

Innovative Financial Issues for MSMEs

Dr.Shailaja.S.M., M.Com.,M.Phil.,Ph.D

Associate Professor, Dept.of Commerce and Management,

SSA Govt. First Grade College, Ballari, Karnataka India

Abstract: - Whether in organized or unorganized sector, one of the problems faced by the MSMEs is getting finance for their various activities. This is a handicap when it comes to achieving competitiveness in the national or international markets. The problem of credit rationing for SME can be overcome with the help of a Credit Guarantee, which is a financial product that an entrepreneur can buy as a partial substitute for collateral. It is a promise by guarantor to pay all or part of the loan if the borrower defaults and it motivate banks to lend to group that cannot access credit under normal circumstances. Mutual Credit Guarantor (MCR) provide a means to help entrepreneurs who have sound business ideas but have difficulty in finding finance. An attempt has been made in this paper to discuss the various issues related to Mutual Credit Guarantee Schemes (MCGS) for MSMEs.

Keywords: *Micro, Small and Medium Enterprises, Mutual Credit Guarantee, UNIDO.*

I. INTRODUCTION

Micro, Small and Medium Enterprises (MSMEs) is the second larger employer after agriculture. MSMEs with 26th million units provide jobs to 60 million people and contribute 40% to the country's manufacturing sector. They also accounted for 45% of India's total export of 246 million in the fiscal 2010 and 2012. In the world wide MSMEs have been recognized as engine of economic growth. They manufacture over 6000 products ranging from handloom saris and carpets and soaps to pickles, papads and machine parts for large industries over the years, MSMEs have been characterized by their traditional strengths of the relatively low investment requirements, effective resource utilization, greater operational flexibility, mobility and higher innovativeness. They are present as a part of the value chain in almost all distinguished industry sectors like automotive, gems and jewellery, IT garments and textiles, leather, drugs and pharmaceutical industry, etc. However according to SME Chamber of India absence of adequate and timely bank finance limited capital and knowledge non-availability of suitable technology, low production capacity ineffective marketing strategy, identification of new markets, constraints on modernization and expansions, non-availability of highly skilled labor at affordable cost follow-up with various government agencies to resolve problems are some of the stumbling blocks in their path.

There is no globally accepted definition of MSMEs, Different countries use different criterion; most of the definitions are based on investment ceiling and number of people employed. According to a World Bank Research

Paper 54 countries define SMEs as enterprises employing not more than 200-300 people. These include 13 low-income, 24 middle-income and 17 high-income countries. Most African countries use a cut off of 200 employees. Japan use 300 employees. In India, Micro, Small and Medium Enterprises Development (MSMED) Act 2006 defines MSMEs. It introduces the concept of 'enterprise' as opposed to the earlier concept of industry. According to the Act, MSMEs are classified into the following:

- i. Enterprises engaged in the manufacture or production of goods pertaining to any industry specified in the first schedule to the Industries (Development and Regulation Act-1951).
- ii. Enterprises engaged in providing or rendering services.

The following table defines the MSMEs in both these sectors

Manufacturing Sector

Enterprise :	Investment in plant and machinery
Micro enterprises:	Does not exceed Rs 25 lakh
Small enterprises:	More than Rs 25 lakh and upto Rs five crore;
Medium enterprises :	More than Rs five crore and less than Rs. 10 crore.

Service sector

Enterprises:	Investment in equipment
Micro enterprises :	Does not exceed Rs.10 lakh
Small enterprises:	More than Rs. 10 lakh and does not exceed Rs.two crore
Medium enterprises:	More than Rs. Two crore and less than Rs.five crore.

Source: Micro, Small and Medium Enterprises, Development Act 2006

II. OBJECTIVES OF THE PAPER

Mutual Credit Guarantee (MCG) provides a means to help entrepreneurs who have sound business ideas but have difficulty in finding finance. An attempt has been made in this paper to discuss the various issues and related to Mutual Credit Guarantee Schemes (MCGs) for MSMEs.

