

S S Mundra: Empowering MSMEs – issues & challenges

Inaugural address by Mr S S Mundra, Deputy Governor of the Reserve Bank of India, at the 2nd Bankers Borrowers Business Meet 2016, New Delhi, 6 April 2016.

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1. Shri Rajkumar Dhoot, Member of Parliament; Shri K.K. Jalan, Secretary, Ministry of MSME, Govt. of India; Shri Ashwani Kumar Chairman, Indian Banks' Association & CMD, Dena Bank; Dr. Kshatrapati Shivaji, Chairman & Managing Director, SIDBI; Shri Sunil Kanoria, President, Assocham; dignitaries on the dais; distinguished colleagues from the banking fraternity; members of Assocham; representatives of the print and electronic media; ladies and gentlemen! Bringing the bankers and the borrowers together on a common platform to deliberate on issues and challenges that afflict businesses is a very novel idea and hence, I could not refuse an invite to address this gathering for the second year in a row. So, I begin by complimenting ASSOCHAM for conceptualizing this “Bankers-Borrowers-Business” meet and more so, for choosing “Empowering MSMEs” as the theme for the second edition of the Meet. The theme is extremely significant for a number of reasons: continued moderation in economic growth; rising pile of stressed assets in the corporate loan book of banks; need for employment generation; fulfilling entrepreneurial ambitions and so on.

2. I understand that three fundamental issues pertaining to the MSME sector are getting covered during the deliberations here: firstly, enabling better understanding of the sector by the banking community; secondly, ensuring timely financial support to distressed Micro and Small enterprises; thirdly empowering MSMEs, an objective that is closely linked to the first two.

3. Let me set the ball rolling by briefly speaking on each of these three issues which can then be deliberated upon in greater detail in the technical sessions that follow. To put things in context, I would like to recall that the MSME Sector has emerged as a vibrant and dynamic sector of the Indian economy, contributing 37.5 per cent of India's GDP, with its vast network of 48 million enterprises providing employment to 111.4 million persons.¹ It may not be out of place to mention here that in the face of adverse economic conditions prevalent in the country today, the MSME sector stands as a beacon of hope. Realizing the potential that the sector holds, both Government of India and Reserve Bank of India have been laying substantial emphasis on means to energize the sector. Among the GOI initiatives that have a bearing on the sector are provision for Udyog Aadhaar, Start-up India, Make in India and steps for improving “Ease of Doing Business” in the country. Likewise, Reserve Bank of India has also been very conscious of the needs of the MSMEs and has hence, initiated a plethora of steps to support them through their lifecycle. I will delve upon some of these measures in the course of my address today.

Strengthening the Banking System for lending to MSMEs

4. With a view to strengthen the reach and scope of credit delivery mechanism for small entrepreneurs and businesses, RBI has recently issued in-principle approvals for setting up of 10 Small Finance Banks (SFBs). The SFBs are mandated to extend 75 per cent of their Adjusted Net Bank Credit (ANBC) to the sectors eligible for classification as priority sector lending (PSL) by RBI. Further, these banks are also mandated to ensure that at least 50 per cent of their loan portfolio should constitute of loans and advances of up to

¹ Annual Report Ministry of Micro, Small and Medium Enterprises 2014–15.

Rs.25 lakh. This is intended to ensure that these SFBs have a diversified loan book with exposures to small entrepreneurs. We believe that together with the existing players, these banks would be able to meet the credit needs of small businesses in a holistic and timely manner, which is so central to the financing needs of the MSMEs.

5. The recent revision to the priority sector lending guidelines has also sought to facilitate flow of credit to the sector. While on the one hand, the target for banks' lending to micro enterprises has been progressively increased to 7 percent by March 2016 and 7.5 percent by March 2017, medium enterprises have been brought within the ambit of priority sector, whereby all loans to medium enterprises in the manufacturing sector and those up to Rs. 10 crore in the service sector now qualify for priority sector classification.

6. An extremely important, but relatively much less appreciated aspect of credit delivery system is the availability of trained human capital within the banks. Bankers ought to have a sound understanding of the businesses that they finance. In respect of established businesses with predictable cash flows, conducting a credit appraisal, developing a proper understanding of the business cycle and analyzing problems is a lot easier when compared to small businesses, which often do not follow a set business cycle, are too dependent on idiosyncratic events and where promoters are not in a position to bring additional equity quickly. In this decade of retirements for the PSBs, the number of trained personnel has been dwindling very fast while the relatively inexperienced bottom rung does not possess appropriate skill-sets to lend to the MSME sector, which is perceived to be risky and costlier to service.

