and Progress of Banking in India 2008-09 says "The Scheduled Commercial Banks in India, unlike their global counterparts, showed considerable resilience to the global financial crisis and its effects on Indian economy. Nonetheless the balance sheet of the banks shrank and their financial performance decelerated suggesting that the Indian banking system was not completely insulated from the effects of the slowdown of the Indian economy". Over the last four decades Indian banking system has been logging steady and good growth. Continuing with this trend, the overall business of the banks has recorded a positive growth of about 12.5% p.a in the last four years. The overall growth rate, however, has marginally declined in the years 2007-08 and 2008-09. It can be inferred from Chart-2 that the overall growth rate could have been worse had it not been for the PSU Banks accounting for about 76% of the volume of business and recorded steady growth through the years 2005-06[4] to 2008-09. In the case of New Private Sector bank, volumes have come down in the year 2008-09. All the bank groups had recorded a positive growth in the volume of business in the year 2008-09. As such the impact of the crisis does not become evident here.

Chart-1 : Total Asset of Banks

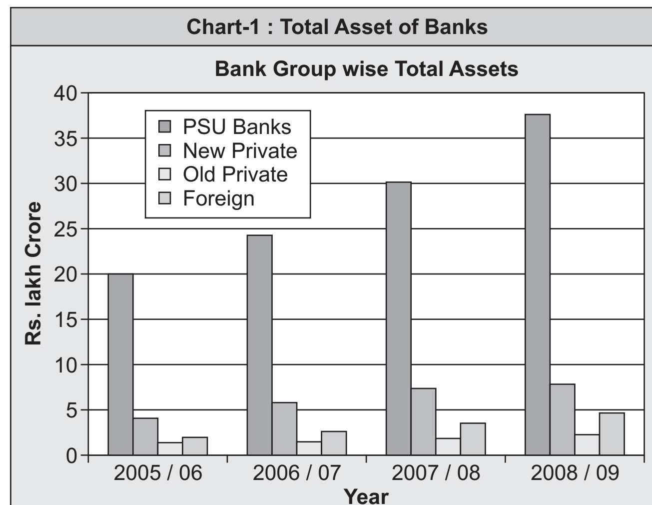
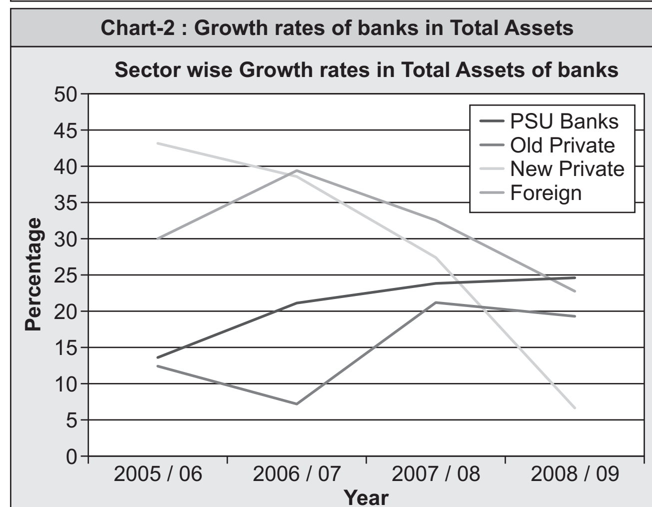


Chart-2 : Growth rates of banks in Total Assets



However, if one were to study the growth rates (Chart-2) it would show that though the growth rate for the PSU banks lies in a steady upward sloping curve there has been some slackening in the pace in the year 2008-09. Old private sector banks have witnessed a dip in the growth rate in the year 2008-09. The impact is, more apparent in the case of new private sector banks and foreign banks which have shown a decline in the growth rate reflecting the global scene of shrinking growth rates / volumes. It can be seen that the new private banks and foreign banks had recorded higher growth rates in the years 2005-06 and 2006-07 and the fall in growth rate in the last two years is therefore

3. Being presented in a separate article, later.

4. The data for the various charts in the article have been sourced from the RBI's Report on Trend & Progress of Banking in India for the years 2006-07, 07-08, and 08-09.

dramatic. In the year 2005-07 the retail sector was growing at a scorching pace and these two groups had a major share in it.

Market Share :

As banks manage crisis they reposition the business mix and volumes. This impacts the market share of the banks. The SBI group has been accounting for nearly half the PSU pie. The new Private Banks have been, over the last two decades, steadily increasing their share. At one point of time the new private sector banks had nearly 25% market share. Post crisis, particularly in the last two years the new private sector banks (Chart-3) have witnessed a fall in the market share. At the same time it is observed that nationalized banks and SBI group have gained certain market share. Possibly the gain could be on account of a poorer performance by private and foreign banks than any concerted efforts by the nationalized banks to capture more market.

Chart-3 : Share in the Business of various bank groups.

