REPORT

OF

WORKING GROUP

ON

REHABILITATION OF SICK SMEs

PREFACE

Industries are an integral part of the Indian Economy since the Harappan era. Until the advent of British rule and modern industry, it had perforce, to be small scale. The entrepreneurial spirit was stifled during the long colonial rule as also reflected in the GDP growth rate of 0.9% during the first half of the 20^{th} century. The Europeans were expanding their colonial rule all over the world in search of raw material for their factories and markets for the products of these factories. It was during this period that the Industrial Revolution was sweeping the European continent. India missed the Industrial Revolution as the foreign rulers would not allow the Indian Entrepreneurship to flourish. We have only to recall the Swadeshi Movement and boycott of foreign goods in the first quarter of the last century, to realize the place of entrepreneurs and small industry in the developing consciousness of modern and free India.

Independent India's economic planning gave a place of pride to the small scale sector, especially, with the objective of fostering entrepreneurship and promoting employment. The small scale sector flourished notably as ancillary to large industries, as a robust export sector and under the policy of reservation of some products for small scale. The GDP growth rate had improved substantially to 3.5%. However, as the First Five Year Plan was focussed on agriculture and Second Plan on large industries, the MSMEs sector could not get the desired focus. By the early eighties, the weaknesses of small scale industries came to prominence, especially, the fact that they lacked the capacity to withstand adverse developments. Another notable development was a gradual shift from manufacturing sector to the service sector. The share of tertiary sector in GDP is an indicator of growth. Realising the importance of service sector and the contribution of small service enterprises in the economy, Government has brought a paradigm shift in its approach to the sector. Small enterprises, which were earlier called Small Scale Industries (SSI) are now Small and Medium Enterprises (SMEs). With the enactment of MSMED Act, the importance of service enterprises and the need for migration of small enterprises to medium enterprises has been clearly brought out.

After nationalization of banks in 1969, the banking sector became a key source of support for small and medium industry. Technical consultancy support and various financial institutions formed a framework for supporting SMEs. Within this framework, in 1987 and in 1989, Reserve Bank of India announced schemes for rehabilitation of small and medium industries. These schemes entailed restructuring of debt of sick companies with relief and concessions. The rehabilitation schemes worked selectively and were effective where markets were available for the units' products and where entrepreneurs were skilled and serious. This was a period of economic growth ranging between 3% & 5%. For specific sectors, the wolf of recession was always at the door. It was an era of protection, which was a support to domestic industry. However, growth of internal & international competition and technological changes continued to erode the financial strength and viability of SMEs, putting them in need of rehabilitation measures. The protection available to the industry has been gradually coming down since 1991 with integration of Indian economy with global economy. IRAC norms were introduced in 1992, making the banks hesitant to lend to small enterprises as it is perceived as risky lending.

“Marketisation” of the Indian economy has also meant greater possibilities of Equity Financing and a climate in which businesses can be bought and sold, including, mergers and acquisitions. Prospects of viability and turnaround of sick SMEs are better in this scenario.

Dr. Rakesh Mohan, Deputy Governor, RBI, in his address at Annual Bankers’ Conference at Hyderabad on November 3, 2006 has succinctly painted the picture of SMEs as under.

“There has been a burst of entrepreneurship across the country, spanning rural, semi-urban and urban areas. This has to be nurtured and financed. It is only through growth of enterprises across all sizes that competition will be fostered. A small entrepreneur today will be a big entrepreneur tomorrow, and might well become a multinational enterprise eventually if given the comfort of financial support. But we also have to understand that there will be failures as well as successes. Bank will therefore have to tone up their risk assessment and risk management capacities, and provide for these failures as part of their risk management. Despite the risk, financing of first time entrepreneurs is a must for financial inclusion and growth.”

SMEs need to be strengthened financially to better withstand external shocks. Secondly, lenders have to diagnose and treat sickness promptly when it emerges. The Working Group has focussed on both these aspects and suggested suitable measures in the context of the current economic scenario in India. These measures constitute a fresh policy framework to address the rehabilitation challenge for SMEs in the contemporary liberalized economy.

ACKNOWLEDGEMENT

The Working Group wishes to acknowledge the contribution made by a large number of persons and organisations in preparing this report.

The Group acknowledges the guidance and encouragement extended by Sh Mahabir Prasad, Hon'ble Minister for MSME and the members of the Parliamentary Consultative Committee attached to the Ministry of MSMEs in formulation of its suggestions. Smt Usha Thorat, Deputy Governor Reserve Bank of India graced the third meeting of the Working Group and guided the Group in identifying the focus areas and encouraged the Group to think on radical lines. The Group acknowledges that the advice and encouragement provided by Smt. Usha Thorat were the guiding spirit for the working of the Group. The Group's working was facilitated, supported and guided by Dr. Chandrapal, IAS, the then Secretary and Sh. Dinesh Rai, IAS, the present Secretary to Government of India, Ministry of MSME. We acknowledge the same.

Sh Jawhar Sircar, IAS, Additional Secretary & Development Commissioner (MSME), associated himself with the Group closely & actively. The enthusiasm and the focussed approach of Sh Sircar helped the Group in identifying the areas that needed its attention. Sh Sircar was the driving force in the interactions of the Group with the promoters of sick enterprises. The Group wishes to place on record its deep appreciation of his contribution in finalizing the recommendations.

Sh. R.M. Malla, Chairman and Managing Director, SIDBI, was kind enough to support and share his experiences in the different areas which were found to be very useful by the Group and its recommendations carry an imprint of his views. We acknowledge his guidance and valuable suggestions.

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The Group benefitted in particular from the views and suggestions received from:

1. Approach Paper to the 11th 5 year Plan, Economic Survey 2006-07 and the Report on Financing of Enterprises in the Unorganised Sector prepared by National Commission for Enterprises in the Unorganised Sector, Study on sickness in SME sector conducted by various Regional Offices of RBI, Draft recommendations of Committee on Financial Sector Reforms

2. Banks, SME Associations, Director of Industries of different states and Entrepreneurship Development Institutes who gave their views in response to the Questionnaire circulated by the Group,

3. The various MSME Associations and banks during its interactions with them, Officials of Reserve Bank of India and various Ministries

4. Various entrepreneurs with whom the Group interacted on a one to one basis including entrepreneurs of Jagdishpur and Kosi Industrial Estates.

The Group drew upon the vast experience and expertise of Smt Sudeshna Sharma, General Manager, Central Staff College, PNB, Sh Kota Krishnamurthy, Retired GM, Indian Bank, Sh V V Anand, DGM SBI & other officials of Stressed Assets Management Group of SBI and Sh N K Somalingam, Deputy General Manager, PNB and wishes to place on record its appreciation of the inputs given by them.

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GLOSSARY

ABBREVIATION	FULL FORM
ADC	Additional Development Commissioner
AGM	Assistant General Manager
BIFR	Board for Industrial and Financial Reconstruction
BITS	Birla Institute of Technology and Science
CART	Credit Assessment and Rating Tool
CAS	Credit Authorisation Scheme
CC	Cash Credit
CC (BD)	Cash Credit (Book Debt)
CEO	Chief Executive Officer
CGM	Chief General Manager
CGTMSE	Credit Guarantee Trust for Micro and Small Enterprises
CIBIL	Credit Information Bureau (India) Ltd
CMA	Credit Monitoring Arrangement
CMD	Chairman and Managing Director
CPC	Centralised Processing Cell
DGM	Deputy General Manager
DI	Director of Industries
DIC	District Industries Centres
DP	Drawing Power
ED	Executive Director
EDC	Entrepreneurship Development Centre
EDI	Entrepreneurship Development Institute
EDP	Entrepreneurship Development Programmes
FITL	Funded Interest Term Loan
GBC	Gross Bank Credit
GDP	Gross Domestic Product
GM	General Manager
GOI	Government of India
IBA	Indian Banks Association
ICAI	Institute of Chartered Accountants of India
IIM	Indian Institute of Management
IIT	Indian Institute of Technology
IITK	Indian Institute of Technology, Kanpur
IRD	Industrial Rehabilitation Department
ITI	Industrial Training Institute
KVIC	Khadi and Village Industries Commission
MFI	Micro Financing Institution
MNC	Multinational Corporation
MSE	Micro and Small Enterprises
MSME	Micro, Small and Medium Enterprises
MSMED Act	Micro, Small and Medium Enterprises Development Act
NABARD	National Bank for Agriculture and Rural Development
NAFUS	National Fund for the Unorganised Sector
NCEUS	National Commission for Enterprises in the Unorganised Sector
NCLT	National Company Law Tribunal
NGO	Non Governmental Organisation

ABBREVIATION	FULL FORM
NIT	National Institute of Technology
NPA	Non Performing Asset
NSE	National Stock Exchange
NSIC	National Small Industries Corporation
OD	Overdraft
OTCEI	Over The Counter Exchange of India
OTS	One Time Settlement
PBF	Permissible Bank Finance
PMRY	Prime Minister's Rozgar Yojana
PNB	Punjab National Bank
PS	Priority sector
PSB	Public Sector Bank
R & D	Research and Development
RAM	Risk Assessment Model
RBI	Reserve Bank of India
REGP	Rural Employment Guarantee Programme
RIDF	Rural Infrastructure Development Fund
RRB	Regional Rural Bank
SBI	State Bank of India
SBIC	Small Business Investment Company
SCB	Scheduled Commercial Bank
SEO	Small Enterprises Organisation
SEWA	Self Employed Women's Association
SFC	State Financial Corporation
SFURTI	Scheme of Fund for Regeneration of Traditional Industry
SGSY	Swarnajayanti Gram Swarozgar Yojana
SICA	Sick Industrial Companies (Special Provisions) Act, 1985
SIDBI	Small Industries Development Bank of India
SIDC	Small Industries Development Corporation
SIDO	Small Industries Development Organisation
SME	Small and Medium Enterprises
SN	Serial Number
SSI	Small Scale Industry
TEV	Techno Economic Viability
TL	Term Loan
TUFS	Technological Upgradation Fund Scheme
WC	Working Capital
WCTL	Working Capital Term Loan

CONTENTS

1. INTRODUCTION

1.1 MANDATE FOR THE WORKING GROUP

1.1.1 RBI has constituted a Standing Advisory Committee under the Chairmanship of one of its Deputy Governors to monitor the flow of institutional credit to SME sector. The Committee meets on a regular basis to take stock of the developments, analyse the problems being faced by the sector and suggest corrective measures.

1.1.2 In the 8th meeting of the Standing Advisory Committee on Flow of Institutional Credit to SME Sector held on 16.1.2007, while reviewing the position of rehabilitation of sick SME units, the Chairperson, Smt. Usha Thorat, Deputy Governor, RBI observed that there was considerable delay in rehabilitation/nursing of the potentially viable units. It was informed that the inability of the promoters to bring in their contribution was one of the major reasons for delay in rehabilitation/nursing. The Chairperson suggested examining feasibility of bringing in additional capital through alternative routes such as equity participation, venture financing, etc. Shri Jawhar Sircar, Addl. Secretary & Development Commissioner, Ministry of MSME, GOI suggested constitution of a small Working Group under the Chairmanship of Dr. K. C. Chakrabarty, CMD of PNB (then CMD of Indian Bank) with SBI and SIDBI as members to look into these issues and suggest remedial measures so that potentially viable sick units can be rehabilitated at the earliest.

1.1.3 Reserve Bank of India vide their letter No. RPCD.PLNFS.No. 12002/06.02.28 (i)/2006-07 dated June 18, 2007 advised setting up of the Working Group with Dr K C Chakrabarty, CMD, Punjab National Bank as its Chairman and Sh J Chandrasekaran, CGM, SBI and Sh P Rudran, CGM, SIDBI as its members.

1.1.4 Smt Usha Thorat, Deputy Governor, Reserve Bank of India was present in the Third meeting of the Working Group held on 19-09-2007. During discussions, she suggested that the Group should interalia look into the problems (including infrastructure) faced by new as well as sick MSMEs, timely and adequate flow of funds including promoters' contribution for startup capital and for rehabilitation, setting up of credit information companies, counselling services that banks can provide, and role of SIDBI/ other apex institutions in the development of SMEs & rehabilitation of sick SMEs.

1.2 METHODOLOGY ADOPTED

1.2.1 The Group has approached the issue from the perspective of the banks, SMEs, SME Associations, Chambers of Commerce, Entrepreneurship Development Institutes, DICs and State Governments. A survey was conducted among Commercial Banks, Industry Associations/Chambers of Commerce and the State Governments to obtain their views on the impediments in the growth of SME sector, corrective actions required especially with regard to flow of credit, promoters' contribution, entrepreneurship development, role of large corporates and the industry associations. The views of these stakeholders were also obtained on the need for change in the definition of sickness in small enterprises, causes thereof, steps required for arresting the same, reasons for delay in rehabilitation and the contribution of delayed realisation of receivables and non availability of promoters' contribution. The Questionnaire circulated to the stakeholders is placed at Annexure I. The group relied upon responses to the Questionnaire circulated as also the information provided by various institutions connected with MSMEs. The responses received have been tabulated at Annexure II.

1.2.2 The Group met Smt Usha Thorat, Deputy Governor, RBI, Sh Jawhar Sircar, Additional Secretary, Government of India and DC (MSME), Shri R. M. Malla, CMD & Sh V Chandrasekaran, ED of SIDBI, Sh H P Kumar, Chairman and Managing Director, National Small Industries Corporation, Senior Officers of RBI, Senior Officials of Commercial Banks, representatives of Industry Associations, Chambers of Commerce and Industry, Non-Governmental Organisations, DICs, entrepreneurs etc. Bankers having experience and expertise in the area of Priority Sector lending, SME financing and sickness in SMEs were especially invited to the meetings and their views find mention in the report.

1.2.3 Extensive discussions were held with entrepreneurs and MSME Associations individually and in Groups, in various parts of the country in order to understand their problems, get feedback on the issues outlined above and obtain their suggestions. In order to understand the problem of units located in industrial estates, two Industrial Estates namely Jagdishpur and Kosi in UP were selected. A team of technical and financial experts was constituted to discuss and understand the problems of these units. The team visited these centres and the views of promoters of units located in these areas were obtained. These views were kept in mind while identifying the problems and suggesting the remedial measures. Besides, the studies conducted by various organisations and the findings thereof were also considered. The recommendations of various Committees appointed by RBI or/ and Government were also studied and the relevant recommendations in the area of sickness in small and medium enterprises were discussed and find mention in the report.

1.2.4 In order to obtain the views of the entrepreneurs and their Associations, the Group circulated Questionnaires to the MSME Associations, invited them to meetings and also requested them to provide details of sick units among their members so that first hand information on the causes of sickness could be obtained by the Group. However, the response of the Associations was not found very encouraging.

1.2.5 The views expressed during the meetings/visits which were relevant to the systems and procedures and also to policy and operational matters have been given due consideration while drafting the Report.

1.3 FRAMEWORK OF THE REPORT

1.3.1 The Report consists of ten chapters.

1.3.2 The First Chapter deals with the Mandate for the Working Group, the Methodology adopted by the Group and the Framework of the Report. The Second Chapter gives an Overview of the MSME Sector in India. The Third Chapter gives the status of flow of funds to small enterprises and the corrective action required. The Fourth Chapter analyses the issue of financial inclusion and micro enterprises. The Fifth Chapter brings out the present status and the need for further action on development of backward and forward linkages including capacity building, upgradation of technology, marketing support, need for development of credit information system, the need of an umbrella organisation and the suggested structure thereof. The Sixth Chapter suggests some changes in credit guarantee structure for MSEs. The Seventh Chapter deals with development of induced clusters/ industrial estates. The status of sickness in MSME sector is presented in Chapter Eight. The Ninth Chapter deals with Rehabilitation of Sick MSMEs. Summary of Major Recommendations and Action Points are presented in Chapter Ten.

2. AN OVERVIEW OF THE MSME SECTOR IN INDIA

2.1 INTRODUCTION

2.1.1 Small Enterprises play a very significant role in terms of balanced and sustainable growth of the economy by way of employment generation, development of entrepreneurial skills and contribution to export earnings. These units produce a wide range of items employing traditional to state-of-the-art technology. This vibrant segment of the Indian economy, has been contributing over 39% of the manufacturing sector output, 33% of the national exports and providing employment to nearly 312 lakh people through about 128 lakh units, located in both the rural and urban areas across the country.

2.1.2 The contribution of small enterprises to the Indian economy over the last seven years is given hereunder.

Year	**Units (lakh nos)**	**Production(Rs. Crore)**		**Employment (lakh nos)**	**Prod per employee**	**SSI Exports**	
		At 1993-94 prices	**At current prices**		**At 1993-94 prices(Rs.000)**	**Rs. Crore**	**US$ million**
2000-01	101.1	184401	261297	240.9	77	69797	15278
2001-02	105.2	282270*	282270	252.3	112*	71244	14938
2002-03	109.5	306771	314850	263.7	116	86013	17773
2003-04	114.0	336344	365547	275.3	122	97644	21249
2004-05	118.6	372938	429796	287.6	130	124417	27690
2005-06	123.4	418884	497842	299.9	140	150242	33935
2006-07 P	128.4	473339	587196	312.5	151		
P Provisional * Since 2001-02, Production figures are at 2001-02 prices.							

Table 2.1: CONTRIBUTION OF SMALL ENTERPRISES TO INDIAN ECONOMY

Source: Ministry of MSME

2.1.3 Most countries adopt the level of employment and/or sales turnover as the criterion for defining the Small Enterprise sector. In India, it is defined in terms of investment in plant and machinery. With enactment of Micro, Small and Medium Enterprises Development Act 2006, there has been a paradigm shift and includes all business enterprises and not just manufacturing units (earlier most service enterprises were not covered under the definition of SSI). The enterprises are now grouped under two major heads namely manufacturing and service enterprises. RBI has advised adopting the new definition as under.

The term "Small Enterprise(s)" used in the report refers to "Small Scale Industry" wherever it refers to the historical data, as it came into existence only after enactment of the MSMED Act. At all other places, it has the same meaning as defined in the Act.

a) Enterprises engaged in manufacturing activity

i) A **micro enterprise** is an enterprise where investment in plant and machinery [original cost excluding land and building and the items specified by the Ministry of Small Scale Industries vide its notification No. S.O. 1722(E) dated October 5, 2006 **does not exceed Rs. 25 lakh;**

ii) A **small enterprise** is an enterprise where the investment in plant and machinery (original cost excluding land and building and the items specified by the Ministry of Small Scale Industries vide its notification No. S.O. 1722(E) dated October 5, 2006) is **more than Rs. 25 lakh but does not exceed Rs. 5 crore;** and

iii) A **medium enterprise** is an enterprise where the investment in plant and machinery (original cost excluding land and building and the items specified by the Ministry of Small Scale Industries vide its notification No. S.O. 1722(E) dated October 5, 2006) is **more than Rs.5 crore but does not exceed Rs.10 crore.**

(b) Enterprises engaged in providing or rendering of services and whose investment in equipment (original cost excluding land and building and furniture, fittings and other items not directly related to the service rendered or as may be notified under the MSMED Act, 2006) are specified below. These will include small road & water transport operators (owning a fleet of vehicles not exceeding ten vehicles), retail trade (with credit limits not exceeding Rs.10 lakh), small business (whose original cost price of the equipment used for the purpose of business does not exceed Rs.20 lakh) and professional & self employed persons (whose borrowing limits do not exceed Rs.10 lakh of which not more than Rs.2 lakh should be for working capital requirements except in case of professionally qualified medical practitioners setting up of practice in semi-urban and rural areas, the borrowing limits should not exceed Rs.15 lakh with a sub-ceiling of Rs.3 lakh for working capital requirements).

(i) A **micro enterprise** is an enterprise where the investment in equipment **does not exceed Rs. 10 lakh**;

(ii) A **small enterprise** is an enterprise where the investment in equipment is **more than Rs.10 lakh but does not exceed Rs. 2 crore**; and

(iii) A **medium enterprise** is an enterprise where the investment in equipment is **more than Rs. 2 crore but does not exceed Rs. 5 crore**.

A policy for reserving selected products in the manufacturing sector for exclusive production in the Small Enterprise sector exists since 1967. The list has been revised from time to time. However, of late, the focus is more on downsizing the list.

2.1.4 It is well recognised that small enterprises contribute to the development of the country. Small enterprises are less capital intensive and generate more employment. It can be derived from the data given in Table 2.1 that the employment generation has increased from 2.38 persons per unit to 2.43 persons per unit over the last 7 years. Employment generation is of paramount importance in our labour surplus and capital scarce economy. We can observe from the data given in Table 2.1 that production per employee during the last 7 years has almost doubled from Rs 77000 to Rs 151000 at 1993-94 prices.

2.1.5 While the large corporates are catering to the customers all over the country or even international markets, MSMEs cater to the niche markets. They normally employ traditional technology. The products of MSMEs are normally absorbed by the local markets. These units carve out a separate exclusive market zone for themselves. They enjoy the comfort of confidence of the local people. With passage of time, the successful ones grow into large corporates. MSMEs of yesterday are the large corporates of today and could be MNCs of tomorrow. Thus the banks and other agencies should take pride while servicing the MSMEs as they are playing an instrumental role in the formation of MNCs of tomorrow.

The share of tertiary sector in GDP is an indicator of growth. In our country also, the contribution of service sector in GDP has been increasing. Realising the importance of service sector and the contribution of small service enterprises in the economy, Government has brought a paradigm shift in its approach to the sector. Small enterprises, which were earlier called Small Scale Industries (SSI) are now Small and Medium Enterprises (SMEs). With the enactment of MSMED Act, the importance of service enterprises and the need for migration of small enterprises to medium enterprises has been clearly brought out.

2.1.6 Various measures taken by the Government and RBI for the development of MSE include product reservation, fiscal concessions, preferential allocation of credit (by including the same in Priority Sector) and regulated rate of interest (for total credit requirement upto Rs 2 lacs), launch of Credit Guarantee Fund Trust for Small Industries, [later rechristened as Credit Guarantee Trust for Micro and Small Enterprises (CGTMSE)], extension of business and technical services, preferential procurement by the government. Small Industries Development Bank of India (SIDBI) has been set up in April 1990 as the principal financial institution for promotion, financing and development of the small enterprises sector and for coordinating the activities of other institutions engaged in similar activities. Several expert committees namely Narsimham Committee, Nayak Committee, Kapoor Committee, Ganguly Committee, Khan Committee, Murthy Committee, Kohli Committee and Rangarajan Committee have also been set up over the last few years to analyse the problems of the small enterprises sector and suggest remedial actions. The pace of de-reservation of small enterprise items has been accelerated so as to ensure that size does not remain a constraint to higher production, cost-efficiency and technological upgradation. The Government can now focus on smooth migration of small enterprises to medium enterprises and then to large enterprises progressively. It should act as a catalyst for such migration in addition to its role as facilitator for setting up new enterprises and sustaining them.

The recent policy packages for improving the flow of credit and growth of the sector are as under.

2.1.7 Announcements in Union Budget 2008-09

a. Creation of a Risk Capital Fund of Rs. 2000 crores with SIDBI.

b. Creation of a fund of Rs. 2000 crores with SIDBI for providing refinance to MSME sector

c. Reduction in CGTMSE guarantee fee from 1.5% to 1% and annual service fee from 0.75% to 0.5% for loans upto Rs. 5 lacs.

d. Allowing retired bank officers and ex-servicemen to act as Business Facilitators / Business Correspondents and Credit Counsellors.

e. Provision of Rs 100 crores for development of six Mega Clusters at - Varanasi & Sibsagar for handlooms, Bhiwandi & Erode for Powerlooms and Narsapur & Moradabad for handicrafts.

2.1. 8 Package for Promotion of Micro and Small Enterprises, 2007

The Ministry of MSME announced a package for promotion of Micro and Small Enterprises in February 2007. The major features of the package are as under:

a. Implementation of the measures for 20% year on year growth to be closely monitored by the RBI and the Government.

b. SIDBI, assisted by scaled up Government grant, to cover 50 lakhs additional beneficiaries over the five years beginning 2006-07.

c. Creation of Risk Capital Fund by the Government with SIDBI

d. SIDBI to increase the number of branches from 56 to 100 in two years beginning 2006-07.

e. Eligible loan limit under the Credit Guarantee Fund Scheme raised to Rs.50 lakhs. The credit guarantee cover raised from 75 per cent to 80 per cent for micro enterprises for loans up to Rs. 5 lakhs. The corpus of the Fund to be raised from Rs.1,189 crores as on 1 April 2006 to Rs.2,500 crores over a period of five years.

2.1.9 Enactment of MSMED Act 2006

The Government of India enacted the Micro, Small and Medium Enterprises Development Act in June 2006. The Act aligns the definition of small enterprises with the internationally accepted definition, provides protection to small enterprises from delayed payments by the large corporates and provides a definition to medium enterprises. The Act has brought a paradigm shift in the treatment to small enterprises by bringing the service sector under the definition of MSMEs.

2.1.10 **<u>Policy Package for Stepping Up Credit to SMEs – 2005</u>**

i. **Measures to increase the quantum of credit to SMEs at the right price**

⇒ Public Sector Banks will fix their own targets for funding SMEs in order to achieve a minimum 20% year-on-year growth in credit to SMEs so that credit flow to SMEs doubles in 5 years.

⇒ Public Sector Banks will link the cost of credit to the credit rating of the enterprise. Credit rating system developed by NSIC to be considered appropriately for the purpose.

⇒ SIDBI in association with Credit Information Bureau (India) Ltd. (CIBIL) will expedite setting up a credit rating agency.

⇒ SIDBI and Indian Banks' Association (IBA) would collect and pool common data on risk in each identified cluster and develop an IT-enabled application, appraisal and monitoring system for small (including tiny) enterprises.

⇒ Public sector banks to utilise the Credit Appraisal & Rating Tool (CART) as well as a Risk Assessment Model (RAM) developed by SIDBI.

ii. The commercial banks (including regional rural banks) to provide credit cover on an average to at least 5 new tiny, small and medium enterprises at each of their semi urban/urban branches per year.

iii. **Nursing the Sick Units Back to Health: Debt Restructuring**

a. Banks to formulate liberal policies based on guidelines on Debt Restructuring Mechanism for SMEs to be issued by RBI.

b. An OTS scheme for small-scale NPA accounts as on March 31, 2004.

iv **Facilitative Measures**

Banks to formulate a comprehensive and more liberal policy relating to advances to SME sector based on Reserve Bank of India's Master Circular of March 2005.

v. **Credit Guarantee Fund Trust Scheme for Small Industries(CGTSI)**

Liberalisation of CGTMSE guidelines by way of reduction in one-time guarantee fee from 2.5% to 1.5% for all (i) loans up to Rs.2 lakh, (ii) eligible women entrepreneurs, and (iii) eligible borrowers located in the North Eastern regions (Sikkim) and Jammu & Kashmir. Public sector banks to be encouraged to absorb the annual service fee in excess of 0.25% in respect of guarantee for these categories.

vi. **Cluster based approach**

Cluster based approach to be treated as a thrust area. SIDBI to formulate a scheme in consultation with the stakeholders to broaden the financing options for infrastructure development in clusters through public private partnership.

SIDBI has already initiated the process of establishing Small Enterprises Financial Centres in select clusters. Risk profile of each cluster to be studied by a professional credit rating agency and such risk profile reports to be made available to commercial banks. Adoption of at least one cluster by each lead bank of a district.

vii. A system for monitoring and review was also proposed in the package.

2.1.11 Effective policy environment supporting growth and development of SMEs has three distinct advantages. SMEs enhance competition and entrepreneurship and thus enhance efficiency and productivity growth and encourage innovation. SMEs are generally more productive than large firms but are impeded by failure of an enabling environment. Growth of SMEs boosts employment more than the growth of large firms because SMEs are more labour intensive. In spite of constraints, MSMEs are contributors to the economy. Encouraging SMEs may, therefore, help generate employment and reduce poverty, especially in a nation like ours where the agriculture sector is not in a position to absorb more persons.

2.2 ADVANCES TO MSME SECTOR

2.2.1 The Third Census of Small Enterprises was conducted by Small Industries Development Organisation during the year 2001-02. Summary of the results of the Census is placed at Annexure III. Some of the findings of the Census are as under.

SN	Characteristics	Registered small enterprises Sector	Unregistered small enterprises Sector	Total small enterprises Sector
1	Size of the sector (number)	**13,74,974**	**91,46,216**	**1,05,21,190**
2	No. of rural units	**6,09,537 (44.33%)**	**51,98,822 (56.8%)**	**58,08,359 (55.00%)**
3	No. of small enterprises (Manufacturing and processing units) (Fig in bracket is % of SN 1)	**9,01,291 (65.55%)**	**35,44,577 (38.75%)**	**44,45,868 (42.26%)**
4	No. of SSSBEs (Service enterprises) (Fig in bracket is % of SN 1)	**4,73,683 (34.45%)**	**56,01,639 (61.25%)**	**60,75,322 (57.74%)**
5	No. of ancillary units (% of SN 3)	**45,797 (5.08 %)**	**86,516 (2.44 %)**	**1,32,313 (2.98 %)**
6	No. of tiny units among small enterprises (i.e. units having investment in plant and machinery upto Rs 25 lacs)	**8,82,496 (97.9 %)**	**35,43,091 (99.9 %)**	**44,25,587 (99.5 %)**
7	No. of units having outstanding loan as on 31-3-2002	**2,76,333 (20.1 %)**	**5,01,306 (5.48 %)**	**7,77,639 (7.39 %)**
8	No. of units having outstanding loan with institutional sources as on 31-3-2002	**1,96,137 (14.26 %)**	**2,82,267 (3.09 %)**	**4,78,404 (4.55 %)**

Table 2.2: SUMMARY RESULTS OF THE THIRD CENSUS OF SSIs 2001-02

Source : Ministry of MSME

2.2.2 Several initiatives are being taken to encourage the development of SMEs and improve their access to finance. Notwithstanding these initiatives, impediments to SME finance remain, which constitute the single most important factor that could circumscribe their growth trajectory.

