

S S Mundra: Bankers & SME borrowers - the emerging mantras

Keynote address by Mr S S Mundra, Deputy Governor of the Reserve Bank of India, at the 3rd Bankers Borrowers Business Summit, organized by the Associated Chambers of Commerce and Industry of India (ASSOCHAM), New Delhi, 16 June 2017.

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Dignitaries on the dais; distinguished colleagues from the banking fraternity; members of ASSOCHAM; representatives from the print and electronic media; ladies and gentlemen! At the outset, I would like to compliment ASSOCHAM for the effort in bringing the bankers and the borrowers together on a common platform to enable discussions on various issues of relevance to the MSME sector. With changing times new trends are emerging in every sphere and at this juncture the theme of “10 Emerging Mantras” for the MSMEs is extremely topical.

2. The role of micro, small and medium enterprises (MSMEs) in the economic and social development of the country can hardly be over-emphasized. About one-third of the country's GDP is contributed by more than 50 million MSMEs in the country. It is expected that by 2020, India will have the largest job-ready youth population in the world. However, before I get into specifics on the theme of the Summit, let me first present the big picture on why MSME sector needs our support.

3. First and foremost reason is that with big manufacturing companies increasingly automating their operations and process flow, the number of jobs in these industries is going to decline. A recent research based on World Bank data has predicted that the proportion of jobs threatened in India by automation could be around 69 per cent! That is a huge number. Since MSMEs are capable of generating plenty of jobs in segments like hospitality, apparel manufacturing, food processing and so on, it is time for the policy makers as well lenders to focus on them. In this context, there would also be a need for change in our perception about jobs. Work created in the formal sector alone does not constitute job. Even if entrepreneurship is promoted that also is equivalent to creation of a job. Hence, the public policy should focus on how much more work is created rather than how many jobs in the formal sector.

4. The motivation for the bankers to lend to the MSME segment would probably come from relatively poor return on their advances to the large corporates. Still another push emanates from recent regulatory guidelines restricting banks' exposures to single borrowers or borrowers in the same corporate group and forcing the large borrowers to meet their fund requirements from market borrowings rather than from banks. Under the circumstances, it would make sound commercial sense for the banks to look at MSME sector as a potential growth area.

5. Therefore, with favourable ecosystem in the manufacturing/services sector, MSMEs can pave the way for fulfilling entrepreneurial ambitions and in the process would be able to generate significant levels of employment. Yet providing adequate and timely finance at reasonable rate of interest to these 50 million units at the bottom of the pyramid has remained an elusive goal. It must be appreciated that to realize the country's aspirations for a double-digital growth, it is crucial that the potential of MSME sector is optimally tapped.

6. Before coming to the theme of the Summit proper, let me briefly touch upon few major reasons for the sector's limited access to institutional credit. These include – small ticket size loan which renders these accounts operationally less profitable, lack of information about the operations of these enterprises and financial illiteracy among the small enterprise owners. Due to unavailability of timely as well as flexible institutional credit, a number of MSMEs fail to tide over temporary setbacks and eventually have to shut shop. With the above background, in my address today I intend to outline some mantras for the bankers and the borrowers that need to be pursued for ensuring vibrancy of the MSME sector in emerging environment. I will also dwell upon

few recent policy measures that RBI and Government of India have taken for the sector and also some measures in the pipeline.

Mantras for bankers

7. In my opinion developing empathy for micro, small and medium borrowers and understanding their financial and other related needs is the first and foremost mantra for the bankers. This can obviously be achieved if the Top Management is convinced about the potential of the sector and treats MSME lending as a priority for sound commercial reasons. Developing business sensitivity towards such entrepreneurs would require focused capacity building through training interventions.

a) Appreciating the Life cycle needs of the MSMEs

Micro and small units are more prone to financial difficulties than large enterprises / corporates. Often absence of timely support at crucial junctures during the operating lifecycle of MSMEs leads to their sickness. The banks need to be sensitive in providing continuous support to viable MSEs during phases of transient financial difficulties. Towards this end, Reserve Bank of India has already advised banks to review their lending policies to the MSE sector and incorporate provisions for sanctioning of Standby Credit Facility, Additional Working Capital Limits, Mid Term Review of Regular Working Capital Limits and to set timelines for credit decisions. However, a crucial piece for the success of the endeavour would be execution. Banks need to put in place a strong oversight mechanism over the field level functionaries for ensuring compliance with the policies. I believe this is crucial for vibrancy of the MSMEs.