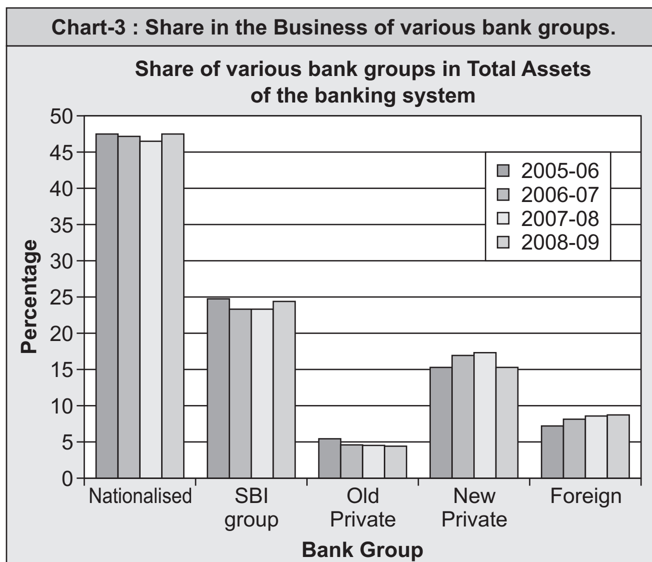
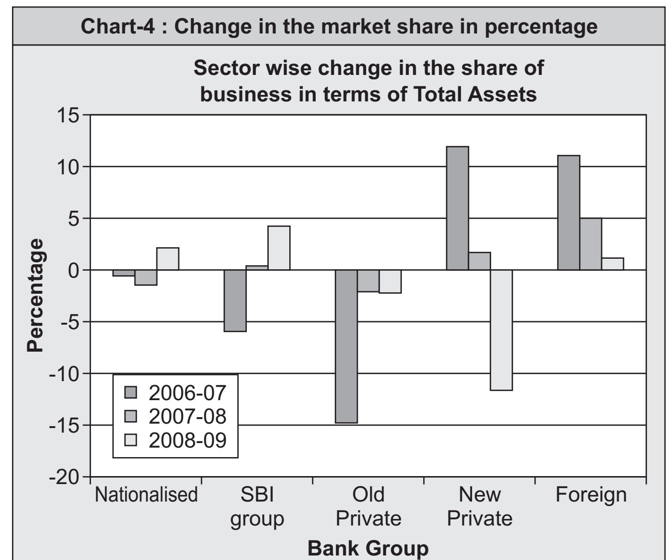


Chart-4 which captures the change in market share of each sector over the previous year. It is seen that the fall in the market share of new private sector banks, during 2008-09 has been significant and similarly the gain by SBI group is noticeable. In the latter's case the increase in market share is also attributable to the massive Parivartan efforts in the bank. There is a perceptible dip in the amount of deposits with the private banks and foreign banks in the year 2008-09.

It is learnt that some of the rivate banks[5] have, in the recent past, possibly gone out of the retail segment on account of the increased NPAs. ARCs have reported larger securitization of assets in the year 2008-09. This could also account for the steep fall in the growth rate of new private sector banks.

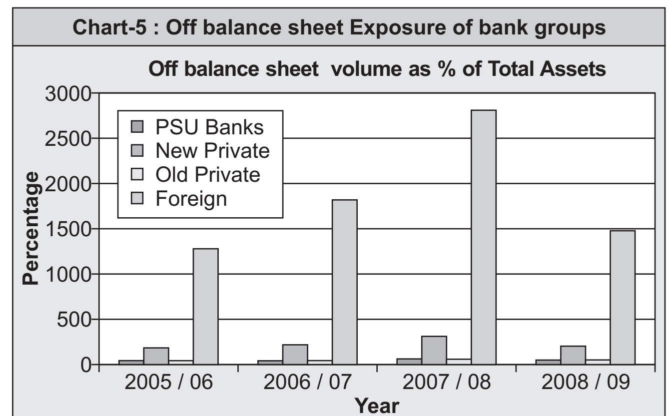
Chart-4 : Change in the market share in percentage



Off Balance Sheet Exposures :

The change in the balance sheet of the new private sector banks and foreign banks within the balance sheet, on account of crisis is less dramatic than the reduction in the off balance sheet exposure as could be seen from Chart-5.

Chart-5 : Off balance sheet Exposure of bank groups

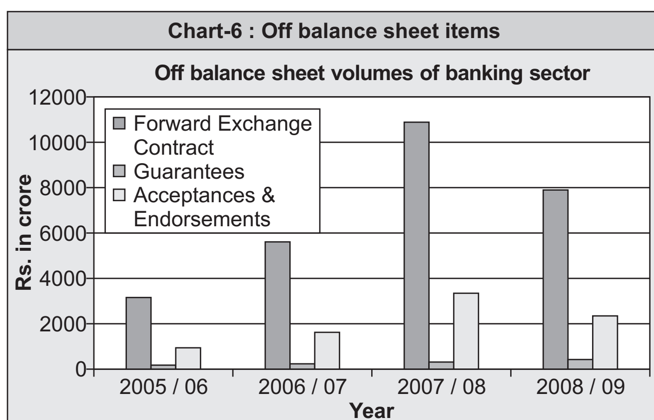


5. Live mint.com Mumbai : Tue, December 1, 2009 "Asset Reconstruction Co. (India) Ltd, Arcil, has shifted its focus to the retail sector by building a home loan portfolio of Rs.2,000 crore in the past year through Arms, its distressed consumer loans division, "said a top executive at the firm. "Even the NHB (National Housing Bank) has sold its portfolio but a large (portion) of it is coming from ICICI Bank" he said.

At the height of the crisis (Chart-5) the foreign banks' exposure to off balance sheet items in terms of size of the balance sheet was very high (nearly 3000% of the balance sheet size) and it has come down to about 1500% as of 31st March 2009. Similarly the new private sector banks have also reduced the off balance sheet exposure substantially. It is however noteworthy that the PSU banks which contribute nearly 75% of banking business in India have negligible exposure to off balance sheet items. Given that risk regulation is common for all the banks, the fact that the PSU banks had very little exposure to off balance sheet items is definitely a reason why they were not adversely affected by the crisis.