The flow of credit to small enterprises sector from 1996-97 to 2006-07 is given below. It is observed therefrom that there has been constant growth in Gross Bank Credit and advances to small enterprises sector. While there is an increase in credit to small enterprises sector in absolute terms (except in one year), the percentage of small enterprises credit to GBC for scheduled commercial banks has come down significantly from 12.60% to 6.34%. In other words, the credit to small enterprises has not grown commensurate with the growth of gross bank credit. The growth in GBC over the last few years has been mainly on account of a spurt in retail lending, which has shown an annual growth of 46% during the period 2002-03 to 2005-06. This has led to increase in the share of retail credit in overall bank credit from 6.4% in 1990-91 to 25.5% in 2005-06. Advances to infrastructure, which are large ticket accounts, have grown at fast pace to Rs. 142975 crores as on March 2007 from Rs. 5941 crores in March 1999. The growth rate of advances to infrastructure sector have been consistently high, even exceeding 100% in the year 2002-03 (the year in which the growth rate in advances to small enterprises had become negative at -3.58%). The growth rate of advances to infrastructure sector has come down to 43% in 2005-06 and 27% in 2006-07. This growth has contributed to the recent expansion in overall bank credit. The policy package announced by the Hon'ble Finance Minister for improving the flow of credit to MSME sector has yielded results and the rate of growth of advances to small enterprises in the year 2005-06 was more than 20%, a level not seen in the last 10 years. In the subsequent year also the rate is an impressive 15%+. The banks are on course to achieve the target of doubling the credit to MSE sector in 5 years timeframe. However, despite good growth of 17% in 2004-05, 21% in 2005-06 and 15% in 2006-07, advances to small enterprises sector has shown a decline as a percentage of GBC.

(Rs. Cr)

Year	Gross Bank Credit	Growth over last year	Credit to Small Enterprises sector	Growth over last year	Small Enterprises Credit: Gross Bank Credit %
1996-97	301698	18.77%	38196	11.53%	12.66%
1997-98	352696	16.90%	45771	19.83%	12.98%
1998-99	399436	13.25%	51679	12.91%	12.94%
1999-00	475113	18.95%	57035	10.36%	12.00%
2000-01	558766	17.61%	60141	5.45%	10.76%
2001-02	680958	21.87%	67107	11.58%	9.85%
2002-03	778043	14.26%	64707	(-)3.58%	8.31%
2003-04	902026	15.94%	71209	10.05%	7.89%
2004-05	1045954	15.95%	83498	17.26%	7.98%
2005-06	1443920	38.05%	101385	21.42%	7.02%
2006-07	1841978	27.57%	116908	15.31%	6.34%

Table 2.3: FLOW OF CREDIT TO SMALL ENTERPRISES *Source : RBI*

2.2.3 Advances of scheduled commercial banks to small enterprises sector are declining as evidenced from the table below. The situation is alarming when it comes to tiny sector. Credit to small enterprises and micro enterprises from Scheduled Commercial banks is given hereunder

(Rs. Cr)

SN	Particulars	2002-03	2003-04	2004-05	2005-06
1	**Gross Bank credit**	**778043**	**902026**	**1045954**	**1443920**
2	**Credit to small enterprises**	**64707**	**71209**	**83498**	**101385**
3	**Credit to Micro Enterprises with investment in P&M up to Rs. 5 lakh**	**15080**	**13677**	**14482**	**17308**
4.	**3 as %ge of small enterprises credit**	**23.3**	**19.20**	**17.37**	**17.07**
5	**Credit to Micro Enterprises with Investment in P&M up to Rs. 25 lakh**	**28976**	**28547**	**28530**	**34980**
6	**5 as %ge of small enterprises Credit**	**44.8**	**40.1**	**34.16**	**34.50**
7	**5 as percentage of GBC**	**3.7**	**3.1**	**2.7**	**2.4**
8	**3 as a percentage of GBC**	**1.94**	**1.52**	**1.38**	**1.19**

Table 2.4: SHARE OF SMALL ENTERPRISES IN GBC *Source: RBI*

The above data reveals that

1. Share of credit to enterprises having investment upto Rs 5 lacs in plant and machinery as a percentage of SSI credit has declined from 23.3% in 2002-03 to 17.07% in 2005-06. When compared with gross bank credit these advances show a decline from 3.7% to 2.4%.
2. Advances to micro enterprises have declined from 44.8% in 2002-03 to 34.50% of small enterprises credit in 2005-06. This is against the RBI stipulated level of 60%.
3. While the data of financing to small industrial enterprises under Government sponsored programmes like PMRY, REGP, SGSY etc is not available, it is expected that a major share of small accounts would be under these schemes.

2.2.4 The high exclusion rate in small enterprises sector (95.5% as per the Third Census of small enterprises conducted during 2001-02), lower than stipulated performance of the banks in extending credit to micro and tiny micro enterprises and the concentration of loan accounts in rural and semi urban areas, indicate towards strengthening the points of delivery in quantity and quality in the rural and semi urban areas. Unlike in agriculture, where the security is in the form of standing crop and monitoring can be done over large areas, the branch is required to closely monitor the working of the borrowers in small enterprises sector. Rural and semi-urban branches do not have adequate reach for the same, especially as the branches are not evenly spread geographically.

Besides other remedial measures discussed in the subsequent chapters, the banks shall have to expand their branch network in such a way as to ensure availability of banking facility in the near vicinity of the MSMEs.

2.2.5 Summary of the findings of Third Census of small enterprises conducted by SIDO in 2001-02 is placed at annexure III. It is seen from table 2.1 that the number of units in small enterprises sector has progressively increased over the last 7 years. The annual increase in number of units was of the order of about 4 lakh units. This has significantly contributed towards production and employment. Though several steps have been taken in the past for upscaling the sector, there is an urgent need to provide more support in order to fully exploit the potential of the sector. It is also observed from the Third Census, a large number of small enterprises rely on non formal sources of finance such as saving, family & friends and informal sectors i.e., money lenders. Only a small fraction of SMEs have access to formal sector finance. A lower share of bank credit in the total financing is systemically lower for SMEs. This phenomenon extends across the development spectrum i.e. underdeveloped to highly developed countries. Asymmetric information, low economies of scale for lenders, high demand for collateral, high risk perception towards small enterprises are reasons for poor credit flow from formal sector to SMEs.

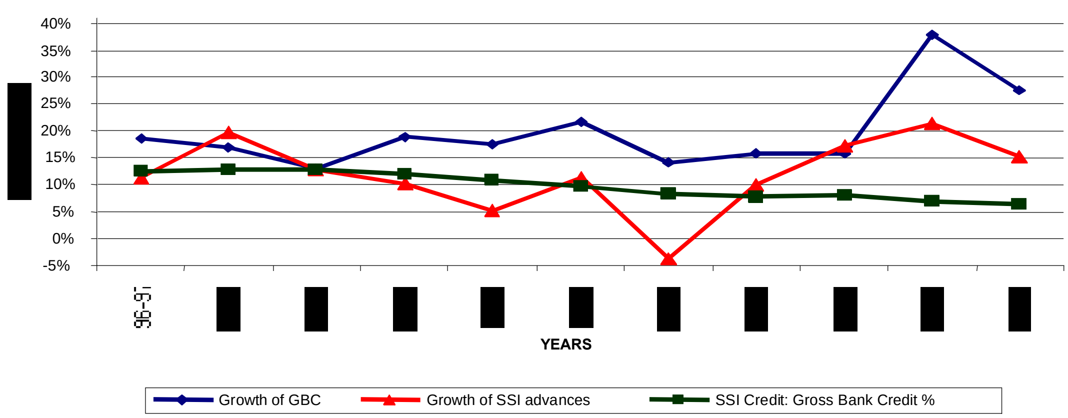
3. FLOW OF FUNDS

3.1 The Doing Business Survey conducted by the World Bank places India very low. However, the profitability of the corporate sector in India is among the highest in the world. It appears that starting a business enterprise is difficult in India. However, once the project is established, there is growth. Apparently, the banks are not adequately geared to finance new ideas and new businesses. The available data reveals that the banks predominantly finance to urban and metropolitan sectors which account for an overwhelming share of credit. Further, the pattern of funding remains skewed towards larger firms, presumably due to the perceived safety and ease of lending giving greater comfort. With improved profitability, the requirement of funds by the corporates has come down leading to a greater competition amongst the banks for financing them and consequently a low(er than BPLR) interest rate regime. Financing new entrepreneurs, ideas and products requires greater efforts but in the given scenario of low returns from the larger businesses, the banks will have to shift to newer businesses.

3.2 The weakness in the MSME sector and the urgency of addressing the same has been well recognised by the policy planners. As already discussed, there is a need for improving the points of delievery of credit in quantity and quality to meet the requirement of MSME sector. A large number of institutions namely, commercial banks, SFCs/SIDCs, RRBs, cooperative banks, Exim Bank, SIDBI etc are presently engaged in credit dispensation to MSMEs.

Comparative position of credit to the small enterprises sector from the scheduled commercial banks is placed at Table 2.3. The graphical representation of the data is as under.

Figure 3.1 GROWTH OF ADVANCES TO SMALL ENTERPRISES IN SCHEDULED COMMERCIAL BANKS



GROWTH OF MSME SECTOR

3.3 The high rate of NPAs in small enterprises sector has created risk aversion among lenders, which has hindered increase in flow of credit to the sector. The non credit related factors responsible for slow growth rate of small enterprises sector are non-availability of power and other infrastructural facilities, delay in getting clearance from different agencies, prevailing condition of the economy, lack of entrepreneurship development infrastructure and historical/social factors etc. Still, states that give due importance to this sector and have provided adequate infrastructure and enabling environment have seen good growth in small enterprises sector. However, there is tremendous potential for growth of MSME due to its inherent strength to contribute to the economy of the nation. The growth, although, has not been commensurate with the requirement for a variety of reasons. The Group interacted with a crosssection of stakeholders viz banks, RRBs, MSME Associations etc and their views on the reasons for slow growth rate are as under:

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIRECTOR OF IND(4)	ENTREPRENEURSHIP DVPT INSTTS (2)	TOTAL (53)
INADEQUATE MARKETING CAPABILITY	11	5	6	1	1	24
LACK OF INFRASTRUCTURE	10	5	2	4	1	22
DELAYED AND INADEQUATE FINANCE	8	1	8	3	1	21
LACK OF MANAGERIAL COMPETENCE	8	2	5	1	2	18
OBSOLETE TECHNOLOGY	10	2	5	0	0	17
TOUGH COMPETITION	5	3	5	0	1	14
HIGH COST OF FUNDS	4	1	6	1	1	13
DELAY IN GOVERNMENT CLEARANCES	5	1	7	0	0	13
DELAYED REALISATION OF RECEIVABLES	4	1	2	0	0	7
CREATION OF AWARENESS	4	1	0	0	2	7
OTHERS	29	7	29	5	6	76

Table 3.1: REASONS FOR POOR GROWTH OF MSME SECTOR

(The number of respondents has been given in brackets in the first row. The number of respondents who attributed the cause given in first column is given in the columns. The total of the numbers given in the columns may not be equal to the number of respondents as more than one reasons have been attributed by them.)

It is observed from the above that the banks consider marketing problems, inadequate infrastructure, and technology related issues as major hindrances to growth. Besides these reasons, RRBs consider lack of managerial competence as another important factor for poor growth. MSME Associations have stated that delayed availability / shortage of funds, non-responsiveness of the government departments, high cost of funds, inadequate infrastructure and marketing problems are the major reasons for poor growth of MSMEs. Directors of Industries and EDIs have also opined on the same lines. We have tried to address these issues in our recommendations.

3.4 **CREDIT RELATED ISSUES**

3.4.1 There is lack of transparency in accounts of small enterprises and their accounts are not based on accounting standards and generally accepted accounting principles. Non-maintenance of proper records by MSMEs is also a problem indicated by the banks during interactions. It is indeed difficult for the banks to assess the capacity of the enterprise to repay.

3.4.2 A banker's risk perception towards SMEs is heightened by the poor historical performance of SME loan portfolios, particularly loans extended by the public sector banks, which account for more than 90 per cent of all lending to SMEs. Incidence of NPAs in total advances and small enterprises for public sector banks is compared in the table given below.

(Rs. Cr)

Year	**Small Enterprises Advances**	**Small Enterprises NPA**	**Net bank credit**	**Total NPAs**	**Small Enterprises NPA: Small Enterprises Adv**	**Total NPA: Net Bank Credit**
2001	48400	10339	341291	53174	21.36%	15.58%
2002	49743	10584	396954	56506	21.28%	14.23%
2003	52988	10162	477899	52806	19.18%	11.05%
2004	58278	8838	558849	50148	15.17%	8.97%
2005	67634	7835	717304	47696	11.58%	6.65%
2006	82434	6917	1017604	41378	8.39%	4.07%
2007	104703	5843	1317705	38602	5.58%	2.93%

Table 3.2: INCIDENCE OF NPA IN ADVANCES OF PUBLIC SECTOR BANKS TO SMALL ENTERPRISE *Source: RBI*

While these banks have large SME portfolios, the non-performing assets (NPAs) have been extremely high. These NPAs have been gradually coming down from 21.36% in 2001 to 5.58% in 2007 but the level of gross NPA has reduced from 15.58% to 2.93% during this period. Thus despite reduction of NPA in small enterprises by 75%, they still stand at double the NPA level in total advances as on 31-03-2007. In absolute terms almost Rs 6000 crores of PS banks are blocked in small enterprises NPAs. Hence these banks are risk averse to expanding their small enterprises portfolio. A few of the new banks report very low NPAs in their total SME portfolio. However, the NPAs of the public and new private sector banks are not directly comparable as the private sector banks have newer portfolios and losses may not yet be recognizable.

3.4.3 45% of the respondents in the survey conducted by us have stated that marketing problems contribute to poor growth of MSME sector. The suggestions of the respondents for improving the growth of MSME sector are as under.

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIRECTOR OF IND(4)	ENTREPRENEURSHIP DVPT INSTTS (2)	TOTAL (53)
ORGANISED MARKETING EFFORTS	8	6	5	1	1	21
PROPER INFRASTRUCTURE	8	6	3	2	1	20
TECHNOLOGICAL UPGRADATION	13	1	5	0	1	20
SKILL DEVELOPMENT	9	4	2	1	0	16
TRG FOR MANAGRIAL COMPETENCE	7	2	3	1	1	14
ADVISORY/ TECH SERVICES	9	1	3	0	0	13
PROMPT SANCTION AND ADEQUATE FINANCE	5	1	4	2	1	13
ENTREPRENEURSHIP DVPT	6	0	2	1	2	11
CHEAP LOANS	5	0	5	0	0	10
SINGLE WINDOW CLEARANCE	3	2	3	1	0	9
OTHERS	28	11	30	7	3	79

Table 3:3: SUGGESTIONS FOR GROWTH OF MSME SECTOR

The major steps for improving the growth of the MSME sector suggested by the respondents are organised marketing efforts, availability of proper infrastructure, technological upgradation, skill development and training/advisory services. The banks have, however, opined that technological upgradation would contribute the most in the growth of the sector.

3.5 <u>SUGGESTIONS FOR FLOW OF FUNDS TO MSMEs</u>

The views of the respondents on steps required for improving flow of funds to MSME sector are given hereunder.

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIRECTOR OF IND(4)	ENTREPRENEURSHIP DVPT INSTTS (2)	TOTAL (53)
CHEAP LOANS	5	1	5	3	0	14
PROMPT SANCTION	3	2	3	3	1	12
TRG TO BANK STAFF FOR CREDIT AND REHAB	5	1	2	1	0	9
CREDIT GUARANTEE ORGANISATION	4	1	2	1	0	8
SPECIALISED BRANCH EXPANSION	5	1	0	0	0	6
SPECIAL CREDIT PRODUCTS FOR MSMEs	3	0	3	0	0	6
COLLTERAL FREE LOANS	1	1	3	1	0	6
DELEGATION OF POWERS TO BRANCH MANAGER	5	0	0	0	0	5
CREDIT RATING INSTITUTION	3	0	1	0	0	4
SIMPLIFIED APPLICATION/ APPRAISAL FOR LOAN UPTO 1 CRORES	3	0	1	0	0	4
OTHERS	0	4	6	0	1	11

Table 3.4: SUGGESTIONS FOR IMPROVING FLOW OF CREDIT TO MSME SECTOR

The banks, MSME Associations and the Directors of Industries have given the highest weightage to reduction in the cost of the loans for improving the flow of funds to the sector. The other steps suggested are prompt sanction of loans, sanction of collateral free loans or CGTMSE coverage and training to bank staff on issues relating to credit and rehabilitation.

The Group also made extensive interaction with the different stakeholders, which include small entrepreneurs, their associations, banks, State Governments etc. Various meetings and seminars were conducted so as to get maximum responses from various quarters. On the basis of these interactions and suggestions received, the Group has selected the following areas for improvement in flow of funds to MSME sector.

3.6 SIMPLIFICATION OF PROCEDURES FOR FINANCING MSMEs

In the survey conducted by the Group, simplification of procedures and prompt sanction have been given top priority by 14% of the banks, 19% associations, 25% of Director of Industries and 44% of the RRBs. Apart from the survey, various meetings with entrepreneurs and their associations reveal that delay in sanction of limit and complex procedures in sanction is one of the reasons for paucity of funds for MSEs. The above section of entrepreneurs has limited resources and has no other source of livelihood. Therefore, they cannot afford to engage professionals and Chartered Accountants to prepare detailed feasibility reports, CMA data etc.

3.6.1 TERM LOANS

In order to simplify the procedure for sanction of term loans for a new project, a system similar to projected turnover method may be introduced. It has been observed that the first generation entrepreneur, having little or no knowledge of project report preparation and viability analysis has to depend on the consultants for the same, who charge a hefty fee, and still the reports are not tailor made for the entrepreneur. Moreover banks also take considerable time to get viability study conducted at their end. There is very little customization of the viability report to the requirements of the entrepreneur. In most cases, the entrepreneur is not even aware of the projections made in the report. In order to make the process of sanction of project loans for small enterprises commonly prevailing in the area, we propose that the following system may be introduced.

a. **The niche industry or the activities having good concentration in the area may be identified by the banks and DIC.**

b. **The model cost of project for different sizes of commonly prevailing industry and the overall viability of the activity may be assessed by a Committee comprising of 2-3 major banks of the District under the aegis of Lead Bank, so as to obviate the need of any expert/professional to prepare TEV study in individual cases. The exercise may be carried periodically after considering the price of machinery and other fixed assets required, prices of raw material and finished goods, conversion cost, skilled labour availability, access to market etc. DIC may also be associated with the process. Small entrepreneurs may use these project profiles and not take help from professionals in preparation of time consuming and costly TEV study/viability report. While financing, banks should also not go for TEV study in individual cases. To begin with, this practice may be started for projects requiring terms loan upto Rs.1 crore. At a later stage, this may be raised to Rs.2 crores after a review. Cash losses that may be incurred in the initial period,**

interest during construction period and provisions for contingency should invariably included in the cost of project. Instalments may be fixed based on cash flows, and may be staggered or ballooning also.

c. **Sufficient delegation of powers for sanction/rehabilitation of SMEs should be made at the field level. The credit needs of all micro enterprises should be met by a Branch Manager of a scale II branch.**

3.6.2 **WORKING CAPITAL**

Nayak Committee had recommended a simplified procedure for sanction of Working Capital to the manufacturing units. It had recommended assessment of WC at 25% of the turnover of which 5% may be contributed by the promoters and the balance 20% may be provided by the banks.

However, our study reveals that some of the bank branches still insist for CMA data despite the fact that the borrower wishes to avail working capital under Nayak Committee norms. Bankers give various justifications for insisting on CMA data in such cases. Thus these guidelines are not implemented in letter and spirit in all cases. **This Group is of the view that in order to simplify and expedite sanction of working capital limits and also to ensure that the micro and small enterprises are not forced to take help of professionals for obtaining working capital limits, it is necessary that no CMA data or any future projections except sales are obtained for assessing WC limits under Nayak Committee. The limits should be assessed at 20% of the projected sales.** As regards projected sales, the borrower has to justify and convince the bankers.

There is a need to impress upon banks that the Nayak Committee norms should be implemented without exception. **Banks should issue clear cut guidelines to their branches that CMA data or Operating Statement, Balance Sheet, Cash Flows etc are not necessary for WC limits upto Rs. 5 crores in the MSME sector.** The need for strict implementation of Nayak Committee Norms for assessment of WC requirement and PBF cannot be overemphasized, especially in light of the views of the various stakeholders regarding delayed financing and inadequacy of limits as one of the major reasons for poor growth of MSME sector and a contributor to sickness in the sector.

3.6.3 **GENERAL**

a. Banks have started paying more attention to the rating of SMEs under the new Basel II framework. The banks increasingly use a risk sensitive approach when calculating the price of a loan. However, lack of transparency in the financial data and the inherent weakness of small enterprises make the process of rating difficult. As already identified, complicated procedures lead to delay in sanction by banks. Risk rating may further complicate and therefore delay the process of sanction.

While rating serves a laudable objective, and is likely to become more popular and practiced in the near future, **the Group feels that for smaller loans i.e. micro enterprises and the smaller small enterprises (say having total credit facilities of Rs 2 crores) scoring models may be encouraged as it is faster, simpler and makes less use of data which is less reliable. The Group suggests two models for score based lending. For micro enterprises, a simple scoring model with basic information may be used to decide the pricing as also the yes-no decision on financing, a more detailed scoring model may be utilised for small enterprises requiring upto Rs 2 crore credit facilities from the**

system. Each lending institution may develop its own scoring models based on its own perception of the importance of different parameters. Development of such models is expected to help the banks' capacity to manage and control losses. It is pertinent to note that Basel II norms permit use of scoring models for loans upto Rs 5 crores.

b. **The banks may be encouraged to tap the available technology for setting up Central Registration of Loan Applications. The same set up can be used by the borrower for tracking of the status of application on the internet on the basis of the receipt issued to him. The borrower may also be provided option of tracking his application over telephone on the toll-free helpline. The same technological setup may also be used for making online applications.** Online applications may be popularized and publicized by all branches. However, as the entrepreneurs in rural and semi-urban areas are not tech-savvy, such method of application may be made optional. **To encourage online applications, a discount in processing fees, of say 20%, may be given on such applications.** This shall introduce transparency and accountability for delays in disposal of loan applications.

c. **The application forms, especially for other than very small loans, may be so designed that all documents required to be executed by the borrower on sanction of the loan form its part. The form could be in the form of a booklet. The forms should invariably have a Checklist of the documents required to be submitted by the applicant along with the application and the formalities required to be completed post sanction.**

d. At present there is a complaint that the application form is too large and ordinarily MSEs are not able to fill them up without seeking outside consultancy assistance. A more intelligent and short application which can have the backing of a score card, cluster profile, etc. will go a long way in addressing the problems of MSMEs. **It is suggested that under the leadership of IBA, a suitable uniform, simple, short application cum sanction note could be developed on the lines of Income Tax Return Form Saral, for use by all banks and FIs. The requirement of any annexure may be done away with especially in loans upto Rs 1 crore and working capital loans under Nayak Committee norms. The forms should have columns for Scoring Model also. It should be ensured that all columns are filled up by the applicant.** This shall reduce the role of professionals who charge exorbitant fees with little value addition. **Application forms for small loans may be made available in regional languages also.**

e. In addition to a common loan form, a **Web Based Central Loan Registry may be created to provide the details of loan seekers and loan providers and enabling match making for speedy delivery and appropriate pricing.** Loan seekers may put the basic information on their project, business plans etc on the online system and the bankers linked to the registry and desirous of funding it can advise the loan seeker about their interest.

It shall act as National Loan Data Center for entrepreneurs and bankers. All the agencies shall report loan information to the center. The site shall provide detailed information on credit extended, outstanding balances, loan status, interest rates and disbursements. It shall also act as a single automated point-of-contact for organizations and individuals requiring timely and accurate verification of entrepreneurs and enterprises.

3.7 There is little coordination between the SFCs and the banks leading to non-availability of WC to the units assisted by SFCs in time, which has resulted in accumulation of NPAs in SFCs and sickness in small enterprises. To obviate this problem, the Group suggests that

3.7.1 **SFCs should invariably ensure that firm arrangements are made for working capital right at the time of sanction of term loan itself. Alternatively, the SFCs may sanction working capital term loan while extending term loan to any unit.**

3.7.2 **The working capital component should be assessed on the basis of Nayak Committee Norms. It may be given as a term loan but the moratorium may be kept at a minimum of 2 years from the date of commencement of commercial production. This moratorium will help the entrepreneur in arranging replacement finance from banks, as working capital facility from SFCs is essentially an interim measure. In other words, the arrangement should be such that eventually the working capital account is taken over by a bank over a period of time.**

3.7.3 **The term loan component may be assessed as per the procedure suggested above.**

3.7.4 **Working capital banks have a floating charge on the current assets of the unit and it is this class of assets which is eroded first in times of stress. It may be considered to have common security for both the term lenders and the working capital lenders.**

3.7.5 During our survey, it has come to our notice that banks have backed out from sanctioning/ releasing working capital facilities even after giving in-principle sanction resulting into sickness. The Group therefore recommends that **in case of micro and small enterprises, wherever in-principle sanction is given by a bank, regular working capital should also be given by the same bank well in advance of trial run.**

3.8 **Banks who have sanctioned term loan singly or jointly must also sanction WC limit singly (or jointly, in the ratio of term loan) to avoid delay in commencement of commercial production. A review may be done by all banks and it may be ensured that there should be no case where term loan has been sanctioned and working capital facilities are yet to be sanctioned.**

3.9 CENTRALISED PROCESSING FOR MSME LOANS

Micro and small enterprises are basically one man show and the promoter's energy and time are too thinly spread to be effective. The stakeholders have identified delayed and inadequate financing as the fourth biggest reason for sickness. The results of different studies have confirmed the views. Information gap of the bank staff and the entrepreneurs regarding market, financial management, technology etc are major contributors to stress in small accounts.

In order to expedite sanction and disbursement of loan to MSMEs a single window concept may be introduced. **Loan facility to small units, say Micro enterprises, should be sanctioned at the level of the branch. For larger accounts Centralised Credit Processing Cell (CPC) should be introduced. These Cells may be utilized for single point appraisal, sanction, documentation, renewal and enhancement.** The arrangement is expected to help in reduction in delay and multiple queries, utilization of the available talent in an optimal fashion besides building reliable MIS, developing fair practices and easier tracking. **Initially, the CPCs may be setup at each Regional Office of the banks and subsequently in the recognized clusters.** We have recommended that in case of micro and small enterprises simplified procedure of loan application/ sanction should be followed, score based lending be done upto Rs 2 crores, working capital limits be given by projected turnover method, and term loans be sanctioned as recommended above to prevent the burden of data collection, project report/ projections preparation for MSMEs. The disposal of applications should be done in a time bound manner, which should be within the overall time limit prescribed by RBI. **The working of Centralised Processing Cell should be reviewed by the controlling office of the bank. CPC should act as the back office of the bank. We suggest an independent CPC for MSMEs.**

Centralised processing of loan proposals is expected to be useful to the banks as the expertise available with the bank can be optimally utilized for appraisal and sanction as also for guiding the entrepreneurs.

3.10 COMMITTEE APPROACH

During its interaction with the banks, the Group was informed that accountability issue played heavily on the minds of the bankers while taking a decision on loan application for green-field projects in the MSME sector or the rehabilitation proposals. Such fears delay sanction by banks. There is a need to change the mindset of the bankers and also reduce the fear of future staff side action.

As regards the rehabilitation projects, the banks opt for the easy way out i.e. to declare the unit as non-viable and escape any possibility of being held responsible for taking additional exposure in an NPA. **We suggest that Committee Approach may be introduced for sanction of new loans as also rehabilitation packages in cases to be sanctioned at Centralised Processing Cells or higher level.** This will not only improve the quality of decision as collective wisdom of the members shall be utilised, but also alleviate the fears of the bankers as regards the accountability issues that play heavily on the minds of the bankers.

The general impression is that the Banking Companies (Acquisition and Transfer of Undertakings Act, 1970 restrains the Nationalised Banks from adopting the Committee Approach. However, the legal opinion on the issue is as under:

“In terms of Section 19(2)(c) Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 the delegation of powers to officers can also be done through Regulations.