b) Supporting faltering MSMEs

Let us recognize that failure is integral to entrepreneurship. Unfortunately, however, failure of enterprises in our system is still not accepted graciously without attaching any stigma. While providing support to the MSME firms over their life-cycle is important, it is also crucial that the banks support the firms in distress. An enabling mechanism has already been created by the GOI and RBI has issued necessary guideline outlining a Framework on Revival and Rehabilitation of MSMEs under temporary duress. Under the Framework, problem resolution is scaled up to a committee with a time bound schedule. I am told that all public sector, private sector and 4 major foreign banks have put in place an internal policy. Until December 31, 2016, 1770 committees have been formed and 41417 cases have been referred to these committees during the period between July-December 2016. In my opinion, these numbers need to go up substantially and resolution reached. Supporting MSME firms in temporary distress is extremely important and hence, I would request my banker colleagues to support this initiative earnestly.

c) Focusing on industrial clusters

By providing shared access to amenities like testing centers, utilities, roads, security, training to workers, and marketing assistance, SME clusters provide substantial benefits in terms of technology absorption, efficiency enhancement and growth. Firms in the MSME sector which earlier faced difficulties in achieving economies of scale, specialization and innovation due to their small size are now increasingly benefitting from the advent of industrial clusters. Several regional organizations have taken up cluster-based projects to promote smaller firms and this is where lies an opportunity for the banks. RBI has already advised banks to open more MSE focused branch offices at MSE clusters which can also act as counseling centers for MSEs. Collaborating with SME association in these clusters can prove mutually beneficial for the banks as well as for the smaller firms.

Mantras for borrowers

8. a) Bridging information asymmetry

One thing that seriously ails the MSME entrepreneurs is large-scale ignorance about banking products & practices as also a lack of awareness about the unfolding economic environment. Under the circumstances, the first mantra for the borrowers is to develop awareness about the changing economic dynamics and its impact on their businesses. The borrowers must make efforts to be updated with the latest regulatory guidelines, schemes offered by the banks and also by the Government. In this context, I am not sure how many MSMEs are aware about the existence of BCSBI Code of Bank's Commitment to Micro and Small Enterprises. We often observe many small entrepreneurs using innovative and ingenious techniques of production within their enterprise but I am not sure how many of them have heard of intellectual property rights (IPRs), let alone making a filing for their unique technique. It is also ironical that in a country where creating jobs is of utmost priority, vocational training still continues to be relatively neglected area owing to social perception. I firmly believe that entrepreneurial skill development by imparting vocational training can solve the problem of unemployment to a large extent and the industry bodies like ASSOCHAM would have a significant role to play in handholding and capacity building of the new entrepreneurs in all the above areas.

b) Reaping digital dividend

Fintech revolution is sweeping the globe and creating immense opportunities for various sectors. It has also opened new opportunities for the banks in the MSME space. Banks can support SMEs as they embrace e-invoicing or mobile payment solutions to allow their customers to make purchases on the go. With the aid of technology there can be a paradigm shift in the approach in lending to MSMEs. The banks can collaborate with Fintech players for either lending directly or through these fintech companies. On the other hand, the MSMEs can adopt technology for scaling up their businesses, achieving operational efficiencies and thereby cutting costs. Data analytics can help the bigger MSMEs to better appreciate customer behaviour and fine-tune their products, processes and services accordingly. I foresee a role for the Industry associations here as they can help create an infrastructure which can be shared by the resource-starved MSMEs thereby helping them prune down their costs.