What are the off balance sheet items?

Chart-6 : Off balance sheet items



Off balance sheet items are broadly classified into Forward Contracts (foreign exchange related), Guarantees and Acceptances and Endorsements. These are considered off balance sheet because at the time of drawing the balance sheet the liability on account of these has not been firmed up or fructified. In normal times these contracts are settled for the difference in price and the banks earn a fee and commission. In the event of a default or bad delivery banks have to provide for the delivery.

The drying of liquidity in the interbank market, particularly in Europe and consequent pressure on some currencies impacted the off balance sheet exposures and market. Thus, the crisis did impact the 'off balance' sheet volumes more particularly the forwards and futures in financial market. Off balance sheet is a convenient method of seeking risk as an opportunity or fee income to improve the profitability ratios. The off balance sheet concept encourages risk taking. Currently there are proposals to stipulate capital charge for the off balance sheet items as also to regulate innovative financial / hedge instruments. Is there a way to bring these items on the balance sheet? Possibly the accounting profession has to work hard to arrive at the standards for doing this. If this is accomplished the balance sheets will become more transparent and the financial statement risk can be avoided.

The single largest item in the off balance sheet exposure (Chart-6) is the forward exchange contracts. It is noteworthy that in the year 2008-09 both forward contracts and acceptances and guarantees have shown a considerable decline (Chart-7). The decline in business (26% as reported by RBI in the Trend & Progress) is more pronounced in these two items than guarantees, which are less speculative in nature. Despite reduction in the volume of off balance sheet items the relative share of various items of exposure has not changed in the last four years (Chart-8).

Chart-7 : Changes in Off balance sheet items

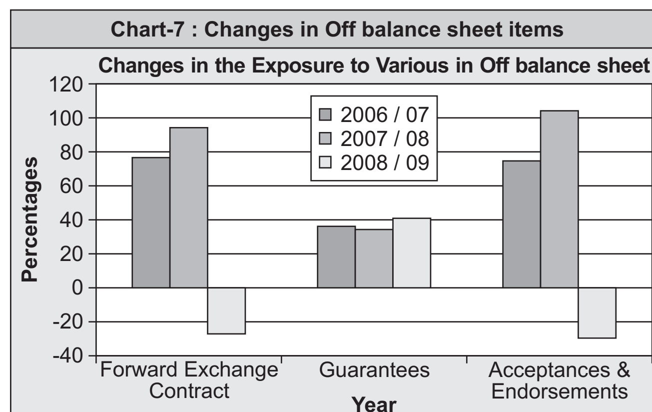
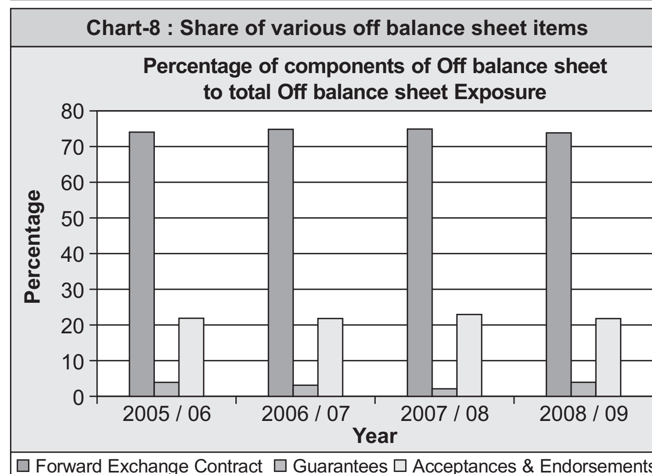


Chart-8 : Share of various off balance sheet items



Exposure to sensitive sector :

The off balance sheet exposure is an indicator of the risk appetite of a bank. Another indicator of the risk appetite is the banks' exposure to sensitive sectors. Exposure in the form of loans and advances or investments to capital market, real estate other than home loans, commodity market, etc., is considered as exposure to sensitive sector. Variations in the business cycle and international trade impact the prices of this sector. Often these markets are volatile and impact the credit quality of bank assets. RBI monitors the exposure of the banks to the sensitive sector very closely. Given that the financial crisis impacted the real estate market and commodity prices its impact on the credit performance is noticeable. It is seen (Chart-9 and 10) that the new private sector banks and foreign banks have, generally a higher percentage of their business exposed to sensitive sector than the PSU Banks. Over all, in the recent years, it is seen that banks have been reducing their exposure to the sensitive sector.