As per clause 14 of Nationalised Banks (Management & Miscellaneous Provisions) Scheme, 1970 the Board may constitute such other committees consisting wholly of other persons (other than directors)to advise the Board and perform such duties as the Board may entrust to them. The delegation of powers can be done through Resolution also. The Board has already delegated powers to officers by designation. It can as well delegate powers to a team/ Committee of officers (by designation).

As such, there is no bar for delegation of powers to a Committee of officers."

3.11 **RATE OF INTEREST**

Small entrepreneurs have complained that large borrowers are charged interest rates below BPLR. Such units are also in a position to access cheap funds from the capital market. Small entrepreneurs in other countries have access to cheaper funds and the competitive strength of the indigenous units is compromised on account of high interest cost. The suggestion has been for reduction in the rate to BPLR-1%. There have also been suggestions of interest subvention of 5% for MSE sector.

The banks have, however, opined that BPLR is based on the cost of funds, management costs, risk margin and minimum margin etc. Further incidence of NPA adds to the cost. The basic rate of interest and the spread on the same on the basis of the risk attached is justified.

The Group undertook a small sample study of 243 units in different parts of the country to assess the veracity of the issue. It was found that the rate of interest was 2.33% of the total cost of sales for these units. We may round off this figure to 2.50% to take care of the sampling and reporting errors. Theoretically speaking also, if the total investment in a small enterprise is rotated four times in a year, the presently charged maximum interest rate of BPLR + 2% (14%) comes to 3.50% of turnover, which is not high. Interest cost at this fraction of cost of sales is very reasonable and **it is felt that any reduction in the rates of interest for MSMEs is not warranted at this stage.**

At present interest rates for loan amounts upto Rs 2 lacs are regulated. In the present era of liberalisation, the rates should be determined by market forces for all amounts. We suggest that interest rates on loans may be completely deregulated. The rating based pricing takes care of the issue as units with good rating and having transparent financials and good management practices are able to obtain loans at lower interest rates.

Any enterprise would engage in activities that are remunerative to it. If the rate of interest for any sector is reduced below a level that affects their bottomline, the banks may shy away from lending to the sector. Thus reduction in rate of interest may become counterproductive for the sector.

3.12 **NON AVAILABILITY OF MARGIN OR/AND COLLATERAL**

The results of our survey show that non availability of promoters' contribution has acted as a deterrent for growth. Very often, it has also been a factor for failure of rehabilitation packages. It has been informed by some entrepreneurs that they were unable to get enhancement as they did not have enough liquidity to provide the required margin, although adequate collateral security was available. The very concept of margin is to ensure a stake of the promoters in the project so that the feeling of ownership is there. If an entrepreneur provides additional collateral, his stake in the project is committed. But the banks as also their rating processes do not take cognisance of the same. Similarly collateral security provides comfort to the lenders as it ensures commitment of the borrower to the project and is also available to them for recovery in the event of failure of the enterprise.

In order to overcome the problem of shortage of liquidity, the banks may be encouraged to accept interchangeability of margin and collateral so as to enable the borrowers having poor liquidity to provide additional collateral without inducting funds and the banks accordingly reducing the margin. This reduction may be permitted even upto zero percent levels. Conversely, promoters having liquidity but little collateral, may provide higher margins and the banks may accept lower collaterals or not insist for collateral security in such cases. This arrangement can be very useful in case of borrowers having poor liquidity or little collateral.

3.13 **<u>RAISE IN THE LIMIT OF COLLATERAL FREE LOANS</u>**

As per the extant RBI guidelines, the banks should not accept any collateral security for advances upto Rs 5 lacs made to units in MSE sector. **RBI may consider raising the limit of compulsorily collateral free loans from Rs 5 lacs to Rs 10 lacs incentivized by 80% coverage under CGTMSE.** A very large number of micro and small enterprises would be covered in this credit bucket.

3.14 **<u>PROMOTERS' MARGIN</u>**

SMEs function with limited funds. In case of large supplies/ delayed realisation of receivables, or large purchases, the total funds get blocked in receivables or stock. In such circumstances it cannot avail the same due to straight-jacketing of the same by the banks. **It is suggested that the banks should consider a combined level of stock and receivables and no separate sub limit for debtors should be fixed. Banks should allow CC/OD against stock and receivables under one facility only. Differential margin on limits against stock and receivables would also be automatically avoided.** Further, in order to avoid difficulty faced by some entrepreneurs due to release of limits only after availability of DP, banks should also consider allowing DP against advances to suppliers, wherever such payment has been made to supplier through the bank.

3.15 **<u>CURRENT RATIO UNDER NAYAK COMMITTEE</u>**

In terms of the Nayak Committee norms, the banks are required to provide minimum 20% of the turnover to the business enterprises as bank finance and 5% is to be obtained as margin. This translates into a current ratio of 1.25. However, the guidelines of banks, the rating models etc provide for a current ratio of 1.33. **RBI may issue necessary clarification that a current ratio of 1.25 is acceptable in accounts where bank finance is provided under Nayak Committee norms.** Such change in the norms shall also take care of the problems of a large number of MSEs, who face the problem of shortage of promoters' contribution. Current ratio of such units normally remains below 1.33.

3.16 Small enterprises normally face teething problems and it takes time to establish quality of product and market. Initially to establish the market, they have to sell the goods without any profit margin or sometimes at loss. It is felt that interest during the period from commencement of commercial production till the unit is in a position to earn profit should also be considered as a part of the cost of project. **We suggest that interest of at least 6 months after commercial production be included as a part of the project cost. Sufficient moratorium of say 2 years for repayment of the principal should also be given.** It will prevent cases of incipient sickness at the commencement of production and help units to establish themselves in the market at the beginning.

3.17 TRANSPARENCY IN FINANCIAL DATA

Lack of transparency in the financial data prepared by MSMEs has been an area of concern. Proper records supported by vouchers are not maintained. Businesses are not required to get the accounts audited if the turnover is less than Rs 40 lacs (Section 44AB of Income Tax Act). Tax considerations may also be one of the reasons. The banks either do not finance or look for more than warranted security cover leading to delayed or inadequate financing. **MSME Associations should be playing a greater role in educating their members on the need for financial transparency.**

RBI had earlier prescribed requirement of audited accounts for all borrowers availing facilities of Rs 10 lacs and above. Subsequently, it was left to the discretion of the banks. Though audit would strengthen the accounting systems and the comfort of the lenders, **we suggest that audited accounts may not be insisted upon by the banks from micro enterprises (turnover not exceeding Rs 40 lacs)** so that they may not be burdened with procedure of audit etc. **However, for all other MSMEs, audited accounts should be insisted upon by the lenders.**

3.18 SIMPLIFIED ACCOUNTING STANDARDS

Larger SMEs in corporate sector have to follow the format of Schedule VI as prescribed in Companies Act and accounting standards prescribed by ICAI. The format and accounting standards are the same in case of large and global companies also. SMEs are not in a position to follow the same formats, procedures and accounting standards. **As simple Companies Act is under formulation, we are of the opinion that simple disclosure norms, which should not be in excessive technical format, should be prescribed. Exemption from certain disclosures and relaxation from certain procedures/ compliances in Accounting Standards may also be allowed. If felt necessary a separate Accounting Standard for small enterprises may be formed.**

3.19 CREDIT APPRAISAL AND RATING TOOL (CART)

SIDBI has developed and put into use a web technology based platform neutral appraisal and rating tool for processing the credit proposals received from SMEs with a view to reduce the processing time. The appraisal rating in this software tool analysis and work flow feature helps the user institutions to reduce paper work and consequently, turnaround time. This was originally done for loans upto Rs. 50 lakh and based on satisfactory experience the cap was raised to Rs. 100 lakh. It has also brought about a couple of variants for appraising loans upto Rs.10 lakh, working capital facilities and for green-field projects as well. The software has been supplied free of cost to banks who have signed MOU with SIDBI and SFCs. The feed-back has been positive. **The Group therefore recommends that Banks may develop appropriate Credit Appraisal and Rating Tool (CART) on the pattern of software developed by SIDBI or can take the help of such tools developed by SIDBI for loan/working capital facilities to small and medium enterprises.**

3.20 **<u>OTHER ISSUES</u>**

a. **<u>SENSITISATION OF BANK STAFF TO THE NEEDS OF MSME SECTOR:</u>** There is a need for sensitisation of the staff towards the needs of small entrepreneurs. The banks should develop systems such that the field staff is regularly updated and is equipped to appraise the financial requirements of MSMEs, assess the technology proposed, the optimum size etc. **The banks should use the platform provided by the technical institutions and send their staff to such institutions on a regular basis. Training is also required to be imparted to the branch managers and their loan officers for change in their mindset, away from the perceived risk in financing MSMEs. A system of incentives for good performance in financing to MSMEs may be implemented, which may be by way of special mention in the Performance Appraisal, special training etc.**

b. **<u>OPENING OF MORE "SPECIALISED MSME BRANCHES":</u>** The need for qualitative and quantitative improvement in the points of credit delievery has been identified as an important step for improving the flow of funds. We, accordingly suggest that **the banks may focus on opening more specialised MSME branches. The expansion of specialised branch network in all identified clusters and Industrial Estates should be completed in a time bound manner say within next 3-5 years. There should be a Cell headed by an officer in scale III or scale IV in each Regional Office which should be assigned exclusive duty of development of micro and small enterprise advances and helping units in rehabilitation and restructuring and counselling the units which are in trouble.**

c. Third Census of Small Enterprises had revealed that only about 5% of the small enterprises were availing loans from the institutional sources whereas 3% were availing this facility from non institutional sources. As a result of the efforts of the Government and the banking system, the absolute number of units availing loans from the formal system would have gone up but it is difficult to say if the percentagewise picture has changed, keeping in view the change in the industrial climate since the Third Census was conducted in 2001-02. The efforts of the system have been focussed on bringing the excluded 92% of the units into the fold of formal banking system. The 3% units taking financial assistance from the non institutional sources have not got the attention of the policy makers. **We suggest that RBI may come out with some model guidelines on financing of MSMEs for replacement of the debt being availed by them from the non institutional sources. The banks, may then formulate their own policies and guidelines based on these model guidelines.**

d. Multiplicity of authorities for registration of charges leads to problems for lenders and procedural delays. We suggest that **there should be a Central Registry for registration of charges of all banks and financial institutions in respect of all moveable and immovable properties of borrowers incorporated as sole proprietorship, partnership, association of persons, cooperative societies, trusts, joint stock companies etc.**

3.21 <u>NEW FINANCIAL PRODUCTS/SERVICES</u>

The banks are offering traditional products to SMEs. However, based on the experience and looking into the difficulties faced by the small and medium enterprises, there is a need that the banks come out with new products to ensure availability of adequate funds, as non availability of funds with the promoters has been often identified as one of the major reasons hampering growth of MSME sector and rehabilitation efforts in case of sickness. Besides, the poor financial position of promoters, vulnerability of the sector as perceived by banks/FIs, delayed realisation of receivables and availability of limited avenues and products for financing to the sector also contribute to the problems of the units.

a. <u>POST SALES FACILITIES</u>

Delayed realisation of receivables has been identified as one of the reasons for poor growth of MSMEs, and as a major contributor to sickness by all stakeholders. We have suggested a combined limit against stock and receivables to take care of this problem. However, if due to any reason the lenders are not in a position to permit combined limits, they may consider the following arrangement.

RBI has been insisting for encouraging post sales limit for bills discounting. In case of SMEs, most of the buyers are large corporates who are reluctant to accept the bills drawn by the small enterprises. Delayed payment from the large corporates makes the flow of funds irregular resulting in irregularity in the account. In general, more than 50% of the working capital of SMEs is blocked under receivables and the sector suffers for want of liquidity. We propose that **in case the borrower desires, the banks may consider 50% of the working capital as post sales limit. This may primarily be allowed under CC (BD)/ bills discounting/ Cheque discounting. This facility may be provided at a lower margin of say not more than 30%.**

b. <u>FACTORING SERVICES</u>

Delayed realisation of receivables has been adversely affecting the liquidity of small units. Although two public sector banks have setup separate subsidiaries for taking up factoring activity and a few private sector banks are engaged in factoring, **we suggest introduction of Factoring Services by all banks may be encouraged**, **particularly for MSMEs.** At present there is no separate Act governing the Factoring Services. There is a need to bring change in the legislative environment for factoring and make the process easier. There is no incentive for the banks to take up the activity. **This may be alleviated by**

1. **Refinance at concessional rates from SIDBI/ RBI may be introduced.**
2. **Bringing in appropriate legislation for factoring.**
3. **Stamp duty is payable on assignment of actionable claims. Modification in these provisions for factors by way of exemption or prescribing a ceiling on the stamp duty would give impetus to the activity.**

c. **STOCK EXCHANGE FOR SMEs**

Any progressive and growing organisation requires funds to finance its growth. The promoters may not always be in a position to infuse the required funds from their own sources or borrow beyond a limit. While the capital market in India has been buoyant, SMEs have not been able to take advantage of this due to the inherent problems like issue size, turnover limit, cost of issue, etc. It is therefore felt that there is a need for enabling them to access the capital market for facilitating growth of these enterprises. Although in the past OTCEI was set up to facilitate small enterprises and investors, this experiment did not work well. It is therefore recommended that **an Exchange with focus on SMEs, with relaxed listing requirements, may be set up at the earliest, preferably with the involvement of NSE (the trading partner) and SIDBI (SME focal point).**

SEBI should come out with simplified disclosure and listing norms for IPO and cost effective norms for publication/ declaration, so as to enable the SMEs to come out with IPO at an affordable cost and within a reasonable time.

d. Small enterprise advances are a part of the Priority Sector as defined by RBI. This sector is included in the Priority Sector for public, private and the foreign banks. All categories of banks have to make advances to MSME sector. However, private banks and foreign banks have limited presence in rural and semi urban areas. Normally SME advances of a bank active in the area remain on its books till their liquidation. **Securitisation of SME needs to be encouraged as the same shall provide a market for such lenders active in rural and semi urban areas to market them to foreign and private banks.** Once securitisation of the SME debt is stabilized, foreign banks, PE players and venture capitalists would take an active part in such indirect SME financing.

e. Hon'ble Finance Minister, while presenting the Union Budget for 2008-09, has announced setting up two Funds of Rs 2000 crores each with SIDBI – one for risk capital financing and the other for enhancing refinance capability of MSME sector.

i. We propose that **another independent Rehabilitation Fund may be created for rehabilitation of sick micro, small and medium enterprises as it has been observed that rehabilitation of sick SMEs could not be taken up due to non availability of promoters' contribution in a large number of cases. The fund may have a corpus of Rs 1000 crores. While 75% of the corpus could be earmarked for assisting the micro and small enterprises and balance could be utilized for assisting medium enterprises.** The very purpose of having two separate windows is to ensure that the small enterprises get their due share. This fund may be utilized for providing soft loan at a concessional rate of interest, say 5-6%/ quasi equity upto 50% of the required promoters' contribution subject to a maximum of Rs 75 lacs.

ii. Similarly, another fund may be created for contributing to the margin required to be brought in by the promoters of units taking up technological upgradation. This assistance may be provided in the form of a soft loan.

iii. Many units fail because of poor marketing or inability to compete with large players in the market who spend enormous amount on advertisements and sales promotion. **In order to encourage MSME units to market their products, it will be desirable to set up a Marketing Development Fund which could inter-alia, be used for providing financial assistance in setting up distribution and marketing infrastructure/ outlets. This Fund can also be utilised for providing resources to institutions/organisations organizing exhibition etc at various levels.**

iv. **National Equity Fund Scheme should be restarted by setting up a fresh corpus by GoI. This fund could be utilized for green field or expansion projects. This fund may be operated through banks on risk sharing basis. The NEF contribution in the form of soft loan may be restricted to 15% of the project cost for micro enterprises and 10% for small enterprises. At least 30% of the funds may be earmarked for micro enterprises.**

v. In USA, The Investment Company Act of 1958 established the Small Business Investment Company (SBIC) Program, under which Small Business Administration licensed, regulated and helped to provide funds for privately owned and operated venture capital investment firms, which specialized in providing long-term debt and equity investments to high-risk small businesses. It was to ensure that small businesses could get the credit they needed to keep pace with technological advancement. Similarly, **in order to encourage the entrepreneurs to innovate new ideas, it is necessary that venture capital should be encouraged. There should be a separate fund with SEO/ SIDBI which should help such venture capital funds in meeting the finance requirements of small enterprises.**

vi. **As an incentive for proper restructuring package at the time of rehabilitation, necessary support for business restructuring, modernisation, expansion, diversification and technological upgradation as may be felt necessary by the lenders may also be encouraged. Support of schemes like Credit Linked Capital Subsidy Scheme in case of units in other (than rural) areas, KVIC Margin Money Scheme (for units in rural areas) may be extended for rehabilitation packages also.**

Venture Capital Funds/ FIs/ banks/ Private Equity investors may be encouraged to take share in the equity/ mezzanine financing and other products. However, **in those cases where the borrower is either a non corporate entity or an unlisted company, the exit route should also be stipulated by way of buy back of shares at a specified rate of return to the investor.**

f. A suggestion has come that small companies may come together to jointly issue bonds, commercial papers etc. This can also be done by various ancillaries of large manufacturers. The Working Group has examined the issue and we are of the opinion that **joint issuance of paper is possible only through trusteeship arrangement. We suggest that it may be tried on a pilot basis. This can also help in cluster development and joint liability of SMEs.**

3.22 **STATE FINANCIAL CORPORATIONS (SFCS)**

SFCs were set up under the SFCs Act, 1951. There are 18 SFCs in the country now. These Corporations were set up primarily as Development Financing Institutions (DFIs) and aimed at regional development through financing of mainly small enterprises in their respective areas of jurisdiction. SFCs have assisted many small enterprises set up by first generation entrepreneurs at a period when no venture capital or angel funds existed. Many large corporates of today owe their origin to these SFCs. These companies with the little and timely assistance given by the SFCs have become international giants. But ironically these SFCs could not withstand the pressure of economic liberalization and market competitiveness. Like many All-India DFIs, the SFCs also became weak institutions requiring a mid course correction. Positive results are emerging out of the efforts to revive these Corporations. However, there are concerns in putting back these Corporations on a sustainable scale of operations. Recognising their contribution to industrialization of the respective regions and having regard to the potential of these Corporations, **GOI may direct the respective State Governments to provide a one time financial support for recapitalization of viable SFCs. Those SFCs which are found unviable may be allowed to wind up their operations and the State Governments should settle the creditors/lenders.**

4. FINANCIAL INCLUSION AND MICRO ENTERPRISES

The economic activities are expanding and new ones are being created leading to improving income levels in both rural and urban areas. Riding on the growth momentum, corporate profitability has also exhibited sustainable trends. At present, our financial depth is much lower than that of peer group, although it has picked up in the recent past. While there is evidence of an increase in financial deepening, particularly during the current decade, there is a need to leverage the present stage of development for an increase in the breadth and coverage of formal finance. Deepening the financial system and widening its reach is crucial for both accelerating growth and for equitable distribution.

4.1 The Government of India appointed a "Committee on Financial Inclusion", which is headed by Dr C Rangarajan. This Committee has opined that "Access to finance by the poor and vulnerable groups is a prerequisite for poverty reduction and social cohesion. Financial inclusion denotes delivery of financial services at an affordable cost to the vast sections of the disadvantaged and low-income groups. The objective of financial inclusion is to extend the scope of activities of the organized financial system to include within its ambit people with low incomes. Through graduated credit, the attempt must be to lift the poor from one level to another so that they come out of poverty." The observations of Dr Rangarajan provide a direction for action by the banks.

4.2 Smt Usha Thorat, Deputy Governor RBI in her Independence Commemoration Lecture delivered at Central Bank of Sri Lanka in February 2008 has raised some pertinent issues on Inclusive Growth. She has succinctly brought out the meaning of inclusive growth and laid down the action plan for achieving the same as under.

"Inclusive growth", is a little more than just the benefits of growth being distributed equitably and evenly; it is the participation of all sections and regions of society in the growth story and their reaping the benefits of growth. It is important to ensure that growth takes place in agriculture, allied sectors as also in secondary and services sectors in rural areas, and amongst urban poor to provide a growing market for the goods and services produced by the expanding corporate sector."

The two basic supply-side issues to address the concerns of inclusive growth are. (i) effective credit delivery system to facilitate productive investment in employment impacting sectors especially, agriculture, micro, small and medium enterprises and (ii) large scale investment in infrastructural facilities like irrigation, roads, railways, communication, ports, power, rural/urban reconstruction and in social infrastructure such as health care, education and sanitation.

4.3 What started as an experiment for financial inclusion of the vast majority having no access to banking facilities has now become a movement. MSME Sector has a very high exclusion rate as brought out in the Third Census. Subsequent measures taken by the Government, RBI and the banks have resulted in higher exposure of the system to the MSME sector. However, the financial exclusion in percentage terms is not expected to show much change as the growth of the sector is quite high and there are a very large number of MSE units that are still outside the banking fold.

4.4 From the statistics compiled in the Third Census of small enterprises 2001-02 (summary of which is placed at Table 2.2), it is observed that average investment in plant and machinery is Rs 2.21 lacs for units in registered small enterprises sector and Rs 0.27 lacs for units in unregistered small enterprises sector. Financial exclusion of small enterprises sector is clearly brought out in the Census – only 4.55% of the units had outstanding loans from institutional sources, whereas 7.39% of the units had outstanding loans from all sources. Thus, while 4.78 lac units had access to institutional finance, almost 3 lac units relied upon non institutional sources and more than 97 lac units had no access to finance. The scenario is graphically represented hereunder.

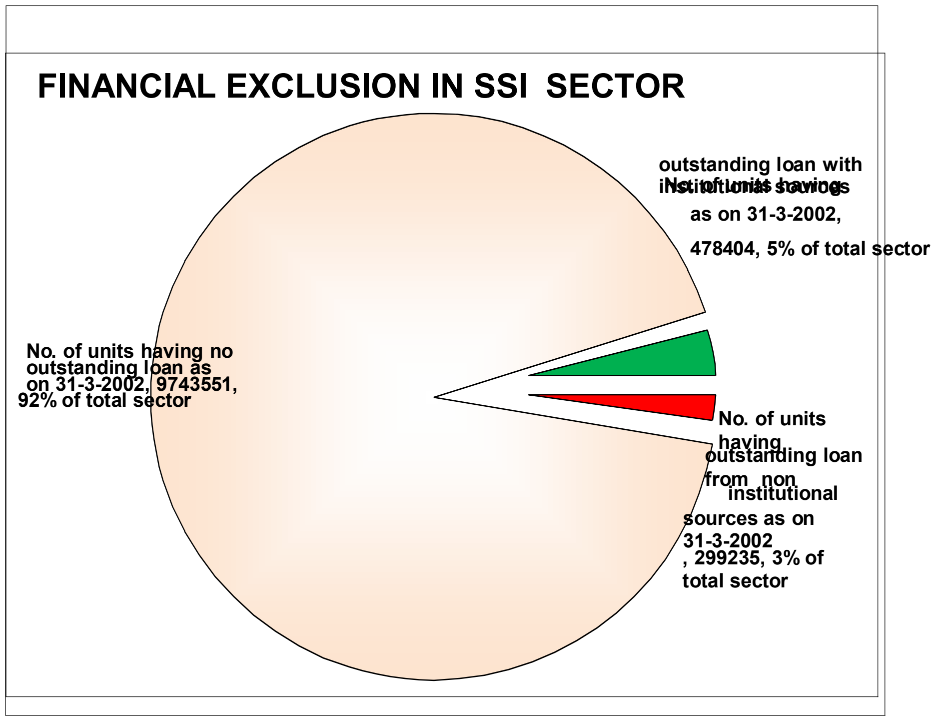


Figure 4.1: Extent of Financial Exclusion in Small Enterprises as on 31-03-2002

Source: Third Census of Small Enterprises

4.5 The data in table 2.4 reveals that only 34.50% of the small enterprises advances were to tiny sector, as against the RBI stipulation of 60%. RBI guidelines stipulate that 40% of the total small enterprises advances should go to units having investment in plant and machinery upto Rs 5 lacs. The figure for SCBs as on 31-03-2006 is only 17.07%. The performance of the banks indicates the need for a concerted approach. **We suggest that RBI may reiterate its guidelines on the sub targets for micro enterprises (60% of the total advances in MSE sector) and the tiny micro enterprises (investment in plant and machinery upto Rs 5 lacs) at 40% of the MSE advances.** Our study also shows that **there is a need to focus on finance to micro enterprises especially in North East Region, hilly areas and other backward areas. A stricter regime of monitoring of achievement of targets at the level of banks and RBI is suggested so as to ensure adequate**

flow of credit to the smaller units. Similarly, more focus is required to be given to these backward areas in case of rehabilitation.

In view of the lower than stipulated achievement of targets for advances to micro enterprises and tiny micro enterprises as a percentage of advances to MSEs, we suggest that RBI may come out with revised guidelines, wherein the target for advances to micro and tiny micro enterprises may be retained at the existing levels, but the banks may be given a timeframe of say 5 years to achieve the targets in a graded fashion. On the lines of contribution to RIDF, the banks not achieving the graded targets may be required to provide funds equivalent to the shortfall to SIDBI for creation of a fund exclusively for micro enterprises. This fund may be utilised for financing infrastructure or refinance to the lenders against their lending to micro enterprises at bank rate or for financing infrastructure for micro enterprises.

4.6 RBI data on distribution of loan accounts in rural, semi-urban, urban and metropolitan areas as on 31-03-2006 reveals that 58.36% of the total loan accounts (accounting for 18.33% of the credit amount) are in rural and semi-urban areas. The high exclusion rate in small enterprises sector (95.5% as per the Third Census of Small Enterprises conducted during 2001-02), and the concentration of loan accounts in rural and semi urban areas, indicate towards the need for strengthening the points of delivery in quantity and quality in the rural and semi urban areas.

4.7 Basic Statistical Returns compiled by RBI for March 2006 reveal that RRBs have 13908 offices in rural and semi urban areas and the average number of accounts and credit per branch is 919 accounts and Rs 2.41 crores respectively. The relevant data for all scheduled commercial banks is 46081 offices and 1082 accounts per branch with credit exposure of Rs 6.02 crores per office. Thus the RRBs need to strengthen their role as development catalysts for the rural areas.

The Group conducted a study of select RRBs on disbursal of credit to SSI sector and the findings are revealing. In the Annual Action Plan for the last five years, the budget for small enterprises ranged from 4.70% to 7.54% of the total plan. The actual performance was only 3.19% to 5.54% of the total credit. Thus, the RRBs focussed on agriculture advances and therefore, were not able to achieve even the meagre budget for small enterprises advances. In fact, while the achievement in the total plan was normally more than 100%, for small enterprises advances it was 50% - 60%. The findings of the study are presented graphically as under.

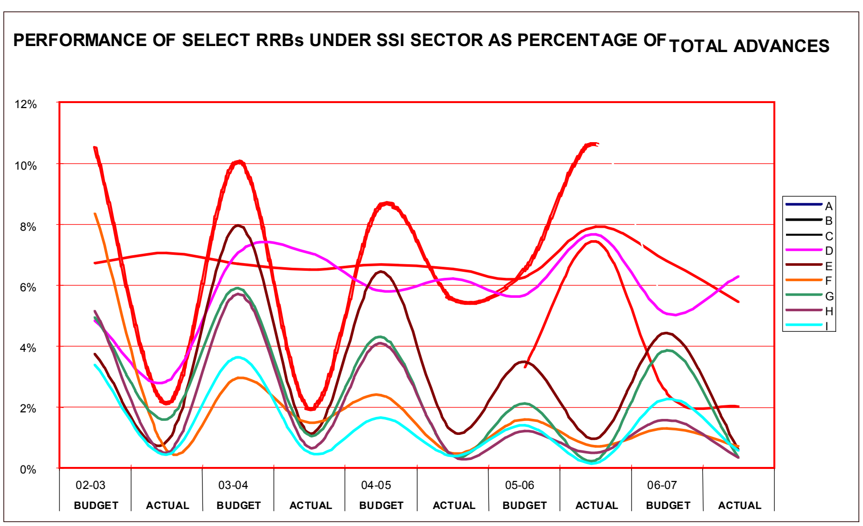


Figure 4.2: BUDGET AND ACHIEVEMENT OF SMALL ENTERPRISE ADVANCES OF SELECT RRBS

With the consolidation and restructuring of RRBs, they need to play a more active role in the development of MSMEs. **RBI may encourage RRBs to take up MSME financing in a big way. Similarly, RBI may emphasis upon cooperative banks to take up MSME financing more aggressively. However, the officers and staff of RRBs/ Cooperative banks posted in the branches have little knowledge of MSME financing and proper training needs to be imparted to them. NABARD may be requested to provide the necessary training and infrastructure for the same. The encouragement may also be given by way of refinance of SME loans on softer terms.**

4.8 The Third Census as also the RBI data on small enterprises reveals that the extent of financial exclusion is higher than in any other sector. The Raghuram Rajan Panel on Financial Sector Reforms in its draft report has recommended creation of well governed deposit taking small finance banks that resemble the earlier Local Area Bank scheme. Having more small finance Banks would increase financial inclusion by reaching out to poorer households and local Small and Medium Enterprises. This would also utilise the local knowledge in creation of products required locally and faster decision making as the decision making centre would be in touch with the client. **The Group feels that there is a need for improvement in credit delivery points and endorses the recommendations of Raghuram Rajan Panel on this issue.**

4.9 Financial exclusion in the MSME sector will have to be addressed in multiple ways. Besides the expanded role of RRBs and cooperative banks, other modes like use of business facilitators/ business correspondents, opening of more MSME branches, capacity building for the MFI Institutions, assisting in building of forward and backward linkages etc. may be used. **For inclusive growth, the banks shall have to reach out to its constituents physically, for which the banks shall have to introduce innovative ways like use of draught animals or barefoot banking. Such radical approach shall have to be backed by technology, so that all services normally used by such remote constituents are made available right at their doorstep.**

4.10 There has been a decline in credit to enterprises with investment in plant and machinery upto Rs 5 lacs. It has come down from 23.3% of small enterprises advances in 2002-03 to 17.07% in 2005-06. As a percentage of GBC the figure has come down from 1.94% in 2002-03 to 1.19% in 2005-06. Thus, the pattern of funding by the banks remains skewed towards larger firms. Financial exclusion in small units is very high. The promoters of tiny micro enterprises normally are neither skilled nor educated.