E-commerce has disrupted the way businesses have traditionally been conducted. E-commerce technologies have the potential to significantly increase productivity gains at firm level as they allow automation of common processes such as distribution, sales, after-sales service and inventory management. E-Commerce has also virtually opened the entire globe for the entities to market their wares. So, instead of competing against large multinational companies, the MSMEs can take advantage of the opportunities afforded by e-commerce to access new and distant markets or global value-chains.

c) Utilizing alternate sources of finance

The MSMEs have always lamented lack of institutional finance as an impediment to their growth. However, lately few alternate sources of finance have become available in the market as a supplement to bank credit. The common forms of alternative finance include crowd-funding, Invoice trading, Peer-to-peer or marketplace lending, Angel investors etc. Similarly, NSE has a SME platform for entities whose post issue paid up capital is less than or equal to Rs.25 crores. The platform allows new, early stage ventures and small companies to raise much needed growth capital as they grow and mature. Alternative finance tend to be more transparent about fees and eligibility as well as flexible in terms of payment. Alternative finance allows businesses to use different assets for security. This is particularly very handy for service industries that can secure loans against the value of their unpaid invoices, rather than tangible assets such as property or stock. Spreading awareness about the availability of these alternate sources of

finance however, remains a challenge which must be addressed by the Industry Associations.

d) Seeking credit rating

A credit rating can make a MSME unit's access to financial services more efficient as it provides transparency, helps overcome perceived uncertainty in lending decisions and thereby reduces time and transaction costs. MSMEs can use ratings to enhance their credibility with other counterparties too, such as technology providers, suppliers, and customers. In this context, having proper documentation would be extremely critical. A related aspect that the lenders need to be mindful of is that MSME is a vast universe comprising of several million micro enterprises without elaborate system of account-keeping. Hence, standard ratio analysis would be an ineffective mode while apprising their credit proposals. In such cases, the banks would need to look to assess their credit worthiness under a credit scoring model using unconventional matrix comprising of utility bill payments, remittance history etc. I would like to add here that adoption of Ind-AS will play a key role in enhancing the quality of ratings as better disclosures will increase information availability on rated companies.

Recent policy measures/Work-in progress

9. The regulators and policy makers have an equal responsibility for supporting the cause of MSME sector. It is pertinent however to mention that the regulators/policy makers are better as enablers rather than doers. Whether it is creating avenues for flow of finance to the sector, creating easy climate for doing business or assisting the firms in distress- both Government of India and RBI have been extremely conscious to the needs of the MSME sector.

a) Smoothing the flow of finance

(i) Trade Receivables and Discounting System (TReDS)

RBI's initiative on creating a TReDS platform to serve as an exchange for electronically accepting and settling bills to enable the MSMEs to encash their receivables, has borne fruition. The system seeks to facilitate financing of trade receivables of MSMEs from corporate and other buyers, including government departments and public sector undertakings (PSUs) through multiple financiers. Out of the three licensed entities, two have already commenced operations. **It would be important that the use of TReDS is made mandatory for, to begin with corporate and PSUs and later for the Government departments. I would urge ASSOCHAM and the MSME Ministry to proactively examine this aspect as success of TReDS initiative can be a game changer for the sector.**

(ii) New institutions/New processes

Besides the two new universal banks, RBI has issued banking licenses to all ten Small Finance Banks that had received in-principle approval from RBI. Seven of them have commenced operations while the remaining three should become operational in next couple of months. The licensing condition of these banks entails focusing on lending to un-served and under-served sections including small business units, small and marginal farmers, micro and small industries and unorganized sector entities. The SFBs will be required to extend 75 per cent of their loans to the sectors eligible for classification as priority sector by the Reserve Bank with at least 50 per cent of the loan portfolio constituting advances up to Rs. 25 lakh. We believe that on account of their prior experience as MFIs/NBFCs, these new banks would be able to serve the MSME sector with aplomb.

Along with measures to improve accessibility, there is also a need to concentrate on new modes of delivery. Reaching out to the MSMEs in the remote corners has always been a complex issue in view of lack of brick and mortar branches across the country. One possible solution for this

problem is convergence of efforts between banks on one hand and the NBFCs, MFIs on the other who are more familiar with local conditions, business viability, better information about the credit worthiness of individuals, their repayment capabilities etc. Currently, within RBI, we are deliberating on a **framework for co-origination of loans by banks and the NBFCs/MFIs with risk participation** which would leverage upon unique strength of both entities, while benefitting the entrepreneurs in form of lower credit costs.

b) Improving ease of doing business climate

(i) An Udyami Mitra Portal has been set up by SIDBI, leveraging the IT architecture of their Stand-Up Mitra portal, which aims at instilling ease of access to MSMEs' financial and non-financial service needs. The Portal, as a virtual market place endeavours to provide 'End to End' solutions not only for credit delivery but also for the host of credit-plus services by way of hand holding support, application tracking and multiple interface with stakeholders (i.e. banks, service providers, applicants). I understand that the portal is far from attaining the level of patronisation than expected. Hence, I urge the banks as well industry associations to help create awareness about this facility amongst the borrowers.