Chart-9 : Exposure to Sensitive Sector

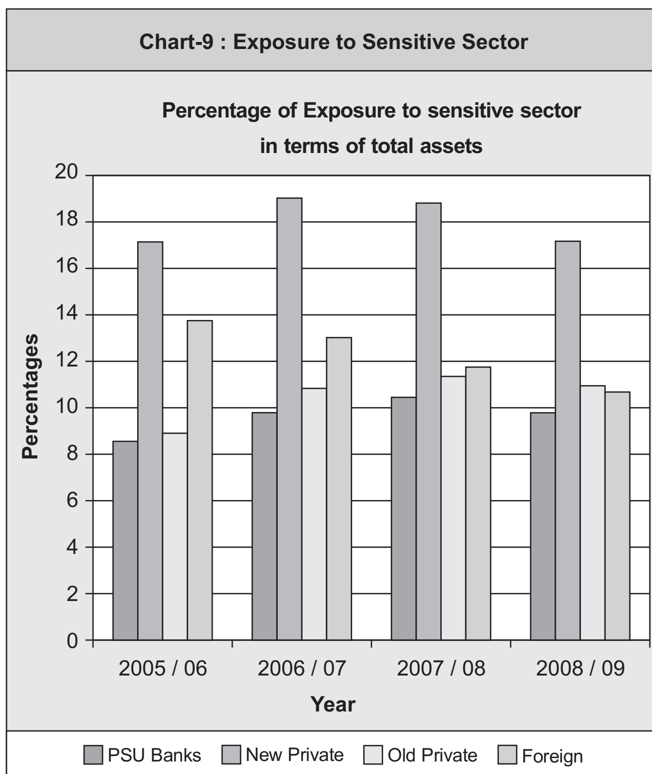
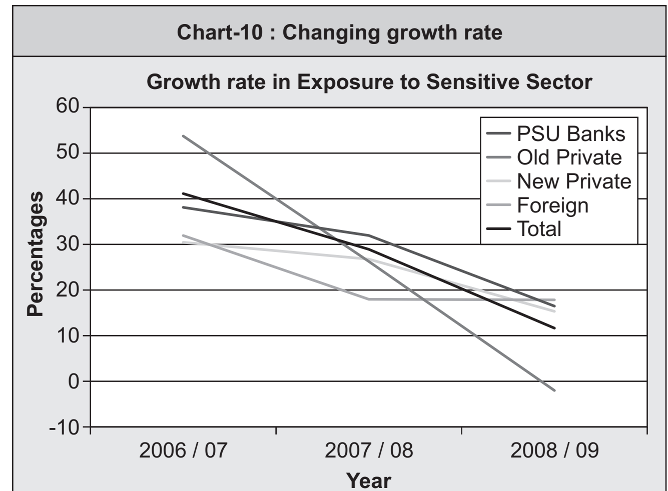


Chart-10 : Changing growth rate



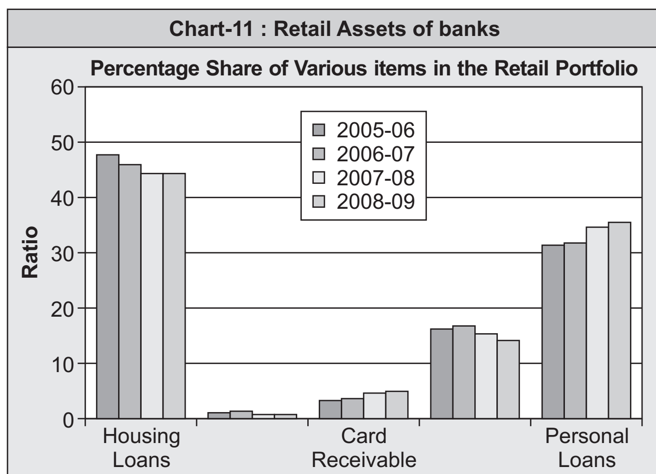
Almost all bank groups have reduced their exposure to the sensitive sector in the year 2008-09. However the decline in the overall exposure of New Private sector banks to these sectors, between the years 2006-09 is significant. Foreign banks, it appears have been reducing the exposure to sensitive sector since 2005-06. In the year 2008-09 however the reduction rate in their case has somewhat slowed down. The reduction in the banks' exposure to sensitive sectors has impacted the growth and prices in the real estate sector and commodity markets in the year 2009.

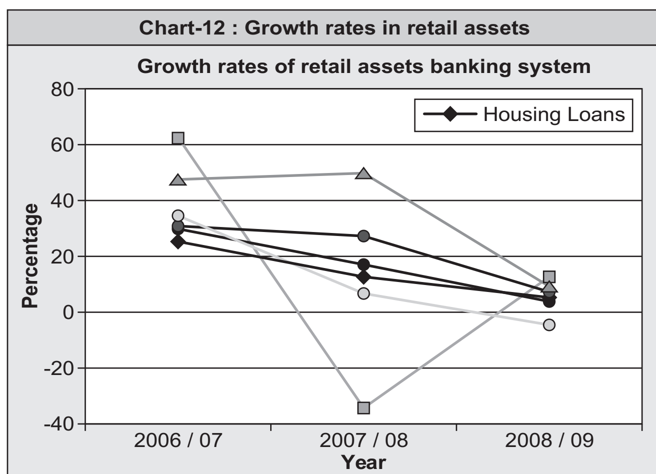
Retail Assets

Retail banking includes deposits and advances. However, the term retail banking has been more closely associated with retail assets than deposits[6]. Retail assets, which include loans made to individuals for home loans, purchase of vehicles, consumer articles etc., can be marketed through a variety of delivery channels while deposits are accepted only at the branches. Historically it is seen that banks have often resorted to aggressive retail lending as a strategy for growth or capturing new market. Retail loans are marketed to the salaried sector and urban markets because it is said that the defaults are less in these two segments. Facility of salary based recovery of EMI and scope for securitization also drives retail business. No wonder that banks have been, in the last few years, vying with each other to make available retail loans to one and all. Marketed through agents, the growth rate of retail

6. One of the reasons for this is that the major source of funds for the banks is deposit (nearly 76% of the total assets) and most of it is retail.

loans, at one point of time had reached dizzy heights. Possibly apprehending a bubble, RBI had, even prior to the onset of current crisis increased the risk weight for home loans / retail assets. Though Indian retail assets, more particularly home loans are **not in the nature of sub-prime**[7], the crisis seems to have impacted the sector as evidenced by higher defaults in the retail portfolio. Banks had slowed down their aggressive marketing efforts and possibly sold their assets to Asset Recovery Companies. As a result the retail story is stagnant and growth rates are declining. Volumes in home loans, auto loans and consumer durables financing have declined. Card business has also slowed down. Though the trend is common for the banking sector the decline in growth rate of exposure has been steeper in the case of new private sector banks and foreign banks.