We suggest that a scheme for utilising specified NGOs for providing the following services to tiny micro enterprises may be launched by the Government.

a. **Training in basic accounting principles and credit management**
b. **Training on marketing, technology, design development, packaging, quality control etc**
c. **Creation and development of institutions of borrowers like cooperatives etc**
d. **Participation in exhibitions and marketing fairs**
e. **Development of common facilities for a group**
f. **Providing financial assistance for infrastructure creation**

In order to enable the NGOs to discharge the above duties, grant equivalent to 25% of the cost of the project or Rs. 5 lakhs, whichever is lower may be provided by the Government. Ministry of MSMEs has launched a schemed titled "Trade Related Entrepreneurship Assistance and Development" for women, wherein it, inter-alia provides a grant upto Rs. 1 lakh per programme. This provision may be extended to cover the training programmes proposed above.

4.11 RBI has already permitted public sector banks to make use of business facilitators/ correspondents. **More and more MFIs may be encouraged towards working as business correspondents and facilitators for banks for micro enterprises, only in identified excluded rural and semi urban areas by necessary tax concessions etc as suggested by the Rangarajan Committee. The banks may encourage these business correspondents especially in backward areas by equity participation, loans on concessional rates and other similar measures. Further, infrastructure at EDCs may be utilised for identification of the weaknesses and the areas for capacity building of the MFIs and the target clientele.**

4.12 Such outsourcing clubbed with score based lending in small enterprises is expected to give quantum jump to lending to micro enterprises especially in the rural and semi urban areas where the informal channels of information are strong and the outsourcing agency being locally placed would be in a better position to assess the creditworthiness, financial strength and other factors and present the same to the bank for decision making. The onetime cost of information etc as a percentage of the loan amount is expected to be less than what the banks incur today, especially in small loans.

4.13 Micro enterprises have very weak financial structure and the banks are reluctant to finance them for this reason. The need for credit enhancement either by collateral security or by credit guarantee gets accentuated in these accounts. However, most such entrepreneurs, being very small, have little collateral security to offer. Further, the premium for credit guarantee coverage at 1.5% as initial fees and 0.75% as annual service fees (proposed to be reduced to 1% and 0.5% for loans upto Rs 5 lacs in the Union Budget for 2008-09) adversely impacts the marginal viability enjoyed by such units. **In order to encourage financial inclusion, we suggest that the Government may explore the possibility of bearing the entire credit guarantee fees for micro enterprises.**

4.14 The incidence of NPAs in small enterprises as regards the public sector banks (which contribute more than three fourth of the total lending to this sector) is 5.58% vis-à-vis 2.93% for the system as a whole. This high level of NPAs makes the lender averse to lending to this sector. There is a need for strengthening the risk taking capability of the banks, especially for micro enterprises. **We suggest that the risk coverage under CGTMSE may be raised to 80% for all micro enterprises.**

4.15 With the objective of bringing more and more micro and small enterprises under the formal credit delivery system, the Government has suggested, in its policy package of 2005, that each semi urban/urban branch of the commercial banks (including regional rural banks) should provide credit cover on an average to at least 5 new tiny, small and medium enterprises per year. **The banks may set higher targets for themselves so that they may finance at an average of at least 10 accounts per semi-urban/ urban branch per year. New branches or branches in residential areas may not be able to achieve this growth and therefore other branches would have to fill in the gap to achieve the targets.**

5. DEVELOPMENT OF BACKWARD AND FORWARD LINKAGES

5.1 CONVERGENCE OF CREDIT AND NON CREDIT SERVICES:

Availability of adequate risk capital coupled with prompt and easy availability of adequate credit are an important prerequisite for growth of healthy micro, small and medium enterprise sector. It has been a major constraint and requires immediate attention of the financial system to put the sector on a high growth trajectory. But, it forms only a part of the whole gamut of factors that contribute to the growth of the sector and arrest sickness in the sector. A well defined policy, effective implementation, enabling environment (with low and stable inflation), adequate infrastructure, supportive approach of bureaucracy, marketing support, technological inputs etc from the Government are vital for the success of the sector. **Therefore, other institutions entrusted with development of the MSME sector need to imbibe professional approach in their working** so that the credit function being discharged by the banks is adequately supplemented by the non credit functions of the Government agencies and other institutions.

With increasing competition, introduction of new products and stringent regulatory environment, the role of banks has also changed from mere lenders to partners in business. This transformation has been muted in underdeveloped/ developing countries but has been more pronounced in developed nations. There is a need for greater participation of banks in the affairs of their constituents by convergence of credit services and non credit services. Accordingly, it is suggested that **the banks should not only provide differentiated products for MSMEs, but also provide counseling and guidance to new and established businesses, marketing support etc.**

5.2 CREDIT COUNSELLING CENTRES

On the initiative of RBI, some banks have set up Credit Counselling Centres which offer free counselling on curative measures mainly to farmers or retail borrowers. RBI has also come out with a Concept Paper on setting up of Financial Literacy and Credit Counselling Centres. The paper focusses on excessive indebtedness due to aggressive marketing by lenders or reasons beyond the control of borrowers. These centres are expected to provide financial literacy and credit counselling, education on responsible borrowing, formulate debt restructuring plans for borrowers in distress etc. These centres would normally cater to retail borrowers in urban areas and agriculturists in rural areas.

The Group, however, feels that promoters of MSMEs are also neither educated nor skilled in financial management and therefore need services of such dedicated counselling centres. We therefore suggest that **banks should set up such Credit Counselling Centres (whether singly or jointly with other banks or with large corporates) exclusively for MSMEs. Such Centres may be set up in major industrial towns/clusters. These Centres may provide preventive as well as curative guidance.**

5.3 CAPACITY BUILDING

5.3.1 Indians were perhaps the earliest traders. Their entrepreneurship took them to all corners of the world. However, with repetitive conquests on the country by the outsiders (made possible by accumulation of wealth, softening of the martial skills and sharpening of the trading skills), the reversal of the process began. The entrepreneurial spirit was further stifled during the rule of foreigners. The Europeans were expanding their colonial rule all over the world in search of raw material for their factories and markets for the product of these factories. It was during this period that the Industrial Revolution was sweeping the European Continent. India could not ride the wave of Industrial Revolution as it was ruled by the foreigners, who did not allow the Indian Entrepreneurship to flourish. The Swadeshi Movement was a result of the suppression of Indian Entrepreneurship. Emergence of India as a growth centre has been a result of entrepreneurship blooming once again. The growth of the economy and the development of entrepreneurship feed upon each other. The country has come a long way from the growth of 3-3.5% of the 1950s to the present rate of 8.5%+. Changes in the public policy over the last 20 years or so have freed the entrepreneurial spirit of the Indians. The Patels (or the Potels) who have virtually taken over the motel business in USA are a shining example. Nano developed by the Tatas is a product of aggressive entrepreneurship pursued by an Indian businessman and so is the spate of acquisitions of sick steel plants all over the world by Sh LN Mittal and thousands of other NRIs.

In the post independence era, the policy makers rightly thought it necessary to provide a protected environment so that the industry could grow and the spirit of entrepreneurship nurtured. Institutions were developed for the same and the momentum picked up. With integration of the Indian economy with the global economy, the protected environment became a handicap and the industry found it difficult to adjust to the new environment. However, the 60 year young Indian entrepreneurship and industry showed resilience and there has been all round growth in the recent times.

Entrepreneurship has to be nurtured and developed. Business enterprises tend to fail less due to delayed, inadequate or costly credit and more due to lack of skill and managerial ability to manage money, material and manpower. While entrepreneurship and skill training does not automatically translate into enterprises development as not more than 10 to 20 per cent of the persons who are provided training become entrepreneurs, the probability of success improves where trained persons formulate a sound project proposal and adequate and timely credit is made available.

5.3.2 Inadequate entrepreneurship development training and information gap in respect of the markets, financial management, technology etc have been cited as important factors hampering the growth of healthy MSMEs besides being major contributors to stress and sickness in MSMEs. In our survey, while banks and RRBs have suggested that more programmes are required for entrepreneurship development and capacity building of the entrepreneurs, MSME Associations have suggested product focused entrepreneurship development programmes and that fresh graduates should be motivated to set up business ventures. MSME Associations have also suggested that banks should come forward in providing entrepreneurship development training. There is a need to bring about a revolutionary change in the way entrepreneurship development programmes are managed in the country today.

5.3.3 The importance of entrepreneurship development has been realised by all stakeholders. EDPs are conducted by Entrepreneurship Development Institutes, State Consultancy Organisations, Banks/ FIs, DICs etc. However, these efforts are grossly inadequate due to the sheer size of our country.

In order to equip the MSMEs with the capacity to manage their businesses effectively and efficiently, all stakeholders need to make concerted efforts. We, therefore, suggest that the stakeholders must set up Enterprise Development Centres with incubators, which shall impart training not only for setting up of new units but also provide continuing education on different aspects like designing of the product, technical upgradation/ absorption of latest technology, packaging, financial management, marketing etc. These EDCs may be setup through a Trust or a Special Purpose Vehicle either independently or in tie up/ association with other stakeholders/ large industrial houses. Setting up of EDCs may be started from identified clusters and later extended to other industrial towns etc. Support may be extended by MSME-DIs and other arms of the Ministry of MSME for running these Centres. The Ministry of MSME or the Umbrella Organisation suggested in the report may provide inputs, assistance and also coordinate networking of the different Entrepreneurship Development Institutes already existing or that may be setup by the banks and other organisations. Such networking shall also help disseminate information and database developed by one centre to the entrepreneurs of the catchment area of other institutes.

5.3.4 **These EDCs may forge ties with the large corporates in their area of operation, IITs and other reputed engineering colleges, IIMs, National Laboratories, Chambers of Commerce and Industry and Universities (including foreign universities).** Such tie ups shall help the EDCs to provide the highest level of training and continuing education to the new as also the old and established units. These institutions can also utilize the platform of EDCs for imparting practical training to their students. The EDCs may be developed as state-of-the-art innovation, incubation and enterprise development centres.

5.3.5 **The EDCs may also tie up with the large corporates for assisting the first generation entrepreneurs in marketing tie ups with them. The EDCs may take up bright ideas emanating from their trainees for incubation i.e. nurturing and complete handholding till the idea turns into a business enterprise extending support from technology validation to patenting, viability assessment, financing, marketing tie up etc.** SIDBI has setup a couple of incubators in association with IITK and BITS Pilani. The centres are being developed as key nodal centres for activities like entrepreneurship development, business incubation, intellectual property rights, technology transfer and augmentation of grassroot innovation. The Centres are expected to leverage the skills and knowledge of students, faculty and the alumni of the Institute.

5.3.6 Ministry of MSME is operating a programme of providing grant of 50% of the cost of project or Rs 1 crore, whichever is less, for setting up a Entrepreneurship Development Institute. The Government may raise this limit to Rs 2.5 crores to enable setting up world class facilities with proper infrastructure. **The State Governments may provide land for setting up such EDCs free of cost. In case the same is not possible, 50% of the land cost may be borne by the State Government.** At present, NABARD is sharing the training cost in case of RUDSETI to the extent of Rs 2500 per trainee. EDCs to be set up in rural areas may be covered under NABARD scheme and for such EDCs to be set up in semi-urban and urban centres **SIDBI may defray a part of the training costs @ Rs 5000 per trainee out of a Fund to be created within SIDBI from out of contribution from Government.**

5.3.7 **While the EDCs envisage continuing education to the new as well as existing units, there is also a need for providing training on skill and technology upgradation by such EDCs so as to take care of the fast changing technology, design, development of new innovative products and processes.**

5.3.8 EDCs may be set up by the stakeholders for research, development and training for entrepreneurial development, inter-alia, under public private partnership arrangement with institutes of excellence, business houses and banks etc.

5.4 UPGRADATION OF TECHNOLOGY

5.4.1 In the present environment, technology in each and every industry is changing very fast. However, small and micro enterprises continue to use obsolete technology leading to poor quality, cost ineffectiveness and unable to withstand competition from large units and imported goods. Unlike large scale enterprises, these units use the same technology for years due to lack of knowledge, funds and skills. In the present scenario of specialization and globalization, SMEs are expected to be a special component in the value chain. However, use of latest technology is an important pre-requisite for the same. During a survey, obsolete technology was identified as a major cause for poor health of the sector. Therefore, if SME sector of India has to be a part of the global economy, there is no alternative except for an on-going programme of technological upgradation.

5.4.2 Upgradation of technology used by the MSMEs to suit the requirement of the present day customer, make the production cost effective and make the production process more environment friendly is the need of hour. However, the MSME units are too small to afford investment in technology. **While Department of Science and Technology is actively working for development of new technologies for the small and large industry, much more needs to be done. Adaptation of technology developed in other countries to the needs of Indian MSME sector also needs to be considered for making them more cost effective and dovetailed to the requirements of the customer.**

5.4.3 There is a need for multiple channels for assisting the MSME sector in technological upgradation, especially in view of the identification of old and obsolete technology as one of the major reasons for the sickness in the sector. **Research for use by MSMEs may be carried out at IITs, NITs, private engineering colleges, polytechnics, ITIs and by the private sector large corporates. The stakeholders may give financial support for establishing a department or a Chair for undertaking research for tech upgradation in MSMEs. All new technology developed at these centres may be passed onto the small enterprises through the Enterprise Development Centres proposed above. The Engineering Colleges may be preferably linked to clusters. In order to encourage R&D towards upgradation of technology for MSME units, we propose that section 10(21) of Income Tax Act may be amended to allow 150% deduction for contribution made towards funding of R&D work in Engineering Institutes.**

5.4.4 At present the Government has a sector specific technological development programme for textile sector named TUFS. As the small units do not have sufficient funds for investment in technological upgradation, **Government may introduce similar industry specific schemes, for technology upgradation. However, the latest technology which may be covered in each industry has to be specified by the Government. It has, however, been observed that the disbursement of subsidy takes a long time. Systems and procedures need to be refined so as to speed up the process of disbursement of subsidy.**

5.4.5 **SKILL UPGRADATION FOR WORKMEN**

Lack of adequately skilled manpower is one of the reasons for sickness in small enterprises in developing nations. SIDBI has funded a number of Skill and Technology Upgradation Programmes (STUPs) through reputed educational institutions like IIT, NIT, etc. and voluntary development agencies. However, feedback received from the entrepreneurs is that much more needs to be done in this regard. Hence it is suggested that the Government may set up more ITIs, Tool room training centres etc for training of the workforce on the latest technology.

5.5 **MARKETING PROBLEMS**

5.5.1 Marketing issues like wrong identification of products, lack of marketing infrastructure, inadequate marketing strategies, inability to meet competition from cheap imports and products of large corporates have a bearing on the growth of the sector. Obsolete technology leading to high cost of production raises the cost of production making it difficult for the small enterprises to meet the competition. 45% of the respondents in our survey have stated that tough competition hampers growth of MSME sector. In the Third Census of SSI units, 66% of the respondents identified lack of demand (or wrong identification of products) and 36% identified marketing problems as causes of sickness. Cheap imports from China have adversely affected the sales turnover of small, medium and large units alike. While the large corporates are able to put across their views to the Government through pressure groups like Chambers of Commerce and Industry, small units have little voice and suffer. The Government should take steps to address these concerns on priority.

5.5.2 **The problem may be addressed by strengthening of entrepreneurs by continuing education on technology upgradation, design and packaging, product innovation and cost reduction. IITs, engineering colleges, polytechnics, ITIs may be made use of for the above. Technology Development Board may be assigned the responsibility for conducting industry specific studies.**

5.5.3 **Central/ State Government should take steps at National Level/ State level/ district level for marketing and distribution of products particularly of micro, small and medium enterprises in corporate/ joint venture/ cooperative sector. The emphasis should be on organisations focusing on sale of products of micro enterprises in backward states / areas on the pattern of KVIC/ Kshetriya Shri Gandhi Ashrams. Marketing organisations like SEWA and AMUL can be encouraged and supported by assistance in the form of reimbursement of discount, storage, marketing and distribution expenses etc. Capital subsidy for setting up retail outlets may also be considered.**

5.5.4 **Industry specific Apex Cooperative Marketing Federation may be strengthened, who can have distribution and marketing tie up through their own retail outlets or other outlets. Autonomous Bodies like Handicraft and Handloom Boards should be set up at National and State levels in other industries also. The existing marketing setups should be strengthened with more retail outlets/ affiliated outlets, market research on the customer preferences (like design, colour etc) so that the small enterprises are in the know of the market demand and produce accordingly.**

5.5.5 **A similar set up is required for providing raw material at reasonable prices at the doorstep of the units. Providing of infrastructural facilities to the units like creation of cold chain, process house, utilities etc also may be provided the same treatment.**

5.5.6 **Under SFURTI scheme, KVIC extends 100% grant to agencies engaged in development of marketing as Market Promotion assistance subject to a maximum of Rs 15 lacs. It may consider extending the grant without any cap to all entities providing raw material at the doorsteps of the units, providing marketing setup or infrastructural facilities in rural areas.**

5.5.7 **In order to help the small enterprises in marketing of their products, the Government may consider setting up of permanent exhibition centres on the lines of Delhi Hat. Besides, periodic exhibitions of the products of small enterprises may be held by the Government in partnership with MSME Associations, or private businesses.**

5.6 As discussed in the earlier chapter **there is a need for developing the micro, small and medium enterprises in such fashion that the micro enterprises produce small components and parts or do preliminary processing of inputs or engage in job works for small enterprises, the small enterprises undertake the assembly of parts produced by the micro enterprises. The designing, technology and marketing should be handled by medium enterprises. The medium and small enterprises need to be induced to opt for such integration by fiscal or tax benefit/ other incentives.** This arrangement protects the micro and small enterprises from the planning and capital intensive aspects of industrial activity.

5.7 **<u>CREDIT INFORMATION COMPANIES</u>**

In the past, a major barrier to adopting the viability approach in financing MSMEs, has been the information gap required in understanding the viability, and the transaction cost required to provide business development assistance. This has largely been overcome in the last few years due to improved communications technology, allowing for easier and cheaper access to information resources. To enable the banking system to nurture growth, its risk assessment practices have to be improved and transaction costs are to be reduced.

One way of fighting the asymmetry of information consists in establishing multiple services that collect data about the credit history of borrowers to impart better capacity to take informed decision making regarding the provision of loans by the banks. Each credit institution must share information collected by it about its customers and in turn be provided access to the information collected by its competitors. The scope and utilisation of information pooled must be, in particular, compliant with regulations on private data protection with appropriate level of security and encoding must be ensured. The government has to provide the necessary enabling environment and achieve a simple, stable and workable rule of the game. Moreover, the implementation of the system must be done in a spirit of cooperation among all involved credit institutions.

The Group is of the opinion that **credit information companies should be private sector enterprises with necessary data security and storage safeguards to be advised by RBI. Further, the fees for providing the information should be kept at a minimum level so that the same does not exceed the collection expense of credit information especially for small borrowers. In order to make the credit report a part of the system, it may be made compulsory for the banks to incorporate the credit score in the appraisal notes in a graded fashion** i.e. starting with large corporates and gradually applying the same to individuals.

The credit score of each entity, as also the negative features impacting such scores so as to enable it to improve the same, should be provided to it at least once a year without any charges.

5.8 **SMALL ENTERPRISE ORGANISATION**

5.8.1 Micro, small and medium enterprises are the mainstay of any economy contributing to production, employment generation and exports. The Ministry of MSME has estimated that more than 128 lakh units contributing Rs. 5.87 lakh crores by way of production and providing employment to more than 312 lakh persons existed as at the end of 2006-07. Government/ RBI have been taking a number of steps for the resolution of the problems faced by MSMEs. The Agriculture sector is not in a position to absorb more people; the large corporates come up only in big industrial centres and have little capacity to generate employment spread over large geographical areas. Further, by their very nature they are capital intensive and generate lower employment per unit investment. Small enterprises have the capacity to generate large scale employment at low capital cost. There is, thus, a need for giving more focused attention to this sector. Although the Ministry of MSME, RBI and SIDBI have taken several initiatives in promotion, financing and development of MSMEs in the country, the Group feels that there should be an umbrella organisation for overseeing the coordinated development of the MSME sector with a view to fully exploit its growth potential.

5.8.2 A study of the different mechanisms built up by the developed economies for catering to the needs of small enterprises reveals that best results have been obtained through a strong setup at the central level capable of providing a long term, systematic, unified, relatively independent and focussed SME development strategy and endowed with the wherewithal to deliver. NCEUS has suggested setting up of National Fund for the Unorganised Sector for development of the unorganised sector. National Commission for Enterprises in the Unorganised Sector in its report on creation of National Fund for the Unorganised Sector has suggested provision of adequate credit on affordable rates and developmental support. We, however, feel that a centralised umbrella organisation providing focussed attention to development of the MSME sector as a whole, including the unorganised sector, may help in bringing the sector in proper focus of the policy makers. This umbrella organisation may focus not only on the availability of funds but also provide all round support including technological support, design inputs, facilitating raw material supplies, marketing support, guidance on IP issues etc.

5.8.3 In USA, a similar organisation, namely, Small Business Administration (SBA) has been set up under SBA Act which is considered the most effective and comprehensive measure taken by any country for the promotion of small business. SBA (USA) is an independent agency established on 30.7.1953 to aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns. Its mission also includes helping businesses and families recover from economic and other disasters. The Small Business Act also stipulated that SBA should ensure a fair proportion of Govt. Contracts to small business. It provides loans directly to businesses and also acts as a guarantor on bank loans. Besides, helping the victims of natural disasters, it works to get the Government procurement contracts for small businesses and assists businesses with management, technical and training issues. It also works with other federal agencies to reduce the regulatory and paper work burden for small businesses. During the decade ending 2000, the SBA helped almost 435,000 small businesses to get more than USD 94.6 billion in loans, the highest in the entire history of the agency before 1991. No other lender in the country - perhaps no other lender in the world – has been responsible for as much small business financing as the SBA has, during that time.

5.8.4 **In view of the foregoing and in order to sustain the high growth trajectory charted by the policy makers, we feel that a similar setup should be created in India also. The setup could be a larger platform to cater to the needs of MSME sector including the micro sector (similar to the unorganised sector defined by NCEUS).**

5.8.5 **The entity may be called as Small Enterprise Organisation (SEO)**

5.8.6 **It may be formed as a company under the Companies' Act or a Statutory Body or realigning the existing institutional set up to form such an autonomous body/organisation (which may be decided in consultation with RBI/ Ministry of MSME/SIDBI) with an initial capital base of Rs 500 crores, to be contributed by the Government of India.** Subsequently, the banks, FIs and even private investors including multilateral agencies like World Bank, IFC etc may be permitted to hold equity in the organisation. **The entity may have a pan-India presence with offices in all States and at major industrial centres.**

5.8.7 The objectives of SEO may be as under.

- To help, support, guide, advise, and protect the interests of MSMEs.
- To work for the promotion of MSMEs across the country with no prejudice against or for any section of society.
- To act as a think tank for assisting and guiding the Government on issues affecting the interest of MSMEs.
- To provide relief and succour to small businesses in times of distress.

5.8.8 Besides the functions performed by SBA of USA, Small Enterprise Organisation may be interalia assigned the following responsibilities.

1. MSME sector suffers from high exclusion and the delievery points need to be strengthened qualitatively and quantitatively. SEO may be instrumental in introduction of investment companies exclusively for MSME sector. These investment companies may come up in public sector, joint sector or private sector and may be permitted to issue bonds for arranging funds for on-lending to MSME sector. As in USA, SEO may provide guarantee to these investment companies. As suggested in Chapter 3, SEO may also support venture capital funds active in lending to MSMEs.

2. **Administration of Risk Capital Fund:** NCEUS has suggested setting up of a National Fund for the Unorganised Sector with initial capital of Rs. 500 crores, to be subsequently raised to Rs 1000 crores. We have suggested setting up of Risk Capital Fund, Rehabilitation Fund, and Market Development Fund etc. The Government is also introducing various funds for the development of MSME sector. The organisation may be entrusted with the responsibility of managing these funds.

3. **Entrepreneurship Development and technical support on an ongoing basis:** It has been discussed elsewhere in the report that entrepreneurship is the key to industrialization and development of economy. It is therefore natural that any organisation working for the cause of industry works for entrepreneurship development. SEO may not only support the existing organisations already engaged in this task but also setup complete infrastructure for Entrepreneurship Development Centres in partnership with other stakeholders like the banks, MSME Associations etc. The coverage of the training may not be limited to the setting up of a new units but it may also focus on providing continuing education to the entrepreneurs, bankers engaged in MSME financing for sensitizing them towards the requirements of MSMEs and Government departments directly or indirectly providing services to the MSMEs.

4. The organisation may also take necessary steps for research and development in coordination with Ministry of Science and Technology and various reputed engineering colleges. It may also take up on priority the networking of existing and proposed Entrepreneurship Development Centres and technical education centres so as to facilitate sharing of the information and data base developed at these centres.

5. **Cluster Development:** A need has been felt in various quarters for a Cluster Development Authority for undertaking concerted efforts for development of business clusters in the country. This assignment may be taken up by the organisation in a comprehensive manner, keeping the overall development of MSMEs in mind. A separate chapter has been dedicated to induced clusters/ industrial estates in this report. The issues raised therein may form a part of the responsibility of this Organisation.

6. **Relief and support to MSMEs directly or/and indirectly affected by natural disasters:** Micro and small enterprises are the worst sufferers when a disaster strikes. Besides the loss of property at the time of flood or draught, strike or riots, law and order problems or natural disasters, it also suffers from discontinuity of business, which it is normally not in a position to bear. The loss suffered by its clientele, which is normally local, deprives them of their purchasing power and renders the recovery of already supplied goods difficult, besides adversely affecting further supplies.

   These units need support in such situations. The needs of agriculture sector are attended to promptly, but MSE advances are normally not covered in the relief measures announced by the Government and RBI, although they are equally devastated. SEO may take up the cause of such units, advocate on their behalf for relief and concessions, and also provide sustenance loans and rebuilding loans at concessional rates.

7. **Market Research for the MSMEs:** The Third Census of SSI units makes some very interesting revelations. The largest cause of sickness has been found in the Census to be market related issues. Small entrepreneurs are too small or have little competence to conduct market research for their products or proposed products. They need market intelligence support on continuing basis. SEO may take up this activity on a regular basis.

8. **Government procurement of products of small enterprises:** The Government assigns priority to SSI units in its procurement policy. SEO may act as the Nodal Agency for procurement preferences by way of consolidating Government requirements and disseminating information to MSMEs, coordinating the procurement procedures, and even acting as the negotiator on behalf of the MSMEs. The Corporation may charge a nominal fee for the services rendered to the small entrepreneurs.

9. **Industry specific studies for different regions on ongoing basis and suggesting corrective action:** With increasing globalization, the world has become a village. What happens in one part of the world affects not only large industries in another part of the world but also the very small units. The fast paced changes in the economic scenario are beyond the comprehension of small units. They need to be supported by an organisation that conducts ongoing studies for specific industries for different regions. To quote an example, import of cheap toys from China has crippled the toy industry in India. SEO may study the methods adopted by Chinese toy industry for bringing the price so low and the feasibility of adopting the same in India.

   Such studies shall be of help to both the entrepreneurs and the lenders by instilling confidence in them about the scientific basis of the study of the specific industry. As a corollary to the study, it may also suggest corrective actions required in say method of production i.e. technological upgradation, design, change in product specifications, marketing techniques etc. It shall also restrict the financing of outdated technology or obsolete manufacturing practices. Model project profiles for different regions could also be prepared by SEO.

10. **Formulating a Governance Code for MSMEs:** Asymmetry of information and lack of transparency and reliability of data has been a major concern for organisations dealing with MSMEs world over. Formulation of a Governance Code by SEO may help build up of confidence in the data and information submitted by the MSMEs. This transparency shall also facilitate them in obtaining finances, getting favourable contracts and improving their business prospects.

11. **Participation in the equity of companies setting up the common facilities (including power projects) predominantly for MSMEs:** Lack of infrastructure has been cited as one of the main reasons of sickness by both bankers and SME Associations. Providing common facilities and other infrastructure shall help in reduction in causes of sickness. SEO, being a think tank, an advocacy group and a facilitator may not be directly involved in providing of these facilities but may participate in the equity of such companies which set up the infrastructure and common facilities, including power projects, predominantly for MSMEs.