7. To overcome this human resource deficit in the banking sector, we at the Reserve Bank of India have embarked upon a fairly ambitious national level skill building programme for the bankers titled National Mission for Capacity Building of Bankers for Financing MSME Sector (NAMCABS) in July 2015. A major facet of the NAMCABS initiative is "Training the trainer", which is intended to serve as a force- multiplier. I am happy to state that close to 1800 bankers have undergone an intensive entrepreneurial sensitivity and skill building programme in the last 8 months. I would like to re-emphasize the "Entrepreneurial sensitivity" content of the capacity building efforts, as this is the key to responding to the lifecycle needs of the small and medium enterprises.

8. Of course, the banking system needs to walk a fair bit to create an environment where an aspiring entrepreneur is more worried about embracing technology, improving productivity and efficiency at his/her unit rather than worrying about the availability, timeliness and adequacy of finance. This would require more enablers in the nature of a more robust and responsive financial infrastructure. There are several initiatives on the anvil towards this objective. Let me give a peek into some of them:

9. Timely availability of credit from the formal financial sector is a very critical issue which the small entrepreneur faces. I receive a fair bit of complaints about the cumbersome processes involved, documentation requirements and concomitant delays that are associated with getting finance from the banks. We have issued guidelines on maintaining electronic records of the loan applications from MSME borrowers and some of the banks have implemented a Credit Proposal and Tracking System. However, that has not been universally implemented. Under the circumstances, the potential borrowers continue to face uncertainty over quantum and timelines after making a loan application. To ease the process, bridge information gaps, enable monitoring of processing time and reducing transaction costs, RBI is in active discussions with GOI, IBA, SIDBI and e-governance experts to set up a universal "Udyami" Portal for access by small entrepreneur.

10. The Committee on Medium Term Path on Financial Inclusion (Chairman: Shri Deepak Mohanty) has recommended exploring a system of professional credit advisors for MSMEs, which could help bridge the information gap between bank and the borrower that is a major constraint in the flow of credit to the MSME sector today. As announced by the Governor in yesterday's Monetary Policy statement, there is a proposal to accord

accreditation to few credit counsellors who would act as facilitators for the micro and small entrepreneurs for accessing the formal financial system with greater ease and flexibility. Since MSMEs are typically enterprises with weak credit histories and inadequate expertise in preparing financial statements, credit counsellors can help bridge the information gap and thereby help banks make better credit decisions. The Reserve Bank will hold consultations with all the stakeholders and come out with guidelines for this by September 2016.

11. Another financial infrastructure, which could have a multiplier effect on lending to small businesses, is a Movable Asset Registry. Today CERSAI provides a facility for registering charge on immovable property. However, most of the small business entrepreneurs do not possess immovable property to offer as collateral and instead they own machinery, stocks, receivables or livestock, which can be leveraged to obtain finance from banking channels if a “Movable Asset” Registry is available. We are working towards this as well.

Tiding over the life cycle issues – MSME way

12. Predicting the lifecycle of MSMEs, particularly the Micro units, is a difficult proposition. The micro entrepreneurs neither have keen business acumen nor sizeable resources. As opposed to larger businesses, the inability to respond in time to the vagaries of these business cycles can often prove fatal to the Micro enterprise. With timeliness of resource support being such a critical element at different stages during the life cycle of small businesses, let me flag a few initiatives which RBI has taken to address the issue.

13. RBI has recently issued licenses to three entities for operating the Trade Receivable Discounting System (TReDS), which when operational, would address a major issue faced by the sector, i.e. timely realization of receivables. This is a path-breaking initiative with very few parallels in other countries. However, the implementation would need wholehearted support from all the major stakeholders, i.e. the large corporates, the PSUs and eventually, the Government enterprises.

14. RBI has also recently issued guidelines to streamline the credit flow to the MSME sector. The banks have been advised to review their existing lending policies to the MSE sector and fine-tune these policies by incorporating provisions for sanctioning of Standby Credit Facility in case of term loans, Additional Working Capital Limits, Mid Term Review of Regular Working Capital Limits, setting timelines for making credit decisions, etc. I take this opportunity to urge the banks to be sensitive to the requirements of the small entrepreneurs and offer a helping hand in times of crisis.

15. Thirdly, it is seen that the life cycle issues of micro entrepreneurs like weavers, artisans, etc. in far flung areas, in agglomerations and unrecognized clusters are much more acute. More often than not they are compelled to borrow towards their working capital needs from local money lenders and informal sources. RBI has carried out a dip stick survey of agglomerations/clusters recently and observed a huge scope for deepening of banking services in such areas. I urge the banks to proactively open their banking outlets in and around clusters/agglomerations as it makes prudent business sense.