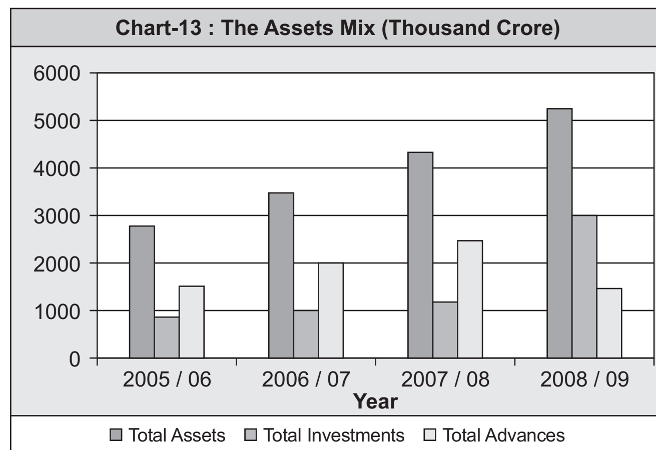




Post crisis, particularly in 2008-09, it is seen that the housing sector and auto loans have seen a lower growth rate over the previous years. The increase in personal loans in the year 2008-09 points out to the possibility that some of the credit card receivables, off balance sheet exposures and retail loans have been possibly converted into personal loans. In the recent months the banking and finance sector has shown a renewed interest in the retail segments. The nudge, it appears is coming from the Government which is worried about the slackening of home loan portfolio. PSU banks have announced attractive interest rates (aka teaser rates) for the first two years of loan and offering inducements to make retail happen yet again.

Investment and Loan mix

The immediate impact of melt down was a slowdown in the loans and advances. Though RBI had allowed banks to roll over some of the credits the fall in the commodity prices seem to have impacted the credit off take by corporates. As a result, despite a fall in the rate of interest, share of investments in the total assets of the banks has gone up.



We have seen that during the crisis period there have been substantial changes in the asset profile of the banks and slackening of growth. The period 2007-09 also witnessed substantial reduction in the rates of interest on deposits and advances. The NPAs and provisions have been increasing in the last three years. Banks have also maintained more than 12% CRAR. The fall in business

7. *Home loans in U.S. are not backed by individual liability. Thus if a home loan is foreclosed or if a house is forsaken the bank can recover the dues, only from sale of house. If the sale proceeds are not adequate to cover the dues the bank cannot proceed against the borrower for the balance. As against this in India the borrower continues to be liable for the balance of the dues. Indian banks also take insurance and surety to safeguard their interest.*

coupled with increase in the provisioning and capital cost must have impacted the profitability.

How has all this impacted the profitability?

Chart-14 : Costs and Yields to total assets

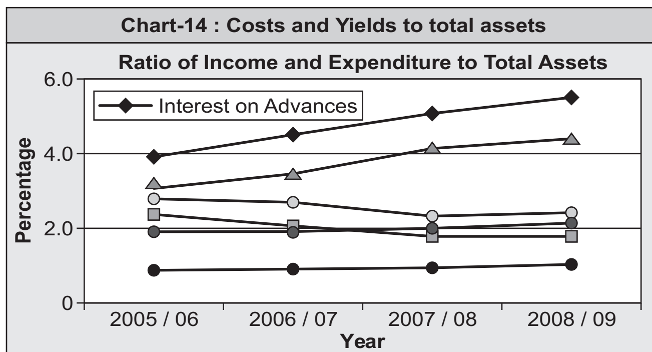
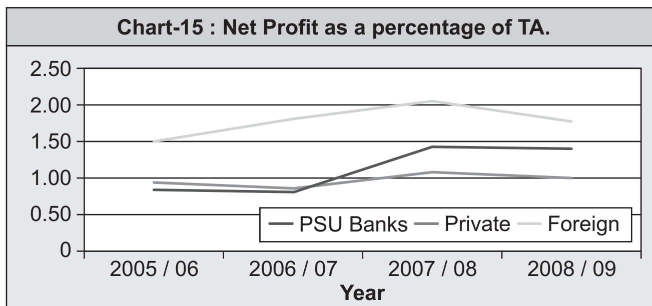


Chart-15 : Net Profit as a percentage of TA.



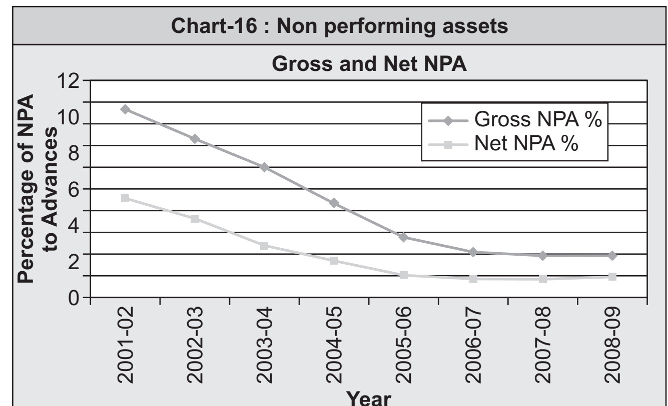
It is seen that the overall profitability of the banking sector, NIM and Net profit margins are favorable (Chart-13 & 14). This could be because the PSU banks have been growing steadily. They have accessed the deposits at competitive rates. The net profit is also a forward sloping curve. It is however important to note that the NIM is declining in the last two years. As regards various banking groups it is clear that private sector banks and foreign banks have witnessed a declining profitability in the last two years possibly on account of their higher exposure to retail assets and off balance sheet exposures.