12. **Advisory Services:** The organisation will have a setup at Central, State and Regional level. It can act as a think tank advocating on behalf of small entrepreneurs and advising measures to Central and State Governments on various matters like interest subvention, formulation of MSME policy and rehabilitation policy by State Governments, conducting industry specific studies for different regions on an on-going basis etc.

While some of the functions proposed for SEO are presently being rendered by Ministry of MSME, RBI and SIDBI. As stated earlier in the report what is now needed is much more focused attention for the development of the sector which has great potential to add tremendous value to the economy. Keeping this in mind it is suggested that SEO may be set up as an independent development organisation. It may be mentioned that while SEO may not by itself provide financial assistance to MSMEs it should enable smooth flow of funds to MSME sector by leveraging the existing institutional set up for credit dispensation. For this purpose it has not only to create adequate fund structure, but also would need to take care of all non-credit support services.

5.9 **FORMATION OF MSME POLICY BY STATE GOVERNMENTS:** In Central Government, a separate Ministry of MSME has been set up to promote the MSME sector. We recommend that **each state Government should also have a separate Ministry for MSME. In addition, the State Governments should also have long term and short term policy for development/ promotion of MSME sector.**

5.10 The Government-entrepreneur partnership and bank-entrepreneur partnership proposed for the first generation entrepreneurs needs to be supplemented by entrepreneur-entrepreneur partnership. **New entrepreneurs may be mentored by the established players in the field.** However, the MSME Associations would have to play an important role in such arrangement.

5.11 Non availability of power has been a constraining factor in the growth of MSMEs and is often the cause of sickness. This problem is unevenly spread over the states. **State Government should provide preferential treatment to MSMEs in providing uninterrupted power supply. In case the same is not possible, the State Government may provide back ended subsidy on loans taken for purchase of DG sets.**

6. CREDIT GUARANTEE SCHEME FOR MICRO & SMALL ENTERPRISES

6.1 Government of India in association with SIDBI implemented the Credit Guarantee Fund for Small Industries. As per the present scheme, term loans and working capital facilities granted to Micro and Small Enterprises (as defined under MSMED Act 2006) by the member lending institutions and insured with the Trust are covered to the extent of 75% of (a) the principal outstanding in case of term loan and (b) total outstanding (maximum being sanctioned limit) in case of WC. The total loans eligible for coverage are only Rs 50 lacs. In case of micro enterprises (with loans upto Rs 5 lacs) and enterprises owned by women the coverage is 80%. The fees for availing the credit insurance is 1.5% as the initial premium and 0.75% as the annual service charges. Union Finance Minister in his budget for the year 2008-09 has proposed to bring down the charges to 1.0% and 0.5% respectively for loans upto Rs 5 lacs. The coverage is available for the total duration of the term loan and for a block of 5 years for working capital facilities. Both TL and WC should be sanctioned by the same lender to be eligible for coverage.

6.2 As per the RBI data, the total exposure of all scheduled commercial banks to micro enterprises in the country as on 31-03-2006 was Rs 34980 crore. Since, the credit guarantee coverage is available only in accounts where no collateral security is available/ obtained, the details of eligible accounts is not available. The actual coverage taken by all lenders is Rs 2767 crores as on 31-03-2008 in respect of 98437 accounts. Even if we assume that collateral security is available in 50% of the micro enterprises, credit guarantee coverage has been obtained in only 14% of the micro enterprises. Accounts where coverage has been obtained as a percentage of eligible accounts would therefore be about 10%. The coverage is thus nominal. The scheme may be modified as under to increase the coverage.

6.2.1 **Coverage under the scheme may be raised from Rs 50 lacs to Rs 1 crores.**

6.2.2 There appears to be an ambiguity as to the treatment of 2nd charge on fixed assets as collateral security because of which many a case could not be covered under the scheme. There is a need to clarify this aspect. The Group is of the view that **charge in any form on any assets of the borrower should not be treated as collateral.**

6.2.3 In order to facilitate the flow of funds to micro enterprises, the coverage has already been increased to 80% for loans upto Rs 5 lacs. **80% coverage may be extended on loans to all micro enterprises. The Government may explore the possibility of bearing the entire guarantee premium for all micro enterprises, as the same shall reduce the cost of credit for such vulnerable sections of the sector.**

6.2.4 The premium for availing the credit guarantee is fixed for all loans. It does not distinguish the MSEs on the basis of their financial strength or their risk rating. **Differential price should be available to the borrowers on the basis of their ratings/ score done by the lending bank or external agencies.**

6.2.5 **The premium for coverage provided for rehabilitation loans may be borne by the promoters and the Government in equal proportions.**

6.2.6 At present CGTMSE is a single product organisation. This is one of the reasons for low coverage. The MSEs need various types of guarantees including sharing of collateral between the lender and the guarantee organisation coupled with greater coverage. **It is, therefore, suggested that CGTMSE may bring out different variances of the guarantee product so as to improve the interest of the lenders and the MSEs in availing the facility.** It is understood that CGTMSE is likely to test pilot a scheme called Risk Sharing Facility to cover loans between Rs 50 lacs and Rs 100 lacs.

6.2.7 The existing CGTMSE guidelines do not have any provision for exit by the lender before the specified period. The CGTMSE may include a provision in their guidelines enabling the banks to exit the CGTMSE coverage in any account after the initial period, at their discretion.

6.2.8 The very purpose of third party guarantee is credit enhancement. **Mutual Credit Guarantee Societies or Joint Liability Groups** are collective initiatives taken by entrepreneurs or by their associations. The philosophy is based on the pooling of the risk and the decision-making by peers. The concept has worked successfully in our country under the SHG / micro-financing being practiced by all banks across the country. MCGS has also been working successfully in Italy. **Although a beginning has been made in this respect, the same has to be upscaled where MSME Associations are strong, which will help to provide comforts to the lenders. CGTMSE may provide 50% of the funds required for building the corpus and the balance 50% may be met out of contributions from the Associations and their members.**

7. DEVELOPMENT OF INDUCED CLUSTERS/ INDUSTRIAL ESTATES

7.1 MSMEs have to be equipped to exploit the emerging market opportunities. In the global free trade regime, only the fittest would survive. Due to the liberalization policy and fiscal rationalization within the country, the competition has increased and the protective umbrella available to the Indian industry for long is no more available. With the technology making rapid strides globally, the Indian small enterprise needs to get rid of its myopic view and with proactive support of the Government plug the technology gaps. Besides the internal bracing up by the entrepreneurs, the external infrastructure too has to be made more efficient. The basic objective of the steps outlined above is to improve the business viability by reducing the cost of manufacturing and improving the quality.

7.2 With increasing cost of land and construction, the cost of fixed assets is going up. It is not possible for the small entrepreneurs to setup units by purchasing land and constructing thereon. **More industrial estates developed by the Government on its own or in association with private sector may facilitate development of the sector.** A cluster is a geographical concentration of units producing similar goods and facing similar threats and opportunities. Natural clusters have come up over the years. The units have business relationships as buyer and sellers. The units join hands to pool resources, production capabilities etc so as to generate economies of scale. However, their development has been sporadic and not orderly. The infrastructure is deficient and the efficiency of the units is low in general. These clusters work on the principle of collaborating while competing.

7.3 **Induced clusters can be located close to the existing clusters so as to capitalize on the existing backward and forward linkages. However, it needs to be ensured that these Industrial Estates have complete infrastructure like roads, uninterrupted power supply, banking facilities and necessary security arrangement.** In fact during our visit to Jagdishpur and Kosi Industrial Estates, poor law and order situation was quoted as one of the reasons for sickness in the units located there. **50% of the area should be reserved for micro and small enterprises.** These estates should preferably have modular units as they would be catering to similar units i.e. having similar activity. By such development, common facilities can be provided at reduced cost and their optimum utilisation ensured. Besides, compliance of statutory guidelines in areas like pollution control etc can be better ensured.

7.4 Development of such Industrial Estates/ induced clusters will come with attendant benefits like availability of raw material at the doorstep of the units at reasonable prices, marketing setup and infrastructure like testing facilities, common services etc which will make it remunerative enough for the private players. Once the concept of induced clusters picks up momentum, the raw material suppliers would have the economies of scale and would be willing to reach the doorsteps of the consuming industry. Similarly, with a large number of similar units in a small geographical block would enable the marketers to provide effective marketing channels to the area as the competition amongst these units would ensure reasonable prices and better terms for them. The infrastructure may be customized to suit the needs of the activity as it is expected that homogeneous enterprises with related services in the value chain shall be located there. The infrastructure providers shall also have the incentive of a captive clientele. However, as the infrastructural provisions may require large capital outlays, a public private partnership model may be more suited for the same.

7.5 Development of induced clusters/ industrial estates would bring all round benefits to all stakeholders. The industrial enterprises would have the benefit of backward and forward linkages, regulatory and social compliances, better quality of production and say in the management of the assets of the cluster. The banks/FIs would be benefitted by spread of risk across units, effective monitoring and common covenants. The Government would have the comfort of employment generation, enhanced revenue, enhanced competitiveness, and technological upgradation of industry.

7.6 **Industrial estates for micro and small enterprises may also be developed along the North South Corridor and East West Corridor as also the Golden Quadrilateral being developed by the Government and the Delhi Mumbai Goods Corridor being developed by the Railways. These estates should earmark at least 25% area for micro enterprises. To encourage development of such estates, fiscal concessions on the lines of SEZs, interest subvention and capital subsidy may be provided by the Government.**

7.7 The Governments would have to come forward in order to develop essential infrastructure for MSME sector and reduce transaction cost. **The institutional framework for improvement in the quality of the products of this sector through research and development, testing labs and quality certifications like BIS and ISO would have to be strengthened. The State Governments shall have to follow a multi-faceted approach in capacity building of these units by way of providing enabling environment, basic infrastructure, marketing support, procedural simplification and low cost financial assistance and incentives to reputed national level research and training institutions for setting up shop in their States.**

7.8 **The Government may take steps to popularize its “Integrated Infrastructure Development Scheme” and provide additional concessions on the lines of those provided for development of SEZs.**

7.9 **CONCESSIONS FOR COMMON FACILITIES**

The State Governments may be encouraged to provide land at 50% of the normal rate for setting up Industrial estates exclusively for MSMEs besides providing 50% subsidy on the capital cost of common facilities like effluent treatment plant, power plant etc. The common facilities may also include the housing and other needs of the workmen and their families working in the Estate.

7.10 **REDUCTION OF CLEARANCES IN INDUSTRIAL ESTATES**

Industrial Estates are developed by the State Industrial Development Corporations or DICs or private entrepreneurs as per the approved layouts and should ideally have complete infrastructure. Accordingly, **there should be no need for obtaining any clearance except registration with DIC.** This shall help curtail inspector raj to some extent. Further, **the defunct Industrial Estates may be re-energised by putting in place the complete infrastructure** thereby putting scarce national resources to good use.

7.11 **FISCAL CONCESSIONS FOR DEVELOPMENT OF INDUCED CLUSTERS/ INDUSTRIAL ESTATES**

Section 80 (I) (A) of Income Tax Act permits 100% exemption on income earned during any block of 10 years out of 15 years from the date of setting up of units. Similar exemption may be provided to the promoters of such induced clusters/industrial estates.

7.12 Hon'ble Finance Minister has provided Rs 100 crores in the Union Budget for 2008-09 for development of six Mega Clusters - Varanasi & Sibsagar for handlooms, Bhiwandi & Erode for Powerlooms and Narsapur & Moradabad for handicrafts. These mega clusters may be developed as model induced clusters**. Banks/ FIs may formulate special schemes for these clusters so that paucity of working capital does not adversely affect the growth of these clusters.**

7.13 There are 388 identified clusters. In terms of the policy package announced by the Ministry of MSME in 2007, risk profile of each cluster is to be studied by a professional credit rating agency and such risk profile reports are to be made available to commercial banks, besides adoption of at least one cluster by each lead bank of a district. We suggest that **each rating agency be allotted 50 clusters for profiling and rating. This can be made available to the banks and FIs which would use them for speedier and hassle free credit to MSMEs.**

8. INCIDENCE OF SICKNESS IN THE MSME SECTOR

8.1 In a dynamic set up, industrial units which are non-competitive, uneconomical and inefficient become sick and die out and new and more efficient units come up to take their place. This process takes place in a cycle as a sequence of economic restructuring. Re-allocation of resources, both material and human, from less efficient to more efficient areas is expected to increase production and productivity. It is also likely to lead to higher employment generation in the long run. However all failures cannot be attributed to irreparable weaknesses. Failure of enterprises will deter the objectives of economic development. It is in this context that the high incidence of NPAs and sickness in MSME sector must be viewed. Thus failure is a hard fact and has to be accepted by all but the corrective actions wherever feasible and warranted must be taken expeditiously.

8.2 NPAs in Small Enterprises Sector and total NPAs in the books of public sector banks since 2001 (as at the end of March) is given at Table 3.2. Inferences drawn from the data are graphically represented hereunder.

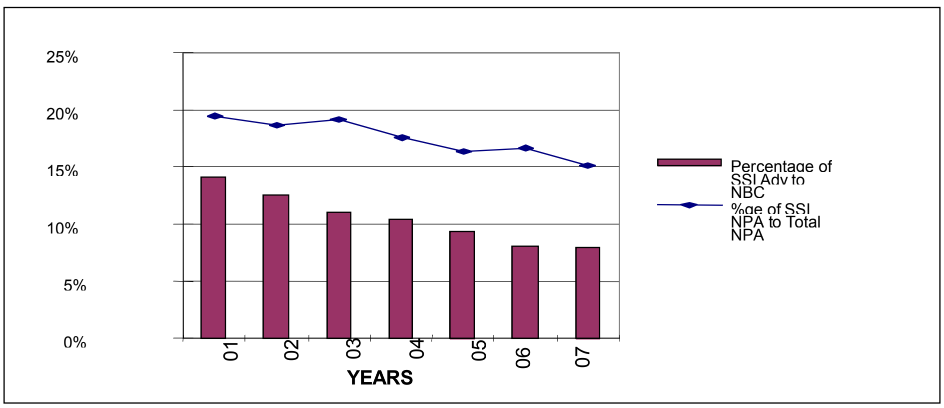
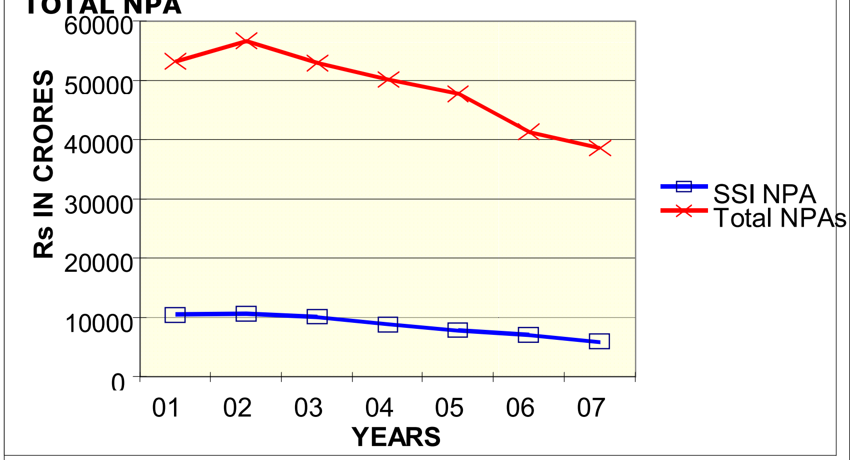


Figure 8.1: MOVEMENT OF SMALL ENTERPRISE NPA AND SMALL ENTERPRISE ADVANCES AS % TO TOTAL NPA AND NBC

Figure 8.2: MOVEMENT OF SMALL ENTERPRISES NPA & TOTAL NPA



8.3 Number of sick small enterprises and the amount outstanding against them in the books of scheduled commercial banks as at the end of March since the year1999is given below:

(Rs. crores)

Year	All India Data		
	No. of A/cs	Amt O/s	Amt o/s per a/c
1999	306221	4313.48	0.014
2000	304235	4608.43	0.015
2001	249630	4505.54	0.018
2002	177336	4818.92	0.027
2003	167980	5706.35	0.034
2004	143366	5772.64	0.040
2005	138041	5380.13	0.039
2006	126824	4981.13	0.044
2007	114132	5266.65	0.046

Table 8.1: INCIDENCE OF SICKNESS IN SSI SECTOR

8.4 **Existing RBI Guidelines on Rehabilitation of Sick Small Enterprises**

The present definition of sickness was introduced on the basis of recommendations made by Kohli Committee.

8.4.1 **Definition of Sick Small Enterprises**

A Small Enterprise should be considered '**Sick**' if

a) any of the borrowal accounts of the unit remains substandard for more than six months i.e. principal or interest, in respect of any of its borrowal accounts has remained overdue for a period exceeding one year. The requirement of overdue period exceeding one year will remain unchanged even if the present period for classification of an account as sub-standard, is reduced in due course; **or**

b) there is erosion in the net worth due to accumulated cash losses to the extent of 50 per cent of its net worth during the previous accounting year; **and**

c) the unit has been in commercial production for at least two years.

8.4.2 **Viability of Sick Small Enterprises**

A unit may be regarded as potentially viable if it would be in a position, after implementing a relief package spread over a period not exceeding five years from the commencement of the package from banks, financial institutions, Government (Central / State) and other concerned agencies, as may be necessary, to continue to service its repayment obligations as agreed upon including those forming part of the package, without the help of the concessions after the aforesaid period. The repayment period for restructured (past) debts should not exceed seven years from the date of implementation of the package. In the case of tiny/decentralised sector units, the period of reliefs/concessions and repayment period of restructured debts not to exceed five and seven years respectively, as in the case of other small enterprises. Based on the norms specified above, it will be for the banks/financial institutions to decide whether a sick Small Enterprise is potentially viable or not. Viability of a unit identified as sick should be decided quickly and made known to the unit and others concerned at the earliest. The rehabilitation package should be fully implemented within six months from the date the unit is declared as 'potentially viable' / 'viable'. While identifying and implementing the rehabilitation package, banks/FIs are advised to do 'holding operation' for a period of six months. This will allow small-scale units to draw funds from the cash credit account at least to the extent of their deposit of sale proceeds during the period of such 'holding operation'.

8.4.3 The data compiled by Reserve Bank of India on sickness in small and medium enterprises as on 31-03-2006 and 31-03-2007 is given below.

BANK-WISE VIABILITY POSITION OF SICK SMALL ENTERPRISES (Rs. CRORE)

	AS AT THE END OF MARCH - 2006						AS AT THE END OF MARCH - 2007					
	TOTAL SICK UNITS		POTENTIALLY VIABLE		UNITS UNDER NURSING		TOTAL SICK UNITS		POTENTIALLY VIABLE		UNITS UNDER NURSING	
	UNITS	O/S	UNITS	O/S	UNITS	O/S	UNITS	O/S	UNITS	O/S	UNITS	O/S
PUBLIC SECTOR	124530	4593.23	4565	473.97	903	229.43	112305	5013.89	4240	404.12	581	262.21
PRIVATE SECTOR	2291	376.56	28	18.18	12	4.34	1824	238.54	45	15.69	7	6.72
FOREIGN	3	11.34	1	6.01	0	0	3	14.22	2	7.65	0	0
TOTAL	**126824**	**4981.13**	**4594**	**498.16**	**915**	**233.77**	**114132**	**5266.65**	**4287**	**427.46**	**588**	**268.93**

BANK-WISE VIABILITY POSITION OF SICK MEDIUM ENTERPRISES (Rs. CRORE)

	AS AT THE END OF MARCH - 2006						AS AT THE END OF MARCH - 2007					
	TOTAL SICK UNITS		POTENTIALLY VIABLE		UNITS UNDER NURSING		TOTAL SICK UNITS		POTENTIALLY VIABLE		UNITS UNDER NURSING	
	UNITS	O/S	UNITS	O/S	UNITS	O/S	UNITS	O/S	UNITS	O/S	UNITS	O/S
PUBLIC SECTOR	12856	2985.88	133	311.6	56	195.62	17902	2101.59	1925	288.3	117	182.11
PRIVATE SECTOR	657	305.16	74	60.91	32	22.14	47	103.71	9	5.71	0	0
FOREIGN	0	0	0	0	0	0	0	0	0	0	0	0
TOTAL	**13513**	**3291.04**	**207**	**372.51**	**88**	**217.76**	**17949**	**2205.3**	**1934**	**294.01**	**117**	**182.11**

Table 8.2: BREAKUP OF SICK UNITS IN 2006 AND 2007

The above data reveals that

⇒ There was a perceptible decline of 10% in the number of sick SSI units in year 2007 but the amount outstanding against them went up by almost 6% as compared with 2006. (126824 a/cs in 2006 to 114132 a/cs in 2007 with aggregate exposure of Rs 4981.13 crores in 2006 to Rs 5266.65 crores in 2007).

⇒ In Small Enterprises Sector out of 114132 sick units, only 3.76% units were found viable by the banks and out of the same only 13.72% units were put under nursing. Thus only 0.52% of the sick SSI units were put under nursing.

⇒ Among the sick medium enterprises, out of 17949 sick units, only 10.77% units were found viable by the banks and out of the same only 6.05% units were put under nursing. Thus only 0.65% of the sick units were put under nursing.

⇒ For the SME sector as a whole, out of total 132081 sick units, the total units found viable are only 4.71%, of which 11.33% were put under nursing i.e. only 0.53% of the sick units were put under nursing.

⇒ It is difficult to assess as to how many units were really studied for their viability out of the 95-97% units not found viable.

8.5 CAUSES OF SICKNESS

The Third Census of Small Enterprises, conducted by Ministry of MSME in 2001-02, identified the following reasons for sickness.

SN	Reason for sickness/ incipient sickness	Proportion of sick/ incipient sick units*		
		Total SSI	Regd. SSI	Unregd. SSI
1.	Lack of demand	66 %	58 %	69 %
2.	Shortage of working capital	46 %	57 %	43 %
3.	Non-availability of raw material	12 %	12 %	12 %
4.	Power shortage	13 %	17 %	12 %
5.	Labour problems	5 %	6 %	4 %
6.	Marketing problems	36 %	37 %	36 %
7.	Equipment problems	11 %	9 %	12 %
8.	Management problems	4 %	5 %	3 %

Table 8.3: **CAUSES OF SICKNESS AS IDENTIFIED IN THE THIRD CENSUS OF SMALL ENTERPRISES 2001-02**

* The total in each column will exceed 100 %, as some units have reported more than one reason.

It is interesting to note from the above table that marketing related issues were identified by the entrepreneurs as a much bigger contributor to sickness than shortage of working funds. The other major causes were power shortage, non availability of raw material and equipment problems.

8.6 Causes of sickness have been well researched and documented. The feedback received from the various stakeholders reveals that some of the major challenges faced by the small enterprises are limited budget for marketing, lack of market intelligence on the demand, delayed payments from the large corporates (who dictate the terms of the transactions and the smaller units being dependent on them for their business are not in a position to differ), non-availability of inputs at reasonable prices, delayed or/and inadequate credit, non-availability of collateral insisted by the lenders (**partially** ameliorated by the introduction of Credit Guarantee Trust for Micro and Small Enterprises or CGTMSE), lack of adequate infrastructure like quality (read uninterrupted) power supply, all weather roads etc, resistance to technological upgradation, lack of adequate number of entrepreneurship development institutes, information gap regarding technology, market etc, globalisation and liberalisation of the economy leading to competition from foreign entities, complex government regulations, unstructured and adhoc incentive systems, no exit policy, multiplicity of laws and regulators, limited financial resources, lack of organisational, financial and management skills and expertise, diversion of funds, diversification/ expansion before stabilisation, obsolete technology etc.

8.7 This issue has been discussed by the Working Group in various meetings and interactions with a cross section of stakeholders, interalia including banks, entrepreneurs, SME Associations. The views obtained are summarized hereunder.

PARTICULARS	**BANKS (22)**	**RRBs (9)**	**MSME ASSNS (16)**	**DIR OF IND and EDI (6)**	**REGIONAL OFFICES OF RBI (16)**	**TOTAL (69)**
MARKETING RELATED ISSUES	13	9	12	2	16	52
MANAGEMENT RELATED ISSUES	13	2	7	3	14	39
DIVERSION OF FUNDS	9	1	1	0	16	27
TECH OBSOLESCENCE	11	2	3	2	8	26
DELAYED / INADEQUATE SANCTION BY BANKS	6	1	8	2	9	26
DELAYED REALISATION OF RECEIVABLES	13	1	2	0	7	23
POOR INFRASTRUCTURE	3	3	4	0	10	20
LACK OF FUNDS	6	2	6	2		16
CHANGE IN GOVT POLICY	2	0	6	1	7	16
OTHERS	29	4	13	3	19	68

Table 8.4: CAUSES OF SICKNESS

We observe from the above table that while marketing related issues, management issues and willful default / diversion of funds were found to be major contributors to sickness by Regional Offices of RBI, the banks attributed high weightage to market factors and management factors as contributors to sickness. If the views of all stakeholders are taken together market issues, management issues, diversion of funds, technical obsolescence, delayed / inadequate working capital, willful default/ diversion of funds and delayed realisation of receivables were the major causes of sickness.

8.8 The number & amount of credit involved in sick small enterprises in six states having highest exposure in sick small enterprises as on 31-03-2006 is given in the table hereunder. The data for six major states having large number of sick small enterprises for March 2007 is also given alongside. The other major states having high sickness rate in small enterprises are Andhra Pradesh – 3520-Rs 786.21 cr, Delhi 1252-Rs 292.03 cr, Karnataka 3611-Rs 240.22 cr, Kerala 4426-Rs 223.07 cr. Regional distribution of sick small enterprises is also given in the subsequent table.

DISTRIBUTION OF SICK SSI UNITS AND THEIR OUTSTANDING CREDIT IN SIX STATES HAVING MAJOR SHARE IN CREDIT TO SICK SSI UNITS								
	AS ON MARCH 2006						AS ON MARCH 2007	
STATE	TOTAL NO OF SSI UNITS	AMOUNT OUTSTANDING	NO OF SICK SSI UNITS	AMOUNT OUTSTANDING	% SHARE IN NO	% SHARE IN AMT O/S	NO OF SICK SSI UNITS	AMOUNT OUTSTANDING
TAMIL NADU	30215	71816	9488	875.3	31.40%	1.22%	9895	1002.35
MAHARSHTRA	22244	33982	8665	630.63	38.95%	1.86%	7401	540.04
GUJARAT	17221	33467	3699	420.37	21.48%	1.26%	3350	271.45
UP	109994	67057	15751	416.8	14.32%	0.62%	13309	823.39
WEST BENGAL	314838	56034	31568	377.28	10.03%	0.67%	28592	352.9
ORISSA	90149	28377	7421	346.46	8.23%	1.22%	3602	70.92
ALL INDIA	1000327	711882	126824	4981.13	12.68%	0.70%	114132	5266.65

DISTRIBUTION OF SICK SSI UNITS AND THEIR OUTSTANDING CREDIT IN FOUR REGIONS IN CREDIT TO SICK SSI UNITS						
					AS ON MARCH 2006	
STATE	TOTAL NO OF SSI UNITS	AMOUNT OUTSTANDING	NO OF SICK SSI UNITS	AMOUNT OUTSTANDING	%SHARE IN NO	% SHARE IN AMOUNT O/S
EASTERN	571070	178711	55617	907.41	9.74%	0.51%
NORTHERN	200279	221370	26685	1081.46	13.32%	0.49%
WESTERN	97069	91443	22638	1360.64	23.32%	1.49%
SOUTHERN	131909	220358	21884	1631.62	16.59%	0.74%
ALL INDIA	**1000327**	**711882**	**126824**	**4981.13**	**12.68%**	**0.70%**

Table 8.5: REGIONAL AND STATEWISE DISTRIBUTION OF SICK SSI UNITS

It is evident from the above tables that the number of sick units and the share of credit involved in sick units as a percentage of total exposure to small enterprises is high in states/ regions having a high rate of industrialisation. An important inference from the above data is that sickness tends to creep in at the initial stages in small enterprises. As has been noted by Dr Rakesh Mohan, Deputy Governor, RBI in his Bharti Annual Lecture at Entrepreneurship Development Institute on 28-03-2008 “There is some corroborating evidence suggesting the difficulty of entry of new business entrepreneurs. When we look at the World Bank surveys on doing business across countries, India typically ranks quite low in the range of 120-130. At the same time, we find that both the level of profit of corporate sector in India and the growth of profits is among the highest in the world. .. once you get in, it is easy to grow, but getting in, in the first place, is difficult.” The stakeholders have also opined on similar lines. Small enterprises not being financially strong are more susceptible to even minor malfunctions and tend towards sickness. A small enterprise, like a sapling or a baby, has to be nurtured in the initial stages. The stress induced at the initial stage, if not managed promptly, leads to sickness and ultimately closure of the unit in most cases. Thus, there is a strong possibility of sickness setting in small enterprises at the initial stages and the banks should more carefully monitor the working of small enterprises in the initial stages.