III. MUTUAL CREDIT GUARANTEE SCHEME

The Mutual Credit Guarantee Scheme component of the United Nations Industrial Development Organization (UNIDO) project aims to address the issue of lack of credit to SMEs in India through the innovative tool of mutual Credit Guarantee on the lines of established best practices of the Indian experience with Mutual Guarantee Associations (MGAs) called CONFIDI. Mutual Guarantee Associations have been a great success in Italy. They are formed as solidarity groups, in the form of consortia or co-operatives by micro-small firms with limited no access to credit. Members contribute to the corpus/capital of MGAs and return get credit guarantee and other services such as consultancy, training and hand-holding. The corpus gives significant leverage effects as default levels are kept low. The decisive characteristics of MGAs have been strong local ties and support from regional business associations-creating social capital in addition to financial capital. These MGAs help in establishing a financial mechanism, which would facilitate better access to finances for MSME projects with an ultimate objective of facilitating growth of MSMEs. They are designed as parallel complimentary financial and technical service delivery channels for MSMEs and work primarily as interface between the entrepreneurs and the lending organizations. They are structured to offer both guarantee and non-guarantee products and services. Their inherent design allows them to function as a credit guarantee provider; a rating agency; a potential regional credit bureau; a credit appraisal and screening agency; recovery facilitator and above all a potential business provider all roles into one. Today, there are more than 1000 MCGAs of various sizes (average size of 2,100 members minimum of 634 members and maximum of 11000) operating in Italy, in a variety of sectors, largely successful due to the direct involvement of the local industry association of commerce about 60 per cent of the Italian banking industry channelizes its MSME loans through the CONFIDIs.

One of the most impressive achievements of the MCGs in Italy is keeping the average default of the guaranteed loans for lower than the average of the banking system. Insolvency in CONFIDI-guaranteed loans is reportedly lower by 1.5 per cent to two per cent of the national insolvency rate.

Through MCGs the lenders benefit through quality portfolio i.e. new risk mitigation tool and lower defaults; new business opportunities (specific structured products designed for local needs of the industry); and reduced transaction costs (innovative outsourcing entity reducing duplication of work related to credit screening, appraisal, follow-up and recovery).

Most SME specialists agree that the high administrative costs in relation to loan size which results in low profitability in SME lending is the most serious disincentive to commercial banks lending to these enterprises. Commercial banks also regard lending to SME as a high risk however, and the inability of such borrowers to offer adequate collateral is also a major deterrent.

The member units/borrowers in turn benefit from better credit access and growth opportunities in terms of reduced interest rates, lower collateral requirement and improved leverage on their equity, improved knowledge through advisory services and consultancy inputs, reduced operational costs through access to group insurance products, group machine and equipment purchase and access to finances for intangible assets like IT investment research, and development, training etc. The most serious argument against Credit Guarantee Schemes, which cannot be totally refused, is the 'moral hazard' issues. Namely those schemes weaken the will and commitment of the borrowers to repay the loan when they know that a guarantee fund will reimburse the lending institution. There is also a danger of moral hazard on the part of the lending bank which it is feared has less incentive to supervise the loan properly or to pursue vigorously the collection of repayments. However, moral hazards may be less of a real danger since competent lending banks are zealous of their reputation for high loan-portfolio performance and will make strenuous efforts to avoid loan defaults. Also, SME borrowers will fear being denied further loans. If they fail to repay even if the loan is covered by a guarantee. One important objective of a credit guarantee scheme is to provide (Under conditions of reduced risk) as opportunity for banks to learn more about SMEs their problems and their operations, to help improve their handling of SME loan portfolios. The lenders will gradually learn how to lend profitability to SMEs without guarantees. Guarantees may help lenders realize that the perceived higher risk of lending to SMEs may not be so real. MCGOs are also supported by counter-guarantee structure which help them to further share their risks and also leverage the corpus many times over. MCGOs in Italy come under the control of Central Bank of Italy. Its operating logic relies on mutual responsibility decision making by peers and risk sharing. The key principle is that credit risk, if mutually shared brings advantage to both banks and SMEs, filling the gap or at least, mitigating the effects of information asymmetries.