Non Performing Assets

Another indicator of the impact of crisis is the net NPA levels.

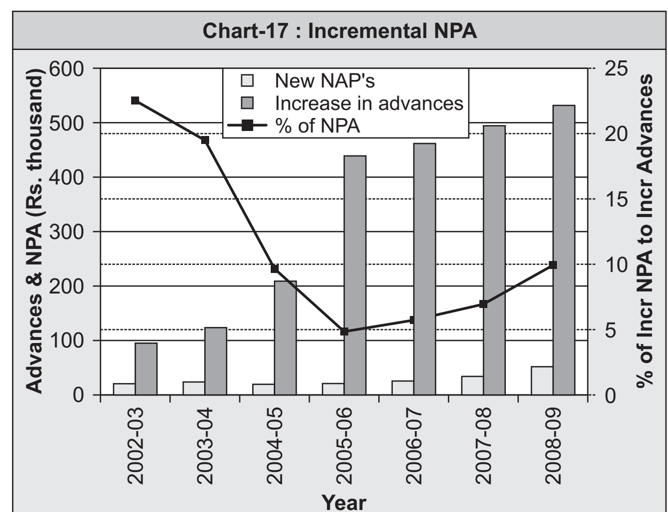
As of March 2009 the gross NPA was in excess of Rs.55000 Crore and provisioning was nearly 55% of the NPA. The net NPA for the sector as a whole was about 1%. Infact all the bank groups had maintained net NPA at about 1% of net advances. Provisioning coupled with increase in the advances helped maintain the ratio. If one were to remove the provisioning effect on the NPA , the position may not be comfortable.

Chart-16 : Non performing assets



Further it is seen that in the recent years new NPA as a percentage of incremental advances is on the rise[8]. This trend (Chart-17) has started in the year 2005-06 coinciding with the beginning of the retail asset exposition. It is thus evident that it is only the extent of provisioning that is containing the NPA ratio. It is a matter of conjecture that, possibly but for the concessions offered under the CDRs, sale of assets to ARC and the impact of Agriculture Debt Waiver the NPA would have been higher. Recently RBI has asked the banks to provide as much as 70% of NPA as provisions. This will help in maintaining a low net NPA ratio. Thus, on account of regulation the situation will continue to be under control. Provisioning has a cost in terms of reduced profit. Banks must delve on strategies other than write off and compromise. NPA is thus an area of concern for the banks.

Chart-17 : Incremental NPA



8. ***Experts have been talking about a 'v' for recovery. The incremental NPA is also 'v' shaped!***

Overall View

In the above pages an attempt has been made to compare the bank groups performance and strategy, in the last four years managing the financial crisis. The following points emerge :

- The Regulator has played an important role in containing the impact of the crisis in the Indian banking system. The higher provisioning norms for NPAs and increased risk weights on retail assets have ensured stability of banks.
- It should be added that the Indian banking system did not have access to exotic risk management / taking products as they have not been cleared by the regulator.
- The business of the PSU banks has been affected but not as much as their counterparts in the New Private and Foreign banks. Their retail loans have been impacted and banks have faced slowdown in the off take of loans. The retail and corporate assets of the PSU banks have been impacted. Yet overall they have passed through the crisis without much blemish. The following factors might have played a role in this :
  - They did not partake in 'risk for profit' products.
  - They complied with the guidelines more scrupulously.
  - They enjoy a much higher public confidence.
  - The stimulus package, roll over of dues, CDR, Waiver etc., have helped them.
- The Private sector banks have been impacted by the crisis. In their case, it seems the impairment in retail assets, off balance sheet items have been some what significant.
- NPAs have increased in all the bank goups[9]. The spurt in the new NPAs is a matter of concern. The increase in NPA has preceded the crisis and coincided with the retail boom. The retail assets are marketed more aggressively than the traditional loans. Given that the retail assets are not income generating assets and sensitive to business cycles, pursuit of a larger share of this market will make the balance sheet volumes and profits more volatile. The securitisation to ARC may be useful in reducing the NPA but is not as good as recovery.
- The NPA management of the banks needs to be studied afresh. If not for the provisioning and concessions under CDR or debt waiver it appears that NPA position would be grave. The write offs and waivers however professionally managed and structured will eventually create a mind set of expectations among the borrowers. Instead the sector should strive to have more appropriate price risk insurances.

About a decade back when the new private sector banks and foreign banks were the flavour of the day the longevity of PSU banks were seriously questioned. The PSU banks have since then adopted the latest information technology and are now on par with private sector banks in the case of products and delivery processes. Today the flavour is PSU banks. But one wonders if the flavour is not due to regulation, government ownership and public confidence which is also a function of government ownership? That, as a block, PSU banks seem to be following identical strategies and seems not impacted by market points out to a sense of 'safe banking'. Regulation seem to be more effective in their case than the other bank groups. A higher dependence of deposits, inability to increase the capital to total asset ratio which constrains the size and a very low level of leverage point out to the fact that the PSU banks cannot grow at a faster rate to meet the growing needs of the economy which is poised to be a world leader. In essence, the crisis, by not impacting the PSU banks has shown how risk averse they are and how much far removed our banking system is from the modern world of banking and finance. Looked at another way the current crisis has shown the possible way forward now that some of the risks have been defined!