(ii) Movable assets registry

Movable assets, as opposed to fixed assets such as land or buildings, often account for most of the capital stock of private firms and comprise an especially large share for micro, small and medium-size enterprises. Hence, movable assets are the main type of securities that firms can pledge to obtain bank financing. CERSAI, in active co-ordination with Government of India and Reserve Bank has already established the movable asset registry, which when mature would have a multiplier effect in lending to the sector. I would again request all stakeholders to make optimal use of this platform.

(iii) Credit counsellors

Most MSMEs are typically enterprises with weak credit histories and also with inadequate expertise in preparing financial statements. To overcome this handicap, RBI took initiatives to implement a scheme wherein services of a set of certified credit counsellor would be available to the MSME entrepreneurs. These counsellors will act as facilitators and enablers to micro and small entrepreneurs, so that they can access the formal financial system channel with greater ease and flexibility. SIDBI's help has been taken for the purpose and I am pleased to inform that the operational guidelines in this regard have been finalised and the scheme is set to be rolled out in the coming days.

(iv) Capacity building

As I mentioned earlier, capacity building with banks is extremely important as it endows them with requisite skill-sets as well as sensitivity to the needs of customers. Realizing the gaps in this area, RBI launched a National Mission for Capacity Building of Bankers for financing MSME Sector (NAMCABS) in collaboration with College of Agricultural Banking, Pune in August 2015. The mission involved structured training initiatives for in-charges of MSME Divisions in commercial banks, training of the trainers at training establishments of commercial bank and training of in-Charges of specialized branches for MSMEs. I am pleased to inform that until end March 2017, about 5605 bankers have been trained under the programme. Presently, we are undertaking an exercise to assess the impact of NAMCABS initiative on operational and behavioral aspect of bankers.

c) Resolving stress in MSME sector

Bankruptcy law

As I mentioned earlier, based on a framework approved by the GoI, RBI has issued guidelines on 'Revival and Rehabilitation of MSMEs' in March 2016. Government of India has further approved the Insolvency and Bankruptcy Code 2016 with an objective of expediting resolution of stressed assets and streamlining the process of liquidating a business. The Code also provides for a fast track insolvency resolution process which will be an enabler for start-ups and MSMEs to complete the resolution process in 90 days (extendable to 45 days in deserving cases).

Conclusion

10. I would like to conclude with following messages for the MSMEs and the banks:

- ♦ MSMEs must not fall into the lure of unrelated diversification or quick expansion. They should rather look to conserve capital and strengthen their balance sheet.
- ♦ The firms need to be open with their bankers about the problems that their enterprise is facing at the earliest opportunity. On their part the banks would need to be pragmatic and sympathetic to the problems that the firms is facing and be willing to provide all possible help. Remember, bankers and borrowers have a symbiotic relationship and one cannot prosper in isolation.
- ♦ Most of the MSMEs are individual-driven enterprises with no succession planning. In order to sustain an enterprise entity, it is essential even for small to mid-size firms to plan for future by identifying a successor.

11. To sum up, the strategic importance of MSME sector as a prime mover of employment and economic growth in the country can hardly be overemphasized. Technology and innovation will continue to play a pivotal role in creating a business friendly atmosphere for the MSMEs. All stakeholders- whether banks, MSME firms or the policy makers- must make efforts in their respective domains to seize the opportunity that the MSME sector provides. For a healthy and mutually beneficial relationship between the banks and borrowers, it would be essential for both parties to understand and appreciate each other's point of view. The bottom line is that the information asymmetry that exists between the two parties needs to be bridged and industry associations like ASSOCHAM would have to strive to make that possible. I once thank ASSOCHAM for inviting me here to share my thoughts and wish the summit all success!