Indian Scenario

The Prime Minister's Task Force in MSME had made 85 recommendations. Of these, action has been completed in respect of majority of the recommendations. Margin money subsidy of Rs 903 crore was disbursed by banks in 2010-11 under the Prime Minister's Employment Generation Program (PMEGP). This will facilitate setting up of 48,000 micro enterprises and generating additional employment opportunities for more than four lakh people. A major reform in the khadi sector viz Market Development Assistance (MDA) has been launched from April 2010, to replace the earlier rebate on the sale of Khadi. This is the first time that a 25 per cent share of assistance is being provided directly to spinners and weavers. The MSME Development Organization has a network of more than 3000 technically qualified personnel working through its Small Industries Service Institutes testing centers, and autonomous organizations such as Tool Room product and process Development Centers etc. In the Eleventh Plan, the Ministry of MSME will establish a Technology Mission to

promote new and emerging technological access prevent level of technology and their up gradation. Set up technology information centers/data banks and an IT portal for information dissemination to carry out detailed technology audits

UNIDO Efforts

As part of its 'consolidated project for SME Development in India: UNIDO is trying to implement MCGS in India based on the best practices of the Italian experience of Mutual Guarantee Associations. UNIDO believes wider implementation of MCGS in India would lead to additional credit to SMEs on better terms graduation of SMEs towards bankable companies development of greater sensitivity of banks towards the SMEs and progressive shifting of loan appraisal criterion from collaterals to project potentials. The concept of MCG has been disseminated across Industry Associations/Chamber of Commerce, SMEs Banks and various other stakeholders through seminars workshops, one-to-one meetings, etc at several places in Maharashtra, Karnataka Tamil Nadu, Uttar Pradesh Punjab and Andhra Pradesh. The stakeholders have started believing in the concept of MCG and appreciating its value propositions.

Advisory Committee for MCGS.

To facilitate the setting up Mutual Credit Guarantee Scheme in India, an Advisory Committee was set up with the support of the Ministry of MSME, Government of India comprising domain experts from State Bank of India, Punjab National Bank, Axis Bank, International Finance Corporation and Small Industry Development Bank of India. Indian Banking Association and UNIDO. The committee is to look into the different structures and guarantee options available globally and suggest schematic modalities of creating proposed MCG mechanism in India through possible funding options for building the guarantee corpus fund. Till date the advisory committee has had two meeting in 2009 and 2010. The committee is working on a draft national scheme for implementing MCGS in India.

Pre-feasibility Studies for MCGS

UNIDO has carried out pre-Feasibility Studies (PFS) for implementation of MCGS, with five Industry Associations/ Chamber of Commerce, viz (a) Maharatte Chamber of

Commerce Industries and Agriculture (MCCIA) Pune in 2008, (b) Ludhiana Hand Tool Association and Punjab Forging Industries Association Ludhiana in 2010, (c) Coimbatore District Small Industries Association (CODISSIA), Coimbatore in 2010, (d) Karnataka Small Scale Industries Association (KASSIA), Bangalore in 2010 and (e) Federation of Karnataka Chamber of Commerce and Industry (FKCCI), Bangalore in 2010. The studies were aimed at formalizing business plans based on which steps would be initiated for implementation of a pilot project. Association of Lady Entrepreneurs of Andhra Pradesh-ALEAP has formed the AIEAP Credit Guarantee Association to help its members to obtain collateral-free loan.

IV. CONCLUSION

SMEs' access to formal finance is difficult owing to the high administrative costs of Small Scale lending asymmetric information high risk perception and lack of collateral.

The issue of cheap adequate timely access to funds for SMEs has been debated. However a level playing field still eludes them. Funds are always hard to come by, be it for new projects, expansion and modernization, diversification, or execution of sudden orders, investment in Research and Development or marketing. Mutual Credit Guarantee Scheme operated through Mutual Credit Guarantee Organizations has proved to be an effective tool to address the financial problems faced by SMEs. MCGOs play a pivotal role in 'Win-win' business model by pulling down the credit risk for the Bank, giving SMEs the opportunity for additional loans, lowering the cost of funds for SMEs, enhancing the credit worthiness of SMEs and increasing business opportunities for Banks.

REFERENCES

- [1]. Eleventh Five Year Plan. Pp/95-206
- [2]. Government of the United Progressive Alliance-Report to the people 2010-11
- [3]. Levitsky.J., "Credit Guarantee Schemes for SMEs- An International review- Small Enterprise Development, Vol.9 No.2, June 1997, pp 4-17.
- [4]. Sinha, M., "Mutual Credit Guarantee Scheme- Opening the Fund Tap", SME world, May-July 2011..
- [5]. Survey of Indian industry-2011, The Hindu
- [6]. www.google.com
- [7]. www.unidosmeindia.org