9. "It is not unusual to expect NPAs to increase in a downturn. Banks are well capitalized to cushion the impact of higher NPAs" RBI

BOOK REVIEW

Name of Book : Banking Risks - Management and Audit

Author : S. N. Bidani

Publisher : Vision Books Pvt. Ltd., 24 Feroze Gandhi Road, Lajpat Nagar 3, New Delhi - 110 024

No. of pages : 232

Price : Rs. 495/-

Reviewed by : Dr. A. C. Chug

Risk management is a discipline at the core of every financial institution and encompasses all the activities that affect its risk profile. Risk management as commonly perceived does not mean minimizing risk; rather the goal of risk management is to optimize risk-reward trade-off. The author of this book has made his best efforts for disseminating the information on banking risks in detail so that a banker can understand the various aspects of risks easily. The book contains 14 chapters which covers whole gamut of risks in banking industry. Primarily, introducing various types of banking risks in the first chapter, credit risks have been dealt with vividly in the second chapter. This chapter mainly contains the risk management of business and industrial advances. The illustrative model of credit risk scoring / rating system is exhaustive and useful. This can be used for designing such scoring models for other types of advances also. The third chapter deals with market risks. Foreign exchange and country risks have been mentioned in the next chapter in a very understanding manner. Different ways in which liquidity risk can be managed finds place with illustrations in the fifth chapter. Management and Audit of operational risks and risks related to control functions have been covered to a limited extent in sixth and seventh chapter. More details is required in regard to Information and System Audit. The other chapters cover Group Risk, Equity and Commodity Price Risks, Environment Risk. Internal Risk-based Audit and its scoring system have been mentioned in details and can be followed by those banks which have yet to adopt this system. At the end, practical suggestions have been given for effective management of banking risks with emphasis on HRD issues. At a time when Indian banks are fully geared up for switching to BASEL-II, the book may be helpful to them in understanding the theme. RBI guidelines and various proforma of reporting system, wherever required, have been incorporated in few chapters.

The book contains useful material for the corporate centre of a bank. Its utility would have been manifold if activity / sector specific risks are covered. Now-a-days, banks are exploring rural markets which have a great potential for business growth. Advances to agriculture sector and home loans are around one third of the total advances of banks. These sectors expose greater risks as compared to big advances. Therefore, every bank is very conscious in minimising risks in micro and small sector advances. These aspects are missing in this book. Further, banks are outsourcing their back office operations to a great extent and also engaging business facilitators and business correspondents for delivering of services at the remote centres. This requires great precaution. RBI has issued detailed guidelines on these matter; and the same could have been covered to enlarge the utility of this book. Use of mobile phones for limited banking services has been envisaged a big tool for financial inclusion, therefore, the technology risks require a separate chapter to cover detailed guidelines in this regard. The book is useful for understanding the inherent risks of large advances. Staff Colleges and Training Centres of banks can make best use of the material of this book for teaching the concept of banking risks. Over-all, this is a comprehensive and practical book on the management and audit of risks in banking.

Name of Book : The Drucker Difference : What the World's Greatest Management Thinker Means to Today's Business Leaders

Author : Craig L. Pearce, Joseph A. Maciariello and Hideki Yamawaki

Publisher : Tata McGraw Hill Education (P) Ltd., 7, West Patel Nagar, New Delhi-110008.

No. of Pages : 336

Price : Rs.595/-

Reviewed by : V. Raghuraman

One thing is for certain and, that is, Peter Drucker, the world's greatest management thinker / guru, will be remembered for his contributions to management thought for a very, very long time to come. For, as the book under review reveals, 18 professors of the Drucker School of Management have put together some thought provoking essays, welding their research findings on his works. This is something quite unusual to occur for it is not easy for several scholars to work together on one subject.

The book is a collection of a few such brilliant essays brought out with a view to show how Peter Drucker and his ideas are relevant in today's business. Perhaps, trying to bring out such a volume could, indeed, be termed as a fitting tribute to him and his teachings.

Basically, the philosophy of the Drucker School, according to the authors, has got deeply rooted in the management wizard's humanistic theory of management / government. He has covered so many topics in his writings that there is a wealth of knowledge for the School's faculty to draw upon. Indeed, they have pointed out that it was Peter Drucker's understanding of art, history, sociology and all other human disciplines and not just of business that has made him so very interesting and popular to so many across the globe for so long a time.

Among the many collection of essays that have found their way to this publication, special mention may be made of the one titled, "The Twenty First Century - The Century of the Social Sector" by Sarah Smith Orr. According to her, Peter Drucker had a special fondness for the social sector as he felt that "the one thing that stood between us and social catastrophe" was the non-profit social sector. A social sector consultant, Sarah Smith Orr has pointed out that Drucker was "unwavering in his belief" as he was very clear about what the government and business sectors could do or not do to bring about a healthy civil society. While Drucker conceded that not all non-profit organizations are doing well, in the "critical areas of motivation and productivity of volunteer knowledge workers, non-profit management leaders are truly pioneers, working out policies and practices that business / government have to necessarily learn and follow tomorrow".