9. REHABILITATION OF SICK MSMEs

Like any other entity, business enterprises are likely to develop stress and fall sick due to internal or external problems. As in any other sickness, the need for timely treatment after identification of sickness cannot be overemphasized in MSMEs. The disease may spread further, in case there is delay in treatment. In case a unit is not found viable, recovery of the dues of lenders through a fair, efficient and swift legal mechanism should be the focus. This is one way to manage sickness - the exit route which may be employed only in terminally ill i.e. non viable cases. However, for viable units, timely and effective rehabilitation by way of renegotiation of terms of loans, induction of fresh dose of funds, business restructuring, change of management etc may become necessary. The process should not only be quick, efficient, cheap and fair to all stakeholders but also acceptable to and implementable by all, with necessary monitoring arrangement for implementation of the same.

The Group has considered the issue of sickness in MSME sector in detail and recommends as under.

9.1 DEFINITION OF SICKNESS

One of the inferences that can be derived from the data on sickness in the last chapter is that the identification of a unit as sick is so late that the possibilities of its revival recede. Therefore, there is a need to hasten the process of identification of a unit as sick by way of change in the definition of sickness.

The Group recommends the following definition of a sick small enterprise, in order to remove the delay factor.

A Micro or Small Enterprise (as defined in the MSMED Act 2006) may be said to have become sick, if any of the borrowal account of the enterprise remains NPA for three months or more

Or

There is erosion in the networth due to accumulated losses to the extent of 50% of its networth.

The existing stipulation that the unit should have been in commercial production for at least two years may be removed so as to enable the banks to rehabilitate units where there is delay in commencement of commercial production and there is a need for handholding due to time/cost overruns etc.

Accounts where willful default is identified or the borrower is absconding should not be classified as sick units and accordingly should not be eligible for any relief and concessions. During our interactions with the entrepreneurs and their associations, it was stated that at times, banks do not come forward for rehabilitation citing willful default by the borrower. **Therefore, declaration of a borrower as a wilfull defaulter should be done strictly in accordance with the guidelines issued by RBI.**

RBI has revised the definitions of non-SSI sick accounts and non-SSI weak accounts vide its notification dated 19-03-2008. These definitions are :

- A Non-SSI sick unit is a non-SSI Industrial undertaking (regardless of type of incorporation) whose accumulated losses, as at the end of the latest financial year, equal or exceed its entre networth (viz. paid up capital and free reserves).

- A Non-SSI weak unit is a non-SSI industrial undertaking (regardless of type of incorporation) if

  a. any of its borrowal accounts (principal or interest) has remained overdue for a period exceeding one year;

  or

  b. there is erosion in the net worth due to accumulated losses to the extent of 50% of its net worth during the previous financial year.

The definitions have been issued recently by RBI, after considering all factors and therefore **we do not suggest any change in the definition of sickness in medium enterprises. However, for the sake of uniformity, we suggest change of the term "Non-SSI weak unit" to "non-SSI incipient sick unit".**

9.2 The data given in the table 8.2 reveals poor identification and rehabilitation undertaken or carried out. The success rate of rehabilitation packages is not known but in the given circumstances, the same too is expected to be low. Some SME Associations have expressed an opinion that a serious entrepreneur tries to induct funds (his own, borrowed from friends and relatives or other informal sources) in the business, as and when it faces any problem. The process goes on for sometime i.e. till he is no more in a position to do so. It is only thereafter that he approaches the bank and shares his position, still only hesitatingly. By the time the banker comes to know the real state of affairs, it is normally too late and the unit is beyond redemption. To overcome this situation, the Group feels that the process of rehabilitation should actually start at the stage of incipient sickness.

9.3 DEFINING INCIPIENT SICKNESS

While the concept of incipient sickness exists, the same has not been defined for MSMEs in the guidelines so far and needs to be defined. **An account may be treated to have reached the stage of incipient sickness/ potential sickness, if any of the following events are triggered.**

a. **There is delay in commencement of commercial production by more than six months for reasons beyond the control of the promoters and entailing cost overrun.**
b. **The company incurs losses for two years or cash loss for one year, beyond the accepted timeframe on account of change in economic and fiscal policies affecting the working of MSEs or otherwise.**
c. **The capacity utilization is less than 50% of the projected level in terms of quantity or the sales are less than 50% of the projected level in terms of value during a year.**

The rehabilitation process should start on a proactive basis at the point of incipient sickness as defined above and not sickness. This will ensure that the rehabilitation of the unit will start right from the stage of sickness itself even if the nursing process does not succeed at the incipient sickness stage.

9.4 **VIABILITY**

The existing criteria for viability are reasonable. However, decision on viability of a unit may be taken at the earliest but not later than 3 months of becoming sick under any circumstances.

In order to arrest the tendency of the banks to declare the sick MSMEs as unviable and go for recovery, we suggest that **the following procedure should be adopted by the banks before declaring any MSME unit as unviable.**

a. **A unit should be declared unviable only if the viability status is evidenced by a viability study. However, it may not be feasible to conduct viability study in very small units and will only increase paperwork. For tiny micro enterprises, Branch Manager may take a decision on viability and record the same, alongwith the justification.**

b. **The said viability study and the declaration of the unit as unviable should have the approval of the next higher authority/ present sanctioning authority, except in tiny micro enterprises. However, in tiny micro enterprises, an opportunity may be given to the borrower to present his case to the Branch Manager before declaring a unit as unviable.**

c. **The next higher authority should take such decision only after giving an opportunity to the promoters of the unit to present their case. They should be informed in writing about the reasons for declaring the unit as unviable before giving this opportunity so that the promoters can present their case properly.**

d. **Decision of the above higher authority should be informed to the promoters in writing. The above process should be completed in a time bound manner not later than 3 months.**

However, banks may take decision in cases of malfeasance or fraud without following the above procedure.

9.5 **REHABILITATION MEASURES**

9.5.1 The extant RBI guidelines on sick small enterprises whether as regards the relief and concessions, viability parameters or coordination among the banks/ FIs and Government agencies are adequate to manage the sickness in MSME sector. Apparently, the problems remain in the implementation of guidelines and not the guidelines per se. More stringent monitoring at the level of HO of the banks/ FIs as also at the level of RBI may help in timely identification and treatment of sickness in MSME sector. However, minor modifications in the guidelines are expected to further strengthen the same. **We suggest the following changes.**

PARTICULARS	EXISTING GUIDELINES FOR SSI UNITS	CHANGES SUGGESTED FOR MICRO AND SMALL ENTERPRISES
Waiver of penal Interest	Waiver of penal Interest from the beginning of the accounting year of the unit in which it started incurring cash losses continuously	The following words may be added "the date of the account becoming NPA, whichever is earlier."
Rate of interest	NIL for FITL, and different concessions for other facilities.	Interest may be made ballooning or staggered also.
Repayment period	The repayment period permitted under DRM for SMEs is 10 yrs with concessions for 7 yrs and therefore no change is suggested in the same.	Staggered or ballooning repayment may also be permitted so that the installments are aligned to the cashflows.
Margin on funding of losses		While funding past and future losses, margin of 40% may be prescribed in case of small and medium enterprises.
The relief and concessions available to sick/weak non SSI units are reasonable and we do not suggest any change in the same.		
SOME NEW SUGGESTIONS		
Banks may consider recovery of principal on the basis of tagging of sales, starting from the quarter of commencement of repayment. However, tagging should be less than the cash margins of the unit.		
In order to make the process of settlement of debt through OTS speedier and to provide resources to such intending borrowers, RBI may consider allowing scaling down of debt burden to sustainable levels. Further, in order to incentivise lenders to fund the OTS and additional requirement of funds, the new lenders may be allowed to convert a part of the debt into equity.		
As an incentive for proper restructuring package at the time of rehabilitation, necessary support for business restructuring, modernisation, expansion, diversification and technological upgradation as may be felt necessary by the lenders may also be encouraged. Support of schemes like Credit Linked Capital Subsidy Scheme in case of units in other (than rural) areas, KVIC Margin Money Scheme (for units in rural areas) may be extended for rehabilitation packages also.		
In terms of extant RBI guidelines, an account gets downgraded if initial moratorium on interest payment is extended as a part of restructuring. These guidelines need to be waived especially for MSMEs.		

9.5.2 While evolving packages**, it should be made a precondition that the promoters should bring in their contribution within the stipulated time frame.** Further, in regard to relief and concessions made available to sick units, **banks should incorporate a 'Right of Recompense' clause in the sanction letter** and other documents to the effect that when such units turn the corner and rehabilitation is successfully completed, the sacrifices undertaken by the FIs and banks should be recouped from the units out of their future profits/ cash accruals.

9.6 **<u>RELIEF AND CONCESSIONS BY STATE GOVERNMENTS</u>**

An MSME unit is a dynamic entity interacting with a universe which comprises of labour, raw material suppliers, market, utilities, global competitors, customers, lenders, legal provisions, shareholders, and other stakeholders. Lenders form a small component of the total universe and affect the rehabilitation only in that proportion. We have gone through the rehabilitation policies of State Governments. The policies vary widely. We are of the opinion that **Ministry of MSME may issue suggestive guidelines which will help the state governments to formulate their guidelines. State Governments should clearly state the relief and concessions available to potentially viable sick small and medium enterprises regarding power dues, sales tax and other statutory dues.** In case the same are considered, the Group is confident that the number of units found viable would certainly go up.

9.7 **The State Governments should not take any recovery/ coercive action if the lender starts rehabilitative action. Such a unit should be treated as a relief undertaking for the dues of the State Government.** The dues of banks/ FIs may be excluded from the provisions of relief undertaking. However, implementation of rehabilitation packages should not be linked to such declaration.

9.8 Another issue pertaining to the concessions available to the MSMEs from the State Governments is the time taken by them for approving and providing these concessions. It has been observed that it takes a very long time for the Government Departments to approve the relief and concessions for the sick MSMEs. **Single Window Concept should be introduced for providing such relief and concessions by the Government Agencies**. In order to ensure judicious grant of the relief and concessions, the powers may be given to the Industries Commissioner of the State who may delegate the same and relief & concessions for micro enterprises may be considered at the District Level Designated Officer, those for small enterprises may be granted by the Designated Officer at the Division level and those for the Medium Enterprises at the State Level. **We suggest that Ministry of MSME should be setup in all states on the lines of centre. A separate Cell may be created therein for rehabilitation of sick MSMEs. In case of delinquency by any Government department in providing relief and concessions in terms of the declared policy of the state government, such cell may take up the issues with the concerned departments.**

9.9 Rehabilitation packages mean haircut for all stakeholders. The lenders suffer in rehabilitation the most as the package is built around continuing relief and concessions from them. In order to incentivise them to take rehabilitation measures, we suggest as under:

9.9.1 As per the extant guidelines of RBI on CDR, the providers of the additional finance have a preferential claim under the restructuring package over the providers of the existing finance, with respect to the cash flows out of recoveries, in respect of the additional exposure. Small and Medium Enterprises are not covered under CDR guidelines. **The banks / institutions should be given priority on cash flows/ security in respect of additional finance provided by them as a part of rehabilitation package, vis-a-vis the lenders of existing finance.**

9.9.2 If the terms of the loan are changed before the account becomes sick, any subsequent restructuring of the account leads to downgradation of the account as per the extant guidelines. The guidelines need to be modified so that **rehabilitation of any unit after its identification as sick is not affected by the earlier restructuring and the asset classification is not downgraded at the time of first restructuring after the unit has become sick**.

9.9.3 As per the extant RBI guidelines, provision is required to be made in case of restructuring/ rehabilitation of accounts on account of the sacrifices being made by the lenders. This sacrifice is calculated if there is any change in the terms of interest calculated by computing the loss of interest, on account of restructuring, discounted at the rate applicable to the account based on the risk rating. Since micro and small enterprises may be in rural and semi urban areas, it may not be possible to make complex calculations. **In order to encourage rehabilitation in micro and small enterprises, we suggest that there should be no provisioning requirement for sacrifices in cases covered under CGTMSE.**

9.9.4 Small enterprises normally face teething problems and it takes time to establish quality of product and market. **We suggest that interest of at least 6 months after commercial production can also be included as a part of the project cost. Sufficient moratorium of say 2 years for repayment of the principal should also be given.** It will prevent cases of incipient sickness at the commencement of production and help units to establish themselves in the market at the beginning.

9.9.5 **Staggering or ballooning of instalments may also be considered to provide opportunity to new SME units to establish in the market and prevent sickness.**

9.10 CREDIT GUARANTEE FOR REHABILITATION

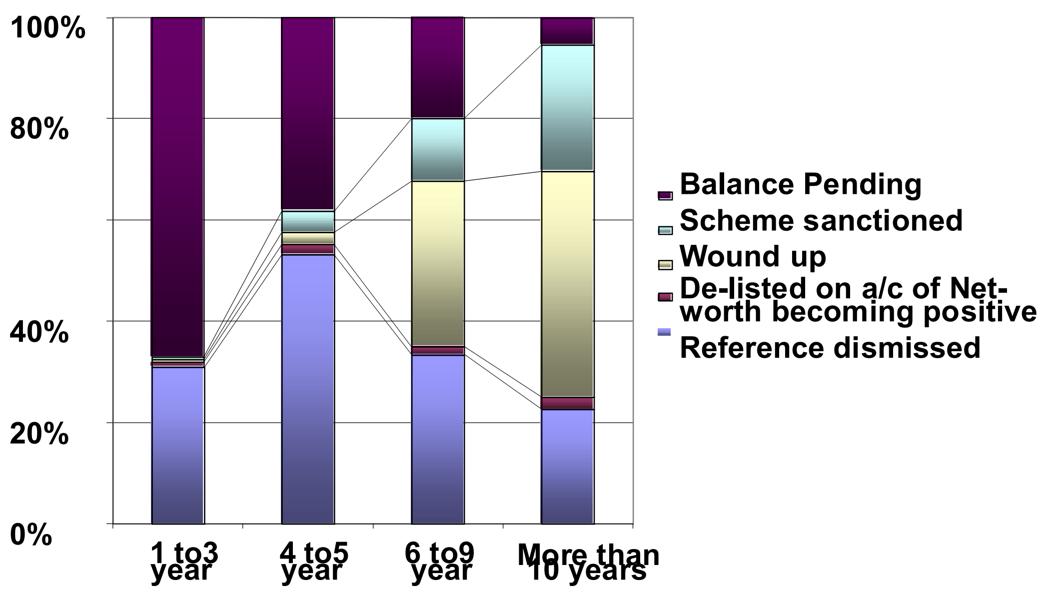
The premium for the coverage of rehabilitation loans may be charged at only half the normal rates as the same shall help in improving the cashflows of the sick unit.

9.11 PERFORMANCE OF BIFR

As per the extant guidelines, rehabilitation of small enterprises is done at the level of the banks/ lenders. However, as regards the Medium Enterprises, only the corporate medium enterprises are covered under SICA and the rehabilitation process is done under BIFR supervision. The performance of BIFR in rehabilitation has been an issue of concern for the Government, the entrepreneurs and the lenders. The performance of BIFR as brought out in the table below clearly reveals that BIFR is overloaded and is not in a position to expeditiously rehabilitate the sick units.

Particulars	1 to 3 years	4 to 5 years	6 to 10 years	> 10 years	Total
(A) Age of BIFR reference	1009	1022	1542	1754	5327
Of which					
(B) resolved by BIFR	333(33%)	632(62%)	1234(80%)	1659(94%)	3858(72.4%)
Mode of resolution :					
(i) Reference dismissed	313	544	515	398	1770
(ii) De-listed due to Net-worth becoming positive	9	20	26	40	95
(iii) Wound up	4	25	501	782	1312
(iv) Scheme sanctioned by BIFR	7(0.7%)	43(4.2%)	192(12.4%)	439(25.0%)	681(12.8%)
Balance(pending)	676(67%)	390(38%)	308 (20%)	95 (06%)	1469(27.6%)

Table 9.1: AGE-WISE RESOLUTION OF BIFR CASES



Based on the information available on pending BIFR cases, the time for which cases are pending in BIFR is as under:

Mean: 8.25 years
Standard Deviation: 4.96 years

The time taken for final resolution depends on factors like lenders involved in dispute, level of support provided by the lenders, the ability of the borrower to bear the additional cost of restructuring etc. In case of PSUs, the stand taken by the Government and Labour Unions also contributes to the delay.

Bringing out the medium enterprises from its purview may help in lightening the workload and expediting the decision making at this Forum.

With the enactment of MSMED Act, Micro, Small and Medium Enterprises are covered under the same provisions and therefore the rehabilitation for all micro, small and medium enterprises should also be given the same treatment. **Medium Enterprises should be taken out of the purview of BIFR and the banks given the responsibility of their rehabilitation, more so because only a fraction of the medium enterprises are covered under SICA and their rehabilitation done under the supervision of BIFR.**

Another issue that merits attention is that the BIFR cannot sanction any rehabilitation scheme without the support of all secured creditors, under Section 19(2) of SICA. In view of the same, rehabilitation of medium enterprises is not likely to suffer on account of their exclusion from the purview of BIFR, rather it shall expedite decision making at the level of BIFR making the rehabilitation of large units smoother and also expedite sanction of rehabilitation packages for medium enterprises as the reference would not shuttle between BIFR, AAIFR and High Courts.

SICA Repeal Act has been enacted but has not been notified by the Government. The provisions regarding appointment of members of NCLT was challenged in the Court and the Government is looking into the issue again. It is expected that NCLTs would become operational soon. However, with the quantum of work involved, NCLTs proposed to replace BIFR would also be equally loaded with work and may not be able to do justice to smaller accounts. Therefore, exclusion of medium enterprises from the purview of BIFR (and its new avatar in the form of NCLT) would help the lenders as also the borrowers.

9.12 <u>CHANGE IN THE APPROACH OF BANKS</u>

The bank officials working in the branches are not fully aware of the concept of sickness. On being queried about the definition of sickness, some of them replied only in general terms. The bank staff was also found to be unaware of the relief and concessions that can be provided to the sick units. The Group feels that **the implications of sickness in MSMEs for the bank, the economy and the nation and the need to promptly act after a unit is identified as sick needs to be ingrained in the field staff.** A few steps that need to be taken are

9.12.1 **The branch staff should be sensitised to the needs of MSMEs by continuing training on various issues pertaining to MSMEs.**

9.12.2 **The Rehabilitation Department should be an independent Department and not a part of the Recovery Department.** (Some of the banks continue to carry out rehabilitation activities from Recovery Department, which speaks of their mindset and the significance of rehabilitation in their overall approach.)

9.12.3 **The banks should have a separate cell manned by a separate cadre of officials for managing their MSME portfolio. This cadre should also provide guidance/ counselling services to sick MSME units as regards the change in product mix, technology adaptation, marketing strategy and network etc in addition to preparation of rehabilitation proposal.** This cell should also work on preparing special products to cater to the MSME sector.

9.12.4 There is a need to change the mindset of the bankers and also the fear of future staff side action. **The banks may consider changing their guidelines so that bonafide actions are not termed as lapses and do not attract staff side action.**

9.13 **CENTRALISED PROCESSING OF REHABILITATION PROPOSALS**

We have already recommended that rehabilitation of micro enterprises should be done at the level of a branch. **All cases beyond the powers of a scale II branch should be referred to Centralised Processing Cell where a separate Rehabilitation Cell should process and sanction the packages. Committee approach should be adopted for rehabilitation proposals also.**

9.14 **MONITORING OF REHABILITATION AT STATE LEVEL**

Delay in rehabilitation at the level of the bank or the Government officials harms the national interest by loss of scarce capital, employment avenues, Government revenue etc. There should be a State Level Body – a Nodal Agency to look into the issues and coordinate rehabilitation efforts and resolve any differences between the different stakeholders to ensure expeditious rehabilitation and monitor the rehabilitation measures. At present Empowered Committee under the Chairmanship of Regional Director of RBI and SLIIC are the two bodies that review the status of sickness in the MSME sector. In order to serve the interests of sick MSEs effectively, the responsibility should lie with only one body. The Group is of the opinion that **the responsibility should lie with the Empowered Committee, so as to ensure expeditious rehabilitation by the lenders. The constitution of the Empowered Committee may be widened to include participation of Senior Officials (competent to take decisions) from all departments of the State Government responsible for healthy growth of MSMEs and rehabilitation of sick MSMEs.**

9.15 **FORMATION OF DISTRICT LEVEL BODY FOR REHABILITATION**

We suggest formation of a district level body for rehabilitation of sick MSMEs where all agencies confirm their participation in rehabilitation. This shall expedite approval of concessions from State Government, in terms of its approved policy.

9.16 **SIDBI'S ROLE IN REHABILITATION**

At present SIDBI has a scheme for rehabilitation of MSE units assisted by it. The Group feels that **being the apex financial institution for MSMEs, SIDBI may provide advisory services to banks for rehabilitation/ revival of sick units by joining the appraisal and participating in financing such rehabilitation/ revival proposals even in respect of units not assisted by it.** SIDBI may also develop a rating/ scoring tool like CART for rehabilitation/ revival of sick MSE units.

EXIT ROUTE

9.17 Risk of failure is present in every entrepreneurial venture. To quote from the address of Dr. Rakesh Mohan, Deputy Governor, RBI, at Annual Bankers' Conference at Hyderabad on November 3, 2006 "there will be failures as well as successes… Despite the risk, financing of first time entrepreneurs is a must for financial inclusion and growth."

In MSME sector, the failure rate is relatively higher – the reasons for which range from delayed/inadequate availability of credit to non-availability of backward and forward support system.

A sound, transparent, clearly worded and equitable exit policy focussing on faster exit is the need of the hour. In order to achieve a more transparent, predictable, efficient, fair, reliable and sound insolvency system, the existing legislations may have to be toned up so as to integrate with the country's broader legal and commercial systems, provide for reorganisation of viable businesses and efficient liquidation of nonviable businesses, provide for equitable treatment of similarly situated creditors and recognise existing creditor rights and respect the priority of claims.

Necessary support system and enabling laws & procedures for providing comfort to the lenders are required to be put in place, especially as the bulk of the business financing especially at SME level is debt financing. An effective credit guarantee system is one of the ways for providing the comfort. Absence of such support/comfort system will increase sickness, as it will instil inertia in the bankers. The credit portfolio of the banks would be adversely affected and the banks would be more averse to lending to the sector.

The support systems should be supportive to the stressed units. Sensitisation towards the problems of the entrepreneurs and a solution finding approach on the part of the bankers would help the banks as well as the small enterprises. The law should be focussed on swift and efficient liquidation in case of non viable enterprises. However, liquidation of the business as a whole should be the preferred mode than piece meal liquidation. Timely rehabilitation measures, where preservation of the enterprise is in the interest of all stakeholders, are crucial for survival of small enterprises. The process of rehabilitation has to be not only quick but also easy to access and cheap when deemed necessary. However, a fertile environment has to be created for such supportive approach to succeed.

The external and internal audit system should be re-oriented. The auditors should be sensitive to timely support extended by field functionaries to the entrepreneurs when in stress. It has to be accepted that failure in revival efforts is a part of the banking business process. The decision of field functionaries as regards revival and rehabilitation should be supported at all levels.

9.18 **REPORTING SYSTEM**

Reporting System needs to be changed as even accounts where recovery has been initiated and there are no possibilities of rehabilitation continue to be reported as sick**. All accounts where recovery action has been initiated, after identification of the unit as unviable may be deleted from the list of sick SME units by the banks.**

9.19 Similarly, it is observed that NPA SSI units are very large in number but the number of sick small enterprises is reported at lower levels by the banks. **Intervention of technology may be adopted for correct identification and reporting of sick small and medium enterprises.**

9.20 The number of sick units as brought out in the RBI data is huge. The sick units reported by the banks include accounts where the balance has been written off leaving a balance of Rs 100, accounts under Government sponsored employment generation schemes like PMRY, SGSY etc. As these accounts are more for self employment, their inclusion in the data only makes the figures swell, with little efforts for their rehabilitation. Some of the States have stipulated a lower limit of credit for the account to become eligible for relief and concessions. The Group feels that **all loans provided for self employment, say all accounts below Rs 2 lacs may be excluded from the data of sick MSMEs.**

9.21 **LIMITED LIABILITY PARTNERSHIP**

The costly, cumbersome and complex paperwork deters the entrepreneurs from forming a corporate structure. On the other hand the other structures like proprietorship and partnership do not inspire confidence among the lending agencies. **A hybrid structure like limited liability partnership shall facilitate the entry of small players in the area as it shall have the advantages of both – the informal arrangement of partnership and the advantages of a company without its cumbersome procedures.** Further, such arrangement may be incentivized by taxing only the income earned by the partners and not the firm.

9.22 **WEAKNESSES IN RECOVERY INFRASTRUCTURE**

The present default redressal system has been designed through Debt Recovery Tribunals (DRTs) apart from civil courts/Lok Adalats. However, a number of DRTs are poorly staffed. **The legal setup for recovery of dues of banks/ FIs needs to be strengthened. Disposal of suits by DRTs should be time bound. A number of DRTs need more staff. At times, there is no presiding officer in some of the DRT which inordinately delays proceedings. Further, the number of cases is much more than that could be handled by the Presiding Officers. The Presidium of DRTs could be changed to a Committee of three retired / serving senior officers of banks / FIs as in the case of BIFR. This coupled with a time bound decision on applications by DRTs will significantly improve the settlement of cases.**

Dedicated Bench for SMEs may be set up at DRTs to expedite the process of recovery/resolution of dispute.

9.22.1 **ARCs**

There are only a couple of active Asset Reconstruction Companies (ARCs) in the country presently. There is no ARC focussed on NPA assets of MSMEs at present. SIDBI being the apex financial institution may set up an ARC with focus on SME assets. Considering the high level of NPAs in the country and the need to resolve them as it involves huge amount of public money, **GoI/RBI could initiate measures to encourage more number of ARCs, whose core competency would be recovery from NPAs.** Banks/FIs may initially be asked to provide capital/manpower for these organisations. Investment in such ARCs may be freely permitted, outside the ceiling limit of investments of banks/FIs under the extant guidelines of RBI. **ARCs should focus on revival of potentially viable sick units and not concentrate only on sale and realisation of the assets.**

9.22.2 **LOK ADALAT**

The Legal Services Authorities [LSA] Act, 1987 provides for organising Lok Adalats for quick disposal of suits pending in courts in summary way through the process of arbitration and settlement between the parties at a reasonable cost. Besides, Lok Adalat is a legally constituted Authority and it can take cognisance of any existing suit in the court and also adjudicate fresh disputes which are not pending before the courts. The Lok Adalats are guided by the principles of natural justice, equity, fair play and other legal principles for expeditious arrival of settlements through conciliation and without the need for going to courts. **Presently, cases having outstanding balance upto Rs.20 lakh only are eligible to be referred to Lok Adalat. GoI could consider raising this limit to Rs 50 lacs.**

9.22.3 **SIMPLIFIED OTS SCHEME FOR MSEs**

A simplified OTS scheme for units in MSE sector was launched in 2005. The scheme provided for a non-discretionary and non-discriminatory settlement at the balance outstanding as on 31-03-2004 for doubtful and loss assets and at balance outstanding **plus** interest at BPLR for doubtful and loss assets. However, out of a total 237222 accounts entailing exposure of Rs 6901.747 crores eligible for settlement under the scheme, only 8692 accounts (Rs 607.82 crores) were settled till 31-03-2006. It is felt that the failure of the scheme was on account of the high settlement amount.

It is derived from the RBI data on sick SMEs that 97% of the units have been found unviable. The measures suggested in the report are for growth of healthy MSMEs and for rehabilitation of potentially viable sick MSMEs. However, the number of units found unviable is very large. An opportunity for exit has to be provided to these units so that the promoters could start their businesses afresh with a clean slate.

In order to give one more opportunity to units which could not avail the facility and also help the banks to cleanse their books, RBI may come out with a liberal scheme of OTS for MSMEs, with the following features.

- **All MSME accounts classified in NPA category as on 31-03-2006 are eligible for settlement under the scheme.**
- **The settlement amount would be at a discount to the principal outstanding as on the date of NPA.**
- **The amount would be paid by the borrower within 6 months of approval.**
- **The promoters of these units would be eligible for obtaining finance after settlement of the dues under OTS.**
- With the above arrangement, all the sick units which became NPA more than 2 years ago would be taken care of. However, the new NPA units would still need support. **RBI may advise all banks to review accounts that became NPA after 31-03-2006 and declared unviable and to explore the possibility of their rehabilitation. If it is found that there is no possibility of rehabilitation or/and the promoters are also not interested in rehabilitation, they may be offered OTS based on the individual bank's guidelines, before any recovery action is initiated against them. Such units may also be considered eligible for further financing.**

9.22.4 There is a need to simplify the procedures and cut the time for exit for SMEs as these are small units and cannot follow lengthy and time consuming procedures for winding up/ exit.

9.22.5 Winding up/ exit, compromise, reconstruction, merger and acquisition of a company are governed by Companies' Act whereas in case of non-corporates (i.e. individuals, partnership firms etc) insolvency is governed by The Presidency Towns Insolvency Act 1909 and Provincial Insolvency Act 1920. The winding up/exit proceedings under these Acts takes a very long time. **We suggest that there should be a separate mechanism and courts for winding up of non-corporate enterprises (like NCLT) for expeditious decision making. We also suggest a simplified and easy exit route for private limited companies (as most of the MSMEs are private limited companies) may be provided in the Companies' Act which is presently under revision.**

As the Companies (Second Amendment) Act, 2002 provides for formation of rehabilitation and revival fund, appointment of professional liquidators and setting up of NCLT with powers to deal with liquidation as well as rehabilitation/ reorganization of a company, its operationalisation needs to be expedited. The Act should provide for a time frame to conclude the liquidation proceedings.