Empowering the entrepreneur

16. Having delved into the supply side issues and focusing mainly on institutional infrastructure, let me now talk about the demand side of things. While it is not difficult to find people with entrepreneurial ambitions, there is a need to imbue the budding entrepreneurs with a keen business sense and awareness about the intricacies of the markets and banking, the demand-supply conundrum, understanding of technology, etc.

17. Preparing an individual for an entrepreneurial venture is as important to the resource provider as it is to the entrepreneur himself. One of the major initiatives in this direction has been the institution of Rural Self Employment Training Institutes (R-SETI) which trains the

rural youth to take up micro entrepreneurial ventures. Close to three lakh youngsters are trained through around 600 RSETIs every year. While conceptually, it is an excellent mechanism, I observe that certain infirmities have come to grip the institution of R-SETIs over time. In my opinion, such institutions require well-defined objectives, a robust process for selection of trainees, constant up-gradation of training methodologies, hand-holding, ensuring credit linkage etc. I feel that there is a need for a fundamental shift in our approach towards operations and management of R-SETIs. It may, perhaps, be ideal to pool the R-SETIs into a single National Trust with a separate Governance framework for achieving better synergy. This would ensure an arms' length distance with the banks in terms of their operations even while they continue to receive funding support from the banks. We have done some internal studies and see a clear possibility for achieving this. I would request the banks and the IBA to work together to make this institution truly meaningful.

18. The second issue that I want to highlight in this regard is the recently announced Framework for Revival and Rehabilitation of MSMEs. GOI, in consultation with RBI and other stakeholders, has provided an institutionalized framework for rehabilitation of enterprises which are potentially viable, but under temporary duress. From a bank's perspective, the most critical period in the lifecycle of small enterprises is the little time window between the unit operating smoothly and turning sick. The Framework provides for a structured mechanism, which could be triggered either by the banker or by the entrepreneur when first signs of stress appear. The problem resolution is scaled up to a committee with a time bound schedule. I am sure, if implemented effectively, it would greatly help in saving productive enterprises rather than letting them slip into morass. I trust, the entrepreneurs would find this mechanism truly empowering.

19. Thirdly, it is time we took a relook at whether we need to change our approach towards the sector from a "one size fits all" approach to a more differentiated approach towards the Micro sector. The Micro sector itself consists of a diverse set of enterprises. The banking fraternity needs to look at how they can differentiate in their procedures and products by making them more attuned to the unique needs of the Micro sector.

20. While on the institutional mechanism, just as a reassuring thought, I would like to mention that we at RBI are extremely mindful of the trials and tribulations of small enterprises and we have put in place institutional mechanism for deliberating and generating solutions for issues concerning the MSME sector. First, there is the Standing Advisory Committee at the national level which I chair and in which some of the industry bodies participate. Then there is an Empowered Committee at the Regional Offices of RBI and then there are town hall meetings held at periodic intervals to serve as a forum for feedback. Each of these fora have evolved into vibrant platforms for deliberating and sorting out policy and operational issues with specific focus on this sector. I would urge the industry bodies, including ASSOCHAM, to use these platforms extensively to deliberate on critical issues (and not merely raising rhetoric for reducing interest rates) and put forward suggestions for policy interventions.

Conclusion

21. Before I conclude, let me reemphasize that an entrepreneur would feel empowered when he/she is able to bridge the asymmetry of knowledge. There is no better way to do this than peer help. Be it in skilling, assisting or hand holding, the industry bodies have a major role to play in empowering the MSMEs. International experience, you might know, is towards industry bodies serving as peer counsellors for small businesses. I visualize a significant role for industry associations like ASSOCHAM in empowering the entrepreneurs. I am happy that ASSOCHAM has been actively working in this area and the report released today is a testimony to their efforts.

22. I stated this at the close of my address last year and at the cost of repetition, would like to re-emphasize the importance of borrower education (especially for small businesses).

The banks and borrowers share a symbiotic relationship and hence, both the lenders as well as the borrowers have to understand their basic responsibilities, co-operate with each other and adhere to a general code of conduct and discipline. We have to realize that only if the business survives would both, the borrowers and the bankers flourish.

23. As I said at the beginning of my address, the MSMEs are key to a sustainable economic growth and hence, it is in our collective interest that these enterprises thrive. To paraphrase Mao-Tse-Tung, "Let a billion MSMEs bloom!" To paraphrase Mao-Tse-Tung, "Let a billion MSMEs bloom!"

I thank ASSOCHAM for inviting me to share my thoughts and wish the conference great success.

Thank you!