Social entrepreneurs, as such entrepreneurs are called, in fact, act as the "change agents for society". While a business entrepreneur might set up new industries, it is the social entrepreneurs who always come up with the real solutions to the social problems and later implement them on a large scale. Citing the case of Andrew Carnegie, a leading educationist, the author adds that the aforesaid person was a social entrepreneur in the true sense as he gifted millions of dollars to set up more than 2000 libraries across the United States. The author has felt that through this singular act, he created ample opportunities for anyone with the right

character to become successful and rich. It is such non-traditional entrepreneurs who would flourish in this 21st century.

In an illuminating essay, Jay Prag has described Peter Drucker as the "Humanist Economist". As an eminent economist and writer who has had the opportunity of being closely associated with the learned management guru, he has pointed out that on one occasion Drucker had commented that "while Keynes was interested in the behaviour of commodities, he was interested in the behaviour of people". This summed up his view of economists as a whole. According to Jay Prag, the management wizard felt that economists in general thought more as scientists and not enough as sociologists, which ought to be the case, as the subject is essentially "social in character".

In an earlier book, "The New Realities", Peter Drucker has propounded the view that counter-cyclical macro economic policy could be bad and likened it to a drug. Even though the effectiveness of this is limited, people expect the government to do something drastic when the economy slows down. On other occasions, they want government participation to the barest minimum. The author has opined that the recent depression in the United States and other countries would have forced Drucker to comment against government's bail out decisions. This is because they usually bail out only banks or firms that have collapsed owing to bad investment decisions and such a policy would only lead to more bad decisions on expectations of further bail outs.

Though not an economist himself, Peter Drucker, as a social scientist, often found his intuition turning out to be right on many occasions. It is pointed out that as far back as 1946 Drucker had advised General Motors (GM), the auto major in the U.S., to adopt a long-term success strategy to come out in a healthy shape when intense competition heated up the automobile market. Needless to say, the company ignored his well-meaning advice. Perhaps, the biggest irony in the current crisis, which has come after his death in 2005, is the "near death" of the auto major, leading to its virtual takeover by the U.S. government. The authors' further feel that had GM heeded Drucker's suggestions, the company would not have been in such a sorry state of affairs.

In short, the publication is aimed to help understand all the principles and teachings of Drucker in a better manner. The book is expected to serve as a great boon for all management lovers, apart from being a must read for all management students, teachers, researchers and scholars. It should definitely find a place in the shelves of all thinkers as well.

Books Added to the IIBF Corporate Library

No.	Title	Author	Publisher & Year of Publication
1.	Agricultural Development Policy : Concepts and Experiences	Roger D. Norton	Rawat Publications, 2006
2.	Ascent of Money : A Financial History of the World	Niall Ferguson	Penguin Books, 2009
3.	Business Communication	Harvard Business Essentials	Harvard Business Review, 2003
4.	Business Ethics : Facing up to the Issues	Chris Moon	Profile Books, 2002
5.	Competitive Advantage : Creating and Sustaining Superior Performance	Michael E. Porter	The Free Press, 1998
6.	Competitive Strategy : Techniques for Analyzing Industries and Competitors	Michael E. Porter	The Free Press, 2004
7.	Complete Guide to International Financial Reporting Standards : Including IAS and Interpretation, 2nd Edn.	Ralph Tiffin	Viva Books, 2007
8.	Crafting and Executive Strategy : the Quest for Competitive Advantage - Concepts and Cases, 14th Edn.	Arthur A. Thompson	Tata McGraw Hill, 2009
9.	Discover Your Destiny : the 7 Stages of Self-Awakening	Robin Sharma	Jaico, 2008
10.	Economic Survey 2008-09	Govt. of India / Ministry of Finance	Govt. of India / Ministry of Finance
11.	Essentials of Business Economics	D. N. Dwivedi	Vikas, 2009
12.	Greatness Guide with CD	Robin Sharma	Jaico, 2008
13.	Guide to Management Ideas and Gurus	Tim Hindle	Profile Books, 2009
14.	Happiness : Gain and Retain	Just Win Singh	Viva Books, 2009
15.	HR Transformation : Building Human Resources from the Outside In	Dave Ulrich & Others	Tata McGraw Hill, 2009
16.	India and Global Crisis	Shankar Acharya	Academic Foundation, 2009
17.	Living the 7 Habits : the Coverage to Change	Stephen R. Covey	Simon & Schuster, 1999
18.	Managing Across Cultures : the Seven Keys to doing Business with a Global Mindset	Charles M. Solomon & Michael S. Schell	Tata McGraw Hill, 2009
19.	McKinsey Engagement : a Powerful Toolkit for more Efficient and Effective Team Problem Solving	Paul N. Friga	Tata McGraw Hill, 2009
20.	Organizational Champion : How to Develop Passionate Change Agents at Every Level	Mike Thompson	Tata McGraw Hill, 2009
21.	Owning Up : the 14 Questions every Board Member Needs to Ask	Ram Charan	John Wiley & Sons, 2009
22.	Penguin CNBC-TV 18 Business Yearbook 2009	Derek O'Brien	Penguin Books (India), 2009
23.	Strategy Maps: Converting Intangible Assets into Tangible Outcomes	Robert S. Kaplan & David P. Norton	Harvard Business School, 2004
24.	World Development Report 2010 : Development and Climate Change	IBRD / The World Bank	The World Bank, 2010
25.	You Can Win : a Step by Step Tool for Top Achievers	Shiv Khera	Macmillan India, 2002

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