It may also be considered to have dedicated bench for SMEs in case of CLB/ NCLT and other courts.

9.22.6 **MARKETABILITY OF SECURITY RECEIPTS**
RBI has recently come out with guidelines for sale of NPAs either on cash basis or on issue of security receipts. **While primary sale of such NPAs has now been permitted, measures for imparting greater depth and broadening of the secondary market for sale of such NPA assets or instruments issued thereagainst would need to be actively pursued by RBI/GoI, to give a fillip to the activity.**

9.22.7 **CHANGES REQUIRED IN SARFAESI**
In view of the changed circumstances – shareholders expectations, charge on scarce capital, ever tightening prudential norms, peer pressure and financial sector reforms, the field staff tends to initiate the process of recovery immediately after an account is classified as NPA. The normal action plan of any banker when a small unit is in stress is to stop operations in the account, serve a recall notice and initiate action under SARFAESI Act. Efforts for rehabilitation, if any, are adhoc and not properly structured after viability study or analysis of the root causes of sickness etc. The bank staff puts in efforts to avoid classification of the account as NPA. All focus of the banks is centered on the asset classification and not health classification.

9.22.8 Some of the SME Associations have suggested in press that the threshold limit for action under SARFAESI should be raised to Rs. 10 lacs. The existing threshold level for action under SARFAESI was fixed about 6 years ago. **The Group feels that the provisions of SARFAESI Act may be made applicable to accounts with outstanding of Rs 5 lacs or more so as to enable the banks to focus on bad debts in medium and large sector instead of micro and small enterprises.** Incidentally NCEUS has also suggested raising the limit for action under SARFAESI Act to Rs 5 lacs.

9.22.9 State Financial Corporations are empowered under Section 29 of SFC Act to take recovery action by takeover of assets of the borrower without judicial intervention. Our study in the industrial estates and the feedback of some of sick units reported by SME associations reveals that SFCs have aggressively used this provision for recovery. **It may be ensured that the SFCs give an opportunity to the defaulting units for rehabilitation before initiating action under the Section of 29 of SFCs Act.**

9.22.10 It is also suggested that **SFCs may be advised by the State Governments to give back the possession of all units taken over by them to their promoters, if the unit has not been sold within 2 years of such possession. Such re-possession may be given only to promoters willing to restart operations. However, the promoters may not be given the right of alienation of the assets. The SFCs may be given concessions on the front of income tax similar to those given to infrastructural developers.**

9.22.11 Section 22 of Sick Industrial Companies (Special Provisions) Act 1985 states that where an inquiry is pending, any scheme is under preparation, a sanctioned scheme is under implementation or an appeal is pending then no proceedings for recovery or enforcement of security shall lie except with the consent of BIFR. **In order to give a reasonable time to the promoters of re-possessed units to restart and stabilize productions at a profitable level and generate funds for repayment, these units may be declared relief undertakings for a reasonable period (say 3-5 years) thereby averting any recovery action by the SFCs during this period.**

9.22.12 Banks have been given powers similar to SFCs (section 29 of SFCs Act) under SARFAESI Act and after the initial inertia have started flexing their muscles for coercive recovery. There is a possibility that, like SFCs, banks may also take this easy route and lose focus on rehabilitation. We suggest that **it should be made compulsory for the banks also to give the promoters an opportunity for the revival of a unit before it is declared as unviable. Further, a stipulation of making at least one effort for rehabilitation before initiating action under SARFAESI Act is expected to help in averting hasty action by the branches in initiating recovery without making any efforts for revival.**

10. SUMMARY OF MAJOR RECOMMENDATIONS & ACTION POINTS

With increasing competition, introduction of new products and stringent regulatory environment, the role of banks has also changed from mere lenders to partners in business. This transformation has been muted in underdeveloped/ developing countries but has been more pronounced in developed nations. There is a need for greater participation of banks in the affairs of their constituents by convergence of credit services and non credit services. The banks should not only provide differentiated products for MSMEs, but also provide counselling & guidance to new and established businesses, marketing support etc. Similarly the Government and other institutions entrusted with development of the MSME sector need to imbibe professional approach in their working so that the credit function being discharged by the banks is adequately supplemented by their non credit functions. The focus of these institutions has to be on providing the enabling environment, infrastructure and forward & backward linkages.

The major suggestions of the Group and a brief rationale for them have been given hereunder. The detailed analysis is given at the relevant paras mentioned in brackets at the end of each recommendation.

A. FLOW OF FUNDS

i. In order to cut delay, simplify procedures and obviate the need to take help of professionals in preparing data / report, we suggest as under

   a. At present small and medium enterprises have to spend a lot of time and money for preparing techno economic viability/feasibility study report. To obviate the need for such study and in order to make the process of sanction of project loans for small enterprises commonly prevailing in the area simple and easy, we propose that the following system be introduced. (Para 3.6.1)

      - The niche industry or the activities having good concentration in the area may be identified by the banks and DIC.

      - The model cost of project for different sizes of commonly prevailing industry and overall viability of the activity may be assessed by a Committee comprising of 2-3 major banks of the District under the aegis of Lead Bank so as to obviate the need of any expert/professional to prepare TEV study in individual cases. The exercise may be carried out periodically after considering the price of machinery and other fixed assets required, sources of raw material, technical expertise and skilled labour availability, access to market etc. DIC may also be associated with the process. Small entrepreneurs may use these project profiles and not take help from professionals in preparation of time consuming and costly TEV study/viability report. While financing, banks should also not go for TEV study in individual cases. To begin with, this practice may be started for projects requiring terms loan upto Rs.1 crore. At a later stage, this may be raised to Rs.2 crores after a review. Cash losses that may be incurred in the initial period, interest during construction period and provisions for contingency should invariably be included in the cost of project. Instalments may be fixed based on cash flows, and may be staggered or ballooning also.

- Sufficient delegation of powers for sanction/rehabilitation of SMEs should be made at the field level. The credit needs of all micro enterprises should be met by a Branch Manager of a scale II branch.

b. At present, banks seek projected Profit and Loss Account, Balance Sheet, Fund Flow/Cash Flow on the pattern of CAS/CMA data as recommended by Tandon/Chore Committee. This requires engaging the services of professionals which the small enterprises cannot afford. There is a need that the Nayak Committee norms are implemented without exception. Banks should issue clear cut guidelines to their branches that CMA data or Operating Statement, Balance Sheet, Cash Flow etc is not necessary for WC limits upto Rs. 5 crores in the MSE sector. (Para 3.6.2)

c. Lack of transparency in the financial data and the inherent weakness of small enterprises make the process of rating difficult in MSMEs. There has been a general complaint that the complex procedures of the banks lead to delay in sanction. Rating may further complicate and therefore delay the sanctioning process. Basel II norms permit use of scoring models for loans upto Rs. 5 crores. We suggest that lending in case of all advances upto Rs 2 crores should be done on the basis of scoring model. Information required for scoring model should be incorporated in the application form itself. No individual risk rating is required in such cases. (Para 3.6.3 a)

d. Banks may be encouraged to start Central Registration of loan applications. The same technology may be used for online submission of loan applications as also for online tracking of loan applications. A discount of 20% on processing fees may be given for online applications. (Para 3.6.3 b)

e. The application forms, especially for other than very small loans, may be so designed that all documents required to be executed by the borrower on sanction of the loan form its part. The form could be in the form of a booklet. The forms should invariably have a Checklist of the documents required to be submitted by the applicant along with the application and the formalities required to be completed post sanction. (Para 3.6.3 c)

f. In case of all micro enterprises, simplified application cum sanction form (which should also be printed in regional language) be introduced for loans upto Rs 1 crore and working capital under Nayak Committee norms, on the pattern of simplified format of SARAL in Income Tax. No other information/ annexure/ report should be sought. (Para 3.6.3 d)

g. A Web Based Central Loan Registry may be created to provide the details of loan seekers and loan providers and enabling match making for speedy delivery and appropriate pricing. Loan seekers may put the basic information on their project, business plans etc on the online system and the bankers linked to the registry and desirous of funding it can advise the loan seeker about their interest. It shall act as National Loan Data Center for entrepreneurs and bankers. (Para 3.6.3 e)

ii. In terms of the Nayak Committee norms, the banks are required to provide minimum 20% of the turnover to the business enterprises as bank finance and 5% is to be obtained as margin. This translates into a current ratio of 1.25. However, the guidelines of banks, the rating models etc provide for a current ratio of 1.33. RBI may issue necessary clarification that a current ratio of 1.25 is acceptable in accounts where bank finance is provided under Nayak Committee norms. (Para 3.15)

iii. The bank branches are burdened with a number of activities like agriculture loans, recovery, deposit mobilisation etc. Very often they are not in position to take decision on loan application of SMEs. In order to ensure that expeditious decision is taken on the credit requirement of small and medium enterprises, Centralised Credit Processing Cell should be introduced. These Cells may be utilized for single point appraisal, sanction, documentation, renewal and enhancement. The arrangement is expected to help by way of reduction in delay and multiple queries, utilization of the talent available to the banks in an optimal fashion besides building reliable MIS, developing fair practices and easier tracking. Initially, the CPCs may be setup at each Regional Office of each bank. It may further be set up in recognised clusters also. The working of Centralised Processing Cell should be reviewed by the controlling office of the bank. CPC should act as the back office of the bank. (Para 3.9)

iv. Committee Approach may be introduced for sanction of new loans as also rehabilitation cases. This will not only improve the quality of decision as collective wisdom of the members shall be utilised, but also alleviate the fears of the bankers as regards the accountability issues that play heavily on the minds of the bankers while taking a decision on loan application for green-field projects in the micro, small and medium enterprise sector or the rehabilitation proposals. (Para 3.10)

v. The rate of interest on loans should be completely deregulated and should be determined by the lenders based on the competitive market forces. Any reduction in the rates of interest for micro, small and medium enterprises is not warranted at this stage. (Para 3.11)

vi. The banks may be encouraged to accept interchangeability of margin and collateral so as to enable the borrowers having poor liquidity to provide additional collateral without inducting funds and the banks accordingly reducing the margin. RBI may consider raising the limit of compulsorily collateral free loans from Rs 5 lacs to Rs 10 lacs incentivised by 80% coverage under CGTMSE. (Para 3.12, 3.13)

vii. At present, SME units which have been incorporated as a company have to follow the Balance Sheet, Profit and Loss Account and other disclosures in the format prescribed in Schedule VI of Companies Act. They are also required to follow the accounting standards as prescribed by ICAI for large corporates. As Government has already set up a committee for amendment of Companies' Act, it is felt that the revised Companies' Act should prescribe simplified disclosures norms and ICAI should come out with simplified account standards for SMEs. Alternatively, exemption from certain disclosures and relaxation from certain procedures/ compliances in Accounting Standards may be allowed. (Para 3.18)

viii. The banks should consider a combined level of stock and receivables and no separate sub limit for debtors should be fixed. Banks should allow CC/OD against stock and receivables under one facility only. (Para 3.14)

ix. In order to avoid incidence of sickness at the initial stage of setting up of the unit, the Group suggests that

   a. SFCs should, as an interim measure, invariably sanction working capital while extending term loan to any unit, if not already tied up.
   b. The term loan component may be assessed as per the procedure suggested above and working capital under Nayak Committee norms.
   c. Pooling of security of term lenders and WC lenders may be considered. (Para 3.7)

x. Banks who have sanctioned term loan singly or jointly must also sanction WC limit singly (or jointly, in the ratio of term loan) to avoid delay in commencement of commercial production. A review may be done by all banks and it may be ensured that there should be no case where term loan has been sanctioned and working capital facilities are yet to be sanctioned.(Para 3.8)

xi. Interest of at least 6 months after commercial production be included as a part of the project cost. Sufficient moratorium for repayment of the principal should also be given. (Para 3.16)

xii. Audited accounts may not be insisted upon by the banks from micro enterprises whose turnover is less than Rs 40 lacs. (Para 3.17)

xiii. Banks may develop appropriate Credit Appraisal and Rating Tool (CART) on the pattern of software developed by SIDBI or can take the help of such tools developed by SIDBI for loan/working capital facilities to small and medium enterprises. (Para 3.19)

xiv. The banks may focus on opening more specialised micro, small and medium enterprise branches. The expansion of specialised branch network in all identified clusters and Industrial Estates should be completed in a time bound manner say within next 3-5 years. An appropriate mechanism for reviewing and overseeing development of MSME sector may also be put in place. (Para 3.20 b)

xv. The available data shows that the focus of the banks has been more on urban and metropolitan areas, the larger borrowers and corporate & retail accounts. The census also reveals that 3% small enterprises availed financial institutions from non-institutional sources as against 5% from the institutional sources. In order to bring these 3% small enterprises into the formal banking fold, we suggest that RBI may formulate model guidelines for the banks for providing replacement debt to MSMEs and based on the same, individual banks may formulate their own schemes. (Para 3.20c)

xvi. There should be a Central Registry for registration of charges of all banks and other lending institutions in respect of all moveable and immovable properties of borrowers incorporated as proprietorship, partnership, cooperative society, trust, company or in any other form. (Para 3.20d)

xvii. The banks should use the platform provided by the technical institutions and send their staff to such institutions on a regular basis. Training is also required to be imparted to the branch managers and their loan officers for change in their mindset away from the perceived risk in financing MSMEs. A system of incentives for good performance in financing to MSMEs may be implemented, which may be by way of special mention in the Performance Appraisal, special training etc. (Para 3.20 a)

NEW FINANCIAL PRODUCTS/ SERVICES

xviii. A single facility against stock and receivables has been suggested by us to take care of liquidity problems arising out of blocked receivables. In case the lenders find it difficult to implement, banks may consider sanctioning 50% of the working capital as post sales limit. Cash Credit (Book Debt) may be provided at a lower margin of say not more than 30%. In case of bill discounting/factoring also, margin may be reduced. (Para 3.21 a)

xix. Although two public sector banks have set up separate subsidiaries for taking up factoring activity and a few private sector banks are engaged in factoring, we propose that all banks may take up factoring activity themselves, particularly for MSMEs. At present there is no separate Act governing the Factoring services. There is a need to bring change in the legislative environment for making the process easier. To encourage the banks to take up factoring for micro and small enterprises, the following steps may be considered.
    a. Refinance at concessional rates from SIDBI/RBI may be introduced.
    b. Bringing in appropriate legislation for factoring.
    c. Stamp duty is payable on assignment of actionable claims. Modification in these provisions for factors by way of exemption or prescribing a ceiling on the stamp duty would give impetus to the activity. (Para 3.21 b)

xx. An Exchange with focus on SMEs on relaxed listing requirements may be set up at the earliest, preferably with the involvement of NSE (the trading partner) and SIDBI (SME focal point). SEBI should come out with simplified disclosure and listing norms for IPO and cost effective norms for publication/ declaration, so as to enable the SMEs to come out with IPO at an affordable cost and within a reasonable time. (Para 3.21 c)

xxi. Securitisation of SME advances needs to be encouraged as the same shall provide a market for lenders active in rural and semi urban areas to market them to foreign and private banks. (Para 3.21 d)

xxii. Government has proposed setting up of two Funds of Rs 2000 crores each with SIDBI for risk capital financing and for enhancing the refinancing capability of MSME sector.
    a. We propose that another independent Rehabilitation Fund may be created for rehabilitation of sick micro, small and medium enterprises as it has been observed that rehabilitation of sick SMEs could not be taken up due to non availability of promoters' contribution in a large number of cases. The fund may have a corpus of Rs 1000 crores. While 75% of the corpus could be earmarked for assisting the micro and small enterprises, balance could be utilized for assisting medium enterprises. The fund could go a long way in rehabilitation of sick micro and small enterprises. This fund may be utilized for providing soft loan at a concessional rate of interest, say 5-6%/ quasi equity upto 50% of the required promoters' contribution subject to a maximum of Rs 75 lacs. (Para 3.21 e (i))
    b. Similarly, another fund may be created for contributing to the margin required to be brought in by the promoters of units taking up technological upgradation. This assistance may be provided in the form of a soft loan/ quasi equity/ equity. (Para 3.21 e (ii))
    c. In order to encourage MSME units to market their products it will be desirable to set up a Marketing Development Fund which could interalia be used for providing financial assistance in setting up distribution and marketing infrastructure/ outlets. This can also contribute resources to institutions organising exhibitions etc at various level. (Para 3.21 e (iii))
    d. National Equity Fund Scheme should be restarted. This fund could be utilized for green field or expansion projects. This fund may be operated through banks on risk sharing basis. The NEF contribution in the form of soft loan may be restricted to 15% of the project cost for micro enterprises and 10% for small enterprises. At least 30% of the funds may be earmarked for micro enterprises. (Para 3.21 e (iv))

e. In order to encourage the entrepreneurs to innovate new ideas, it is necessary that venture capital/ mezzanine finance should be encouraged. There should be a separate fund with the umbrella organisation (suggested in the report)/ SIDBI which should help venture capital funds in meeting the finance requirements of small enterprises by way of equity/ mezzanine finance/ soft loan etc. (Para 3.21 e (v))

f. As an incentive for proper restructuring package at the time of rehabilitation necessary support for business restructuring, modernisation, expansion, diversification and technological upgradation as may be felt necessary by the lenders may also be encouraged. Support of schemes like Credit Linked Capital Subsidy Scheme (for units in other than rural areas) and KVIC Margin Money Scheme (for units in rural areas) may be extended for rehabilitation packages also. (Para 3.21 e (vi))

xxiii. State Financial Corporations have contributed to the development of SSI sector. Positive results have also emerged from the efforts for their revival. However, there are concerns in putting back these Corporations on a sustainable scale of operations. Recognising their contribution to industrialization of the respective regions and having regard to the potential of these Corporations, GOI may direct the respective State Governments to provide a one time financial support for recapitalization of viable SFCs. Those SFCs which are found unviable may be allowed to wind up their operations and the State Governments should settle the creditors/lenders. (Para 3.22)

B. FINANCIAL INCLUSION AND MICRO ENTERPRISES

The Third Census of Small Enterprises 2001-02 amply brought out the extremely high financial exclusion in the micro, small and medium enterprise sector. As per the Census 99.5% of the total small enterprises and 99.9% of the unregistered small enterprises were tiny industries (micro enterprises as per the new definition). While only 4.55% of the total small enterprises had outstanding loans from institutional sources as on 31-03-2002, for the unregistered sector it was only 3.09%. Subsequent interventions by the Government and RBI would have improved the scenario, but much more is still required to be done to improve the delievery points for credit in quantity and quality, especially in rural and semi-urban areas.

i. The Government, in its policy package of 2005, mentioned that each semi urban/urban branch of the commercial banks (including regional rural banks) should provide credit cover on an average to at least 5 new tiny, small and medium enterprises per year. It is suggested that the banks may set higher targets so that they may finance at an average of at least 10 accounts per semi-urban/ urban branch per year. New branches or branches in residential areas may not be able to achieve this growth and therefore other branches would have to fill in the gap to achieve the targets. (Para 4.15)

ii. RBI may consider permitting the public sector banks to use Micro Finance Institutions as business correspondents/ facilitators to scout for business, in micro enterprises sector only in identified excluded rural and semi urban areas. The banks may encourage these business correspondents especially in backward areas by equity participation, loans on concessional rates and other similar measures. Further, infrastructure at EDCs may be utilised for identification of the weaknesses and the areas for capacity building of the MFIs and the target clientele. (Para 4.11)

iii. In rural and semi-urban areas, RRBs and cooperative banks need to play a more active role in the development of micro, small and medium enterprises. RBI may encourage RRBs and cooperative banks to take up micro, small and medium enterprise financing in a big way. However, the officers and staff of these banks posted in the branches have little knowledge of micro, small and medium enterprise financing and proper training needs to be imparted to them. NABARD may be requested for providing the necessary training and infrastructure for the same. The encouragement may also be given by way of refinance of SME loans on softer terms. (Para 4.7)

iv. The Group endorses the draft recommendations of Raghuram Rajan Panel for setting up of small finance banks that may reach out to the poorer sections and small & medium enterprises. For inclusive growth, the banks shall have to reach out to its constituents physically, for which the banks shall have to introduce innovative ways like use of draught animals or barefoot banking. Such radical approach shall have to be backed by technology, so that all services normally used by such remote constituents are made available right at their doorstep. (Para 4.8, 4.9)

v. We suggest that a scheme for utilising specified NGOs for providing the following services to tiny micro enterprises may be launched by the Government.

   a. Training in basic accounting principles and credit management
   b. Training on marketing, technology, design development, packaging, quality control etc
   c. Creation and development of institutions of borrowers like cooperatives etc
   d. Participation in exhibitions and marketing fairs
   e. Development of common facilities for a group
   f. Providing financial assistance for infrastructure creation

   In order to enable the NGOs to discharge the above duties, grant equivalent to 25% of the cost of the project or Rs. 5 lakhs, whichever is lower may be provided by the Government. Ministry of MSMEs has launched a schemed titled "Trade Related Entrepreneurship Assistance and Development" for women, wherein it, inter-alia provides a grant upto Rs. 1 lakh per programme. This provision may be extended to cover the training programmes proposed above. (Para 4.10)

vi. As micro enterprises have small entry barriers, their financial strength is very poor. They work on thin margins and are therefore susceptible to even minor changes in the working environment. In order to provide credit enhancement to the lenders without adversely affecting the liquidity of the enterprises, Government may explore the possibility of bearing the entire credit guarantee fees payable to Credit Guarantee Trust for all micro enterprises. (Para 4.13)

vii. As per the extant RBI guidelines, banks are required to provide at least 40% of their total SSI advances to micro enterprises having investment of Rs 5 lacs or less and 20% to units with investment in plant and machinery between Rs 5 lacs and Rs 25 lacs, thus making it 60% for micro enterprises. The data reveals that the banks have not been achieving these targets. Our study on flow of funds to small enterprises sector reveals that there is a need to focus on finance to micro enterprises in North Eastern Region, hilly areas and other backward areas. A stricter regime of monitoring of achievement of targets at the level of banks and RBI is suggested so as to ensure adequate flow of credit to the smaller units. Similarly more focus is required to be given to these backward areas in case of rehabilitation also. In view of the lower than stipulated achievement of targets for advances to micro enterprises and tiny micro enterprises as a percentage of advances to MSEs, we suggest that RBI may come out with revised guidelines, wherein the target for advances to micro and tiny micro enterprises may be retained at the existing levels but the banks may be given a timeframe of say 5 years to achieve the targets in a graded fashion. On the lines of contribution to RIDF, the banks not achieving the graded targets may be required to provide funds equivalent to the shortfall to SIDBI for creation of a fund exclusively for micro enterprises. This fund may be utilised for refinance to the lenders against their lending to micro enterprises at bank rate or for financing infrastructure for micro enterprises. (Para 4.5)

viii. The incidence of sickness in small enterprises is double of that prevailing in the banking system as a whole. This makes the lenders averse to lending to the sector. There is a need for strengthening the risk taking capability of banks, especially for micro enterprises. We suggest that the risk coverage under CGTMSE may be raised to 80% for all micro enterprises. (Para 4.14)

C. DEVELOPMENT OF BACKWARD AND FORWARD LINKAGES

Small scale industry works in a universe of stringent regulatory environment, erratic power supply, non availability of raw material at reasonable prices, tough competition from imported goods and products of large corporates enjoying economies of scale, tough norms on pollution control, delayed realisation of receivables etc besides the risk-averse mindset of the banks. Small enterprises are the most vulnerable sections of Industry which need systemic support from the government and other agencies. Therefore, other institutions entrusted with development of the MSME sector need to imbibe professional approach in their working so that the credit function being discharged by the banks is adequately supplemented by the non credit functions of the Government agencies and other institutions. The banks should not only provide differentiated products for MSMEs, but also provide counseling and guidance to new and established businesses, marketing support etc.

i. SETTING UP OF CREDIT COUNSELLING CENTRES

On the initiative of RBI, some banks have set up Credit Counselling Centres which offer free counselling on curative measures mainly to farmers or retail borrowers. RBI has also come out with a Concept Paper on setting up of Financial Literacy and Credit Counselling Centres.

The Group suggests that banks should set up such Credit Counselling Centres (whether singly or jointly with other banks or with large corporates) for exclusively for MSMEs. Such Centres may be set up in major industrial towns/clusters. These Centres may provide preventive as well as curative guidance. (Para 5.2)

ii. CAPACITY BUILDING

Industries are an integral part of the Indian Economy since the ancient times. It is the developed state of Indian economy and entrepreneurship that attracted the Europeans to Indian shores. The industrial economy and the entrepreneurial spirit were stifled by the European powers for ulterior motives. The objective behind the expansion of their Empire was to find sources of cheap raw material for their industries and markets for their products. It was during the expansionary phase of the Europeans that the Industrial Revolution was taking that continent on a path of progress and development. India missed the bus as it had no right of self determination. Swadeshi movement was the result of retaliation against economic exploitation of the Indian subjects.

In the post independence era, the policy makers rightly thought it necessary to provide a protected environment so that the industry could grow and the spirit of entrepreneurship nurtured. Institutions were developed for the same and the momentum picked up. With integration of the Indian economy with the global economy, the protected environment became a handicap and the industry found it difficult to adjust to the new environment. However, the 60 year young Indian entrepreneurship and industry showed resilience and there has been all round growth in the recent times.

Necessity entrepreneurship and lack of adequate capacity is the key feature, as regards micro, small and medium enterprises. A well defined policy, effective implementation, enabling environment, adequate infrastructure, supportive approach of bureaucracy, marketing support, technological inputs etc from the Government are vital for the success of the sector.

In order to equip the MSMEs with the capacity to manage their businesses effectively and efficiently, all stakeholders need to make concerted efforts. The stakeholders may setup Enterprise Development Centres (EDC), providing comprehensive guidance and training not only for setting up of new units but also provide continuing education on different aspects of successful management of existing business enterprises. The EDCs may be setup by the stakeholders either individually or jointly, on their own or through subsidiaries or as joint ventures with private entities. These EDCs may provide the following services:

a. Entrepreneurship Development Programmes for first generation entrepreneurs.
b. Continuing education to existing enterprises on issues like designing of the product, technical upgradation/ absorption of latest technology, packaging, financial management, marketing.
c. Setting up of incubators for development and testing of technology. These centres may be affiliated with IITs/ engineering colleges for continuing research and development of new innovative products, cost reduction, design development etc.
d. Tapping the linkage of their promoters with the large corporates in assisting the entrepreneurs in forging marketing tie ups.
e. The Government may provide grant upto Rs 2.5 crores, which should not be more than 50% of the cost of project for setting up each EDC, as against the present provisions of Rs 1 crores.
f. The State Governments may provide land for setting up such EDCs free of cost. In case the same is not possible, 50% of the land cost may be borne by the State Government.
g. While the EDCs envisage continuing education to the new as well as existing units, there is also a need for providing training on skill and technology upgradation by such EDCs so as to take care of the fast changing technology, design, development of new innovative products and processes.
h. SIDBI may defray a part of the training costs @ Rs 5000 per trainee out of a Fund to be created within SIDBI from out of contribution from Government. (Para 5.3)

iii UPGRADATION OF TECHNOLOGY

One of the problems faced by small enterprises is obsolete technology. These units are not able to compete with the large corporates and cheap imports. There is little availability of funds with the promoters for technological upgradation.

a. While Department of Science and Technology is actively working for development of new technologies for the small and large industry, much more needs to be done. Adaptation of technology developed in other countries to the needs of Indian MSME sector also needs to be considered for making them more cost effective and dovetailed to the requirements of the customer. (Para 5.4.2)
b. It is necessary that all stakeholders extend financial support to Engineering Colleges/IITs for a department or a Chair for undertaking research for technological upgradation in micro, small and medium enterprises. All new technology developed under such arrangement may be passed onto the small enterprises through the Enterprise Development Centres. The Engineering Colleges may be preferably linked to clusters. In order to encourage R&D towards upgradation of technology for micro, small and medium enterprise units, we propose that section 10 (21) of Income Tax Act may be amended to allow 150% deduction for contribution made towards funding of R&D work in Engineering Institutes. (Para 5.4.3)
c. It is proposed that the Government should introduce industry specific interest subsidy scheme for SMEs on the pattern of TUFS for technology upgradation and for setting up new units with latest technology. However, latest technology which may be covered in each industry has to be specified by the Ministry. (Para 5.4.4)
d. Lack of skilled manpower has been a constraint in the growth of the sector. The Government may set up more ITIs, Tool room training centres etc for training of the workforce on the latest technology, especially in the command areas of the user industry. (Para 5.4.5)

iv. MARKETING

a. Central/ State Government should take steps at National Level/ state level/ district level for marketing and distribution of products, particularly of micro & small enterprises in corporate/ joint venture/ cooperative sector. The emphasis should be on organisations focusing on sale of products of micro enterprises in backward states / areas on the pattern of KVIC/ Kshetriya Shri Gandhi Ashrams/ SEWA/ AMUL. Such marketing organisations may be given assistance in the form of reimbursement of discount, storage, marketing and distribution expenses etc. Capital subsidy for setting up retail outlets may also be considered. (Para 5.5.3)

b. Industry specific Apex Cooperative Marketing Federation may be strengthened, who can have distribution and marketing tie up through their own retail outlets or other outlets. Autonomous Bodies like Handicraft and Handloom Boards should be set up at National and State levels in other industries also. The existing marketing setups should be strengthened with more retail outlets/ affiliated outlets, market research on the customer preferences (like design colour etc) so that the small enterprises are in the know of the market demand and produce accordingly. (Para 5.5.4)

c. A similar support system is required for providing raw material at reasonable prices at the doorstep of the units. Providing of infrastructural facilities to the units like creation of cold chain, process house, utilities etc also may be provided the same treatment. (5.5.5)

d. Under SFURTI scheme, KVIC extends 100% grant to agencies engaged in development of marketing as Market Promotion assistance subject to a maximum of Rs 15 lacs. It may consider extending the grant without any cap to all entities providing raw material at the doorsteps of the units, providing marketing setup or infrastructural facilities in rural areas. (Para 5.5.6)

e. In order to help the small enterprises in marketing of their products, the Government may consider setting up of permanent exhibition centres on the lines of Delhi Hat. Besides, periodic exhibitions of the products of small enterprises may be held by the Government in partnership with MSME Associations, or private businesses. (Para 5.5.7)

f. There is a need for developing the micro, small and medium enterprises in such fashion the micro enterprises produce small components and parts or do preliminary processing of inputs or engage in job works for small enterprises, the small enterprises undertake the assembly of parts produced by the micro enterprises. The designing, technology and marketing should be handled by medium enterprises. The medium and small enterprises need to be induced to opt for such integration by fiscal or tax benefit/ other incentives. This arrangement protects the micro and small enterprises from the planning and capital intensive aspects of industrial activity. (Para 5.6)

v. CREDIT INFORMATION SERVICES

The banks are in the business of financing businesses. They are equally exposed to risks to which their constituents are exposed. Different methods of risk reduction are credit enhancement by collateral security or by credit guarantee, decision making on the basis of reliable, transparent and updated information, and providing level playing field to the Indian enterprises (vis–a-vis their global counterparts) by way of adequate infrastructure. As regards the availability of transparent credit information, setting up of Credit Information Companies has already been approved by the regulator. We suggest that these should be private sector enterprises with necessary data security and storage safeguards to be advised by RBI. Fees for providing the information should be kept at a minimum level so that the same does not exceed the information collection expense of credit information especially for small borrowers. The credit score of each entity should be provided to it at least once a year without any charges as also the negative features impacting such scores so as to enable it to improve the same. (Para 5.7)

vi. **SETTING UP OF AN UMBRELLA ORGANISATION**

An umbrella organisation for overseeing the coordinated development of the micro, small and medium enterprise sector can put the sector on a high growth path. In order to sustain the high growth trajectory charted by the policy makers, a setup similar to SBA of USA should be created in India also. It may be called as Small Enterprise Organisation and formed as a company under the Companies' Act or a Statutory Body or realigning the existing institutional set up to form such an autonomous body/organisation (which may be decided in consultation with RBI/ Ministry of MSME/SIDBI), with an initial capital base of Rs 500 crores, to be contributed by the Government of India. Subsequently, the banks, FIs and even private investors including multilateral agencies like World Bank, IFC etc may be permitted to hold equity in the Organisation. The entity may have a pan-India presence with the offices in all States and at major industrial centres. (Para 5.8.4, 5.8.5, 5.8.6)

The objectives of this umbrella organisation may be to help, support, guide, advise, and protect the interests of micro, small and medium enterprises, to work for the promotion of micro, small and medium enterprises, to provide relief and succour to small businesses in times of distress. (Para 5.8.7)

Besides the functions performed by SBA of USA, we suggest that SEO may also undertake the following functions. (Para 5.8.8)

a. Development of Investment Companies for onlending to MSME sector
b. To provide financial/managerial assistance in setting up of clusters/industrial estates/common facilities under PPP model for growth of SMEs. It can also help in upgrading/creating further infrastructure in existing industrial estates/clusters and to provide market intelligence support.
c. To provide financial and managerial assistance in setting up of marketing and distribution organisations at national/regional/local level on the pattern of AMUL and SEWA. These organisations may be set up in corporate sector or cooperative sector or in any other form.
d. To provide financial and managerial assistance in setting up entrepreneurship development centres with the assistance of banks, Engineering Colleges, IITs etc. for conducting R&D, Design Development, innovative product development for SMEs units. These Centres can also help in setting up incubators and imparting training to SMEs.
e. To provide support to small enterprises in the event of natural disasters like flood, draught, cyclone, earthquake, etc.
f. Administration of Risk Capital Funds including the National Fund for the Unorganised Sector, Technology Development Fund, Market Development Fund etc
g. Financing/ refinancing technology upgradation
h. Market Research for the micro, small and medium enterprises
i. Advising the Government on various issues relating to MSME sector
j. Participation in the equity of companies setting up the common facilities (including power projects) predominantly for micro, small and medium enterprises

vii. FORMATION OF MSME POLICY BY THE STATE GOVERNMENTS

a. We recommend that each state Government should also have a separate Ministry for MSME. In addition, the State Governments should also have long term and short term policy for development/ promotion of MSME sector (Para 5.9).

b. The Government-entrepreneur partnership and bank-entrepreneur partnership proposed for the first generation entrepreneurs needs to be supplemented by entrepreneur-entrepreneur partnership. New entrepreneurs may be mentored by the established players in the field. (Para 5.10).

c. State Government should provide preferential treatment to MSMEs in providing uninterrupted power supply. In case the same is not possible, the State Government may provide back ended subsidy on loans taken for purchase of DG sets. (Para 5.11).

D. CREDIT GUARANTEE FOR MICRO AND SMALL ENTERPRISES

The Credit Guarantee Trust for Micro and Small Enterprises provides credit guarantee on loans to small and micro enterprises. As per the present scheme, term loans and working capital facilities granted to Micro and Small Enterprises (as defined under MSMED Act 2006) by the member lending institutions and insured with the Trust are covered to the extent of 75% of (a) the principal outstanding in case of term loan and (b) total outstanding (maximum being sanctioned limit) in case of Working Capital. The total loans eligible for coverage are only Rs 50 lacs. In case of micro enterprises (with loans upto Rs 5 lacs) and enterprises owned by women the coverage is 80%. CGTMSE charges Guarantee premium of 1.5% initially and 0.75% as annual service fee. CGTMSE guidelines may be modified as under to increase the coverage.

a. The coverage limit may be raised from Rs 50 lacs to Rs 1 crores. (Para 6.2.1)
b. In order to help the Micro Enterprises, we suggest as under :
    1. Coverage of all micro enterprises may be raised to 80%.(Para 6.2.3)
    2. Micro enterprises should not be burdened with Guarantee Fees and the Government may explore the possibility of bearing the entire premium for all micro enterprises. (Para 6.2.3)
    3. The premium for the coverage of rehabilitation loans may be charged at only half the normal rates for small enterprises as the same shall help in improving the cashflows of the sick unit. (Para 6.2.5)
c. CGTMSE may clarify that any charge on any assets of the borrower for securing the debt will not be treated as collateral security. (Para 6.2.2)
d. Premium for credit guarantee coverage may be differentiated on the basis of risk rating of the borrower, in case of small enterprises. (Para 6.2.4)
e. The CGTMSE may include a provision in their guidelines enabling the banks to exit the CGTMSE coverage in any account after the initial period, at their discretion. (Para 6.2.7)
f. The Group feels that CGTMSE may bring out different variances of the guarantee product including sharing of collateral with it alongwith greater coverage another scheme may be introduced. (Para 6.2.6)
g. While the concept of mutual credit guarantee has been tried, Credit Guarantee coverage by CGTMSE in association with Joint Liability Groups may be upscaled. (Para 6.2.8)

E. INDUSTRIAL ESTATES/ INDUCED CLUSTERS

Natural clusters have developed over the years. Units in such clusters have business relationships as buyers and sellers. They cooperate with each other while competing for business outside. They join hands to pool resources, production capabilities etc. However, their development has not charted a structured path and therefore they lack in infrastructure leading to low efficiency of the units. In order to improve the business viability by improving the quality and reducing the cost of production we suggest development of induced clusters/industrial estates.

i. More industrial estates developed by the Government on its own or in association with private sector may facilitate development of the sector. Induced clusters can be located close to the existing clusters so as to capitalize on the existing backward and forward linkages. However, it needs to be ensured that these Industrial Estates have complete infrastructure like roads, uninterrupted power supply, banking facilities and necessary security arrangement. 50% of the area should be reserved for micro and small enterprises. (Para 7.2,7.3)

ii. Industrial estates for micro and small enterprises may also be developed along the North South Corridor and East West Corridor as also the Golden Quadrilateral being developed by the Government and the Delhi Mumbai Goods Corridor being developed by the Railways. Hon'ble Finance Minister has also announced setting up of six mega clusters in the Union Budget for 2008-09. These estates should earmark at least 25% area for micro enterprises. To encourage development of such estates, fiscal concessions on the lines of SEZs, interest subvention and capital subsidy may be provided by the Government. (Para 7.6)

iii. Income tax benefit under Section 80 (I) (A) of Income Tax Act which permits 100% exemption on income earned during any block of 10 years out of 15 years may be given to developers of induced clusters/ industrial estates. (Para 7.11)

iv. Since power shortage is one of the reasons for sickness in SMEs, it is suggested that Industrial Estates for SMEs should be provided with independent power source.

v. The Government may take steps to popularize its "Integrated Infrastructure Development Scheme" and provide additional concessions on the lines of those provided for development of SEZs. (Para 7.8)

vi. The institutional framework for improvement in the quality of the products of this sector through research and development, testing labs and quality certifications like BIS and ISO would have to be strengthened. (Para 7.7)

vii. The State Governments may be encouraged to provide land at 50% of the normal rate for setting up Industrial Estates exclusively for MSMEs. Further, 50% subsidy may be provided on the capital cost of common facilities like effluent treatment plant, power plant etc. (Para 7.9)

viii. Industrial Estates developed by the State Industrial Development Corporations or DICs or approved Industrial Estates developed by private entrepreneurs for SMEs are developed as per the approved layouts and should ideally have complete infrastructure. Accordingly, there should be no need for obtaining any clearance except registration with DIC for individual SME units set up in such Industrial Estates. This shall help curtail inspector raj to certain extent. Further the defunct Industrial Estates may be made active once again by putting in place the complete infrastructure putting national resources to good use. (Para 7.10)

ix. In terms of the policy package announced by the Ministry of MSME in 2007, risk profile of each cluster is to be studied by a professional credit rating agency and such risk profile reports are to be made available to commercial banks, besides adoption of at least one cluster by each lead bank of a district. We suggest that each rating agency be allotted 50 clusters for profiling and rating. This can be made available to the banks and FIs which would use them for speedier and hassle free credit to MSMEs. (Para 7.13)

F. REHABILITATION OF SICK SMEs

All ventures cannot succeed. Failure is an integral part of entrepreneurship and has to be accepted by all stakeholders. Therefore, no system can be put in place which can guarantee success for all. What is required is an institutional mechanism for timely identification and corrective action for rehabilitation with necessary checks and incentives for the same.

i. The Group recommends the following definition of a sick small enterprise, in order to remove the delay factor. (Para 9.1)

A Micro or Small Enterprise (as defined in the MSMED Act 2006) may be said to have become sick, if any of the borrowal account of the enterprise remains NPA for three months or more **Or**

There is erosion in the networth due to accumulated losses to the extent of 50% of its networth.

The existing stipulation that the unit should have been in commercial production for at least two years may be removed so as to enable the banks to rehabilitate units where there is delay in commencement of commercial production and there is a need for handholding due to time/cost overruns etc.

ii. However, the accounts where willful default is identified (strictly in accordance with RBI guidelines) or the borrower is absconding shall not be classified as sick units and accordingly shall not be eligible for any relief and concessions. (Para 9.1)

iii. As regards the medium enterprises, RBI has revised the definitions of non-SSI sick accounts and non-SSI weak accounts vide its notification dated 19-03-2008. These definitions are :

A Non-SSI sick unit is a non-SSI Industrial undertaking (regardless of type of incorporation) whose accumulated losses, as at the end of the latest financial year, equal or exceed its entire networth (viz. paid up capital and free reserves).

A Non-SSI weak unit is a non-SSI industrial undertaking (regardless of type of incorporation) if

a. any of its borrowal accounts (principal or interest) has remained overdue for a period exceeding one year;

or

b. there is erosion in the net worth due to accumulated losses to the extent of 50% of its net worth during the previous financial year.

The definitions have been issued recently by RBI, after considering all factors and therefore we do not suggest any change in the definition of sickness in medium enterprises. However, for the sake of uniformity, we suggest change of the term "Non-SSI weak unit" to "non-SSI incipient sick unit". (Para 9.1)

iv. At present incipient sickness for small enterprises has not been defined. We suggest that incipient sickness may be defined so that sickness can be checked/ arrested at an early stage. An account may be treated to have reached the stage of incipient sickness/ potential sickness, if **<u>any</u>** of the following events are triggered.

a. There is delay in commencement of commercial production by more than six months for reasons beyond the control of promoters and entailing cost overrun.
b. The company incurs losses for two years or cash loss for one year, beyond the accepted timeframe on account of change in economic and fiscal policies affecting the working of MSEs or otherwise.
c. The capacity utilization is less than 50% of the projected level in terms of quantity or the sales are less than 50% of the projected level in terms of value during a year.
The rehabilitation process should start at the point of incipient sickness (and not sickness) as defined above. (Para 9.3)

v. The existing criteria for viability are reasonable. However, decision on viability of a unit may be taken at the earliest but not later than 3 months of becoming sick under any circumstances.

In order to arrest the tendency of the banks to declare the sick micro, small and medium enterprises as unviable and go for recovery, we suggest that the following procedure should be adopted by the banks before declaring a micro, small and medium enterprise unit as unviable. However, the banks may take decision in case of malfeasance or fraud without following the procedure. (Para 9.4)

a. A sick unit should be declared unviable only if the viability status is evidenced by a viability study.
b. The said viability study and the declaration of the unit as unviable should have the approval of the next higher authority (micro, small and medium enterprises)/ present sanctioning authority for tiny micro enterprises.
c. The next higher authority should take such decision only after giving an opportunity to the promoters of the unit to present their case. They should be informed in writing about the reasons for declaring the unit as sick and unviable before giving this opportunity so that the promoters can present their case properly, within 7 days from the date of such decision.
d. Decision of the above higher authority should be informed to the promoters in writing. The above process should be completed in a time bound manner.

vi. **<u>REHABILITATION MEASURES:</u>**

The existing guidelines on rehabilitation, whether as regards the relief and concessions, viability parameters or coordination between the banks/ FIs and Government agencies are adequate to manage the sickness in MSME sector. It appears that the implementation of the guidelines has not been done properly. More stringent monitoring at the level of HO of the banks/FIs, as also at the level of RBI may help in timely identification and treatment of sickness in MSME sector. However, minor modifications in the same are expected to further strengthen the guidelines. We suggest the following changes.

<table>
<tr><th>PARTICULARS</th><th>EXISTING GUIDELINES</th><th>CHANGES SUGGESTED FOR MICRO AND SMALL ENTERPRISES</th></tr>
<tr><td>Waiver of penal Interest</td><td>Waiver of penal Interest from the beginning of the accounting year of the unit in which it started incurring cash losses continuously</td><td>The following words may be added “the date of the account becoming NPA, whichever is earlier.”</td></tr>
<tr><td>Rate of interest</td><td>NIL for FITL, and different concessions for other facilities.</td><td>The existing concessions on rate of interest may continue. Interest may be made ballooning or staggered also.</td></tr>
<tr><td>Repayment period</td><td>The repayment period permitted under DRM for SMEs is 10 yrs with concessions for 7 yrs and therefore no change is suggested in the same.</td><td>Staggered or ballooning repayment may also be permitted so that the installments are aligned to the cashflows.</td></tr>
<tr><td>Margin on funding of losses</td><td></td><td>While funding past and future losses, margin of 40% may be prescribed in case of small and medium enterprises.</td></tr>
<tr><td colspan="3">The relief and concessions available to sick/weak non SSI units are reasonable and we do not suggest any change in the same.</td></tr>
<tr><td colspan="3">SOME NEW SUGGESTIONS</td></tr>
<tr><td colspan="3">Banks may consider recovery of principal on the basis of tagging of sales, starting from the quarter of commencement of repayment. However, tagging should not be more than the cash margins of the unit.</td></tr>
<tr><td colspan="3">In order to make the process of settlement of debt through OTS speedier and to provide resources to such intending borrowers, RBI may consider allowing scaling down of debt burden to sustainable levels. Further, in order to incentivise lenders to fund the OTS and additional requirement of funds, the new lenders may be allowed to convert a part of the debt into equity.</td></tr>
<tr><td colspan="3">As an incentive for proper restructuring package at the time of rehabilitation, necessary support for business restructuring, modernisation, expansion, diversification and technological upgradation as may be felt necessary by the lenders may also be encouraged. Support of schemes like Credit Linked Capital Subsidy Scheme in case of units in other (than rural) areas, KVIC Margin Money Scheme (for units in rural areas) may be extended for rehabilitation packages also.</td></tr>
<tr><td colspan="3">In terms of extant RBI guidelines, an account gets downgraded if initial moratorium on interest payment is extended as a part of restructuring. These guidelines need to be waived especially for MSMEs.</td></tr>
</table>

(Para 9.5.1)

vii. We have gone through the rehabilitation policies of State Governments. We are of the opinion that Ministry of MSME may issue suggestive guidelines which will help the state governments to formulate their guidelines. State Governments should clearly state the relief and concessions available to potentially viable sick small and medium enterprises regarding power dues, sales tax and other statutory dues. The guidelines should also mention that coercive action would not be taken if rehabilitation is initiated by the banks. The State Governments should introduce a Single Window concept for providing relief and concessions to sick MSEs. We have also suggested that Ministry of MSME should be setup in states on the lines of Centre. A separate Cell may be created therein for rehabilitation of sick MSMEs. In case of delinquency by any Government department in providing relief and concessions in terms of the declared policy of the state government, such cell may take up the issues with the concerned departments. (Para 9.6, 9.7,9.8)

viii. In order to incentivise the banks to take rehabilitation measures, we suggest as under.

A. Repayment of any additional exposure taken as part of the rehabilitation package should be given priority on the cash flows as well as security as compared to lenders of existing finance. (Para 9.9.1)

B. In order to encourage rehabilitation in micro and small enterprises, we suggest that there should be no provisioning requirement for sacrifices in cases covered under CGTMSE. (Para 9.9.3)

C. Staggering or ballooning of instalments may also be considered to provide opportunity to new SME units to establish in the market and prevent sickness. (Para 9.9.5)

ix. Small enterprises normally face teething problems and it takes time to establish quality of product and market. We suggest that interest of at least 6 months after commercial production can also be included as a part of the project cost. Sufficient moratorium of say 2 years for repayment of the principal should also be given. It will prevent cases of incipient sickness at the commencement of production and help units to establish themselves in the market at the beginning. (Para 9.9.4)

x. RBI may issue guidelines that rehabilitation of any unit after its identification as sick is not affected by the earlier restructuring and the asset classification is not downgraded at the time of first restructuring after the unit has become sick. (Para 9.9.2)

xi. The premium for the coverage of rehabilitation loans may be charged at only half the normal rates as the same shall help in improving the cashflows of the sick unit. (Para 9.10)

xii. Medium Enterprises should be taken out of the purview of BIFR and the banks given the responsibility of their rehabilitation, more so because only a fraction of the medium enterprises are covered under SICA and their rehabilitation done under the supervision of BIFR. (Para 9.11)

xiii. The Group feels that the implications of sickness in MSMEs for the bank, the economy and the nation and the need to promptly act after a unit is identified as sick needs to be ingrained in the field staff. A few steps that need to be taken are

- The branch staff should be sensitised to the needs of MSMEs by continuing training on various issues pertaining to MSMEs.
- The Rehabilitation Department should be an independent Department and not a part of the Recovery Department.
- The banks should have a separate cell manned by a separate cadre of officials for managing their MSME portfolio. This cadre should also provide guidance/ counselling services to sick MSME units as regards the change in product mix, technology adaptation, marketing strategy and network etc in addition to preparation of rehabilitation proposal.
- The banks may consider changing their guidelines so that bonafide actions are not termed as lapses and do not attract staff side action.

(Para 9.12)

xiv. All cases beyond the powers of a scale II branch should be referred to Centralised Processing Cell where a separate Rehabilitation Cell should process and sanction the packages. Committee approach should be adopted for rehabilitation proposals also. (Para 9.13)

xv. Being the apex financial institution for MSMEs, SIDBI may provide advisory services and participate in appraisal and financing of rehabilitation packages of MSMEs, even if it had no prior exposure in the same. (Para 9.16)

xvi. At present Empowered Committee under the Chairmanship of Regional Director of RBI and SLIIC are the two bodies that review the status of sickness in the micro, small and medium enterprise sector. The Group is of the opinion that the responsibility should lie with the Empowered Committee. Formation of a district level body for rehabilitation of sick micro, small and medium enterprises where all agencies confirm their participation in rehabilitation shall also help expedite the process of rehabilitation and better coordination between the different agencies. (Para 9.14, 9.15)

EXIT ROUTE

xvii. Risk of failure is present in every entrepreneurial venture. To quote from the address of Dr. Rakesh Mohan, Deputy Governor, RBI, at Annual Bankers' Conference at Hyderabad on November 3, 2006 "there will be failures as well as successes… Despite the risk, financing of first time entrepreneurs is a must for financial inclusion and growth."

In MSME sector, the failure rate is relatively higher – the reasons for which range from delayed/inadequate availability of credit to non-availability of backward and forward support system.

A sound, transparent, clearly worded and equitable exit policy focussing on faster exit is the need of the hour. In order to achieve a more transparent, predictable and sound insolvency system, the existing legislations may have to be toned up so as to integrate with the country's broader legal and commercial systems, provide for reorganisation of viable businesses and efficient liquidation of nonviable businesses, provide for equitable treatment of similarly situated creditors and recognise existing creditor rights and respect the priority of claims.

Necessary support system and enabling laws & procedures for providing comfort to the lenders are required to be put in place. An effective credit guarantee system is one of the ways for providing the comfort. Absence of such support system will increase sickness, as it will instill inertia in the bankers. The credit portfolio of the banks would be adversely affected and the banks would be more averse to lending to the sector. The banks and small enterprises are caught in the vicious cycle where the mistrust of the bankers and the entrepreneurs feed upon each other.

The support systems should be supportive to the stressed units. Sensitisation towards the problems of the entrepreneurs and a solution finding approach on the part of the bankers would help the banks as well as the small enterprises. Timely rehabilitation measures are crucial for survival of small enterprises. However, a fertile environment has to be created for such supportive approach to succeed.

The external and internal audit system should be re-oriented. The auditors should be sensitive to timely support extended by field functionaries to the entrepreneurs when in stress. It has to be accepted that failure in revival efforts is a part of the banking business process. The decision of field functionaries as regards revival and rehabilitation should be supported at all levels. (Para 9.17)

In order to have a focussed approach in managing sickness, all accounts where recovery action has been initiated should be excluded from the sick accounts. Technology may be used for identification of sickness (linked to NPA classification.) All accounts below Rs 2 lacs may be excluded from the data on sick units. (Para 9.18, 9.19, 9.20)

xii. It is derived from the RBI data on sick SMEs that 97% of the units have been found unviable. The measures suggested in the report are for growth of healthy small and medium enterprises and for rehabilitation of potentially viable sick micro, small and medium enterprises. However, the number of units found unviable is very large. An opportunity for exit has to be provided to these units so that the promoters could start their businesses afresh with a clean slate. These units could also not avail the OTS opportunity provided by RBI in 2005. In order to give one more opportunity to such units and also help the banks to cleanse their books, RBI may come out with another scheme of OTS for micro, small and medium enterprises with the following features.

1. All micro, small and medium enterprise accounts classified in NPA category as on 31-03-2006 should be eligible for settlement under the scheme.
2. The settlement amount would be at a discount to the principal outstanding as on the date of NPA.
3. The amount should be paid by the borrower within 6 months of approval or such extended time as may be permitted by the banks.
4. The promoters of these units would be eligible for obtaining finance after settlement of the dues under OTS. (Para 9.22.3)

xiii. There is a need to simplify the procedures and cut the time for exit route for SMEs as these are small units and cannot follow lengthy and time consuming procedures for winding up/ exit. We suggest that there should be a separate mechanism and courts for winding up of non-corporate enterprises (like NCLT) for expeditious decision making. A simplified and easy exit route for private limited companies may be provided in the revised Companies' Act. It may also be considered to have dedicated bench for SMEs in case of CLB/ NCLT and other courts. (Para 9.22.5)

xiv. The limit for Lok Adalat under Legal Services Authorities Act is Rs 20 lacs, which was fixed under the Act notified in Nov 1995. The Government may consider raising the limit of Rs 20 lacs to Rs 50 lacs for Lok Adalats under Legal Services Authorities Act. (Para 9.22.2)

xv. Measures could be initiated by GoI to strengthen the DRT/legal machinery, by increasing the number of DRTs, increasing the number of Benches in existing DRTs, including increasing the number of Presiding Officers and considering Presiding Officers from other fields apart from the judiciary, so as to expedite delivery of judgement in such cases. Dedicated Bench for SMEs may be setup at DRTs to expedite the process of recovery. (Para 9.22)

xvi. GoI should initiate measures to encourage more number of Asset Reconstruction Companies [ARCs], whose core competency would be recovery from NPAs. ARCs especially for MSME loans may be encouraged. ARCs should focus on revival of potentially viable sick units and not concentrate only on sale and realisation of the assets. (Para 9.22.1)

xvii. RBI has recently come out with guidelines for sale of NPAs either on cash basis or on issue of security receipts. While primary sale of such NPAs has now been permitted, measures for imparting greater depth and broadening of the secondary market for sale of such NPA assets or instruments issued thereof would need to be actively pursued by RBI/GoI, to give a fillip to the activity. (Para 9.22.6)

xviii. To account for the increase in the size of micro and small enterprises and neutralize the inflation factor, the Group feels that the threshold limit for taking action under SARFAESI Act should be raised to Rs. 5 lacs. Incidentally National Commission on Enterprises in Unorganised Sector has also suggested raising the limit for action under SARFAESI Act to Rs 5 lacs. (Para 9.22.8)

xix. The provisions of SFC Act may be reviewed and it may be made compulsory for the SFCs to give an opportunity to the defaulting units for rehabilitation before initiating action under the provision as suggested by us in case of banks. (Para 9.22.9)

xx. SARFAESI Act gives powers similar to those available to SFCs under Section 29 of SFC Act. In order to prevent hasty action by banks also, it may be made compulsory for the banks to give the promoters an opportunity for revival of the unit before it is declared as unviable. Further, a stipulation of making at least one effort for rehabilitation before initiating action under SARFAESI Act is expected to help in averting hasty action by the branch in initiating recovery without making any efforts for revival. (Para 9.22.12)

(K C Chakrabarty)
Chairman of the Working Group

(P Rudran)
Member

(J Chandrasekaran)
Member

ANNEXURE I

QUESTIONNAIRE FOR SME ASSOCIATIONS, BANKS AND DIRECTORATE OF INDUSTRIES OF STATES

GROWTH OF SMEs

1. Do you consider that the growth in MSME sector is adequate? If not, what are the major reasons responsible for poor growth? Please give in order of importance?
2. What are your suggestions for growth of MSME sector? What is required to be done to enhance their productivity and make them more efficient?
3. What steps are required to be taken for improving the flow of credit to MSMEs ?
4. What in your opinion is most important for MSMEs as regards the banks? Please state in order of priority.
   - (i) Rate of interest/pricing
   - (ii) Prompt sanction and adequacy of limit
   - (iii) Better service and simplification of procedures
   - (iv) Others
5. Whether the present norms on promoters' contribution / margin are in order? Do you think that there is a need to change these norms? If so, please indicate your considered views on such changes? (% of project cost, equity or unsecured loan, venture capital or subsidies / grants, etc.)
6. Entrepreneurship is the key to industrial progress. Are the present arrangements for entrepreneurship development sufficient? What steps are further required to be taken in this regard?
7. Are the large corporates playing an effective role in vendor development, marketing support, payment of dues of MSMEs etc.? What are your suggestions in this respect?
8. How, in your opinion, the Industry Associations can contribute more effectively in the growth of MSME sector?
9. How to facilitate investment in Managerial talent, R&D and CRM in MSMEs?
10. Whether the same prescriptions in policies, finance, approach should be adopted towards SMEs engaged in manufacturing and engaged in service sector?

SICKNESS IN SMEs

1. Does the existing definition of sickness require any modification ?
2. Please give reasons which, according to you, contribute to sickness in MSME sector. In case any study has been done by your organization, please provide us a copy of the same.
3. Whether, in your opinion, the SME units are getting timely payment from large corporates? If no, what steps are required to be taken?
4. What steps, in your opinion, are required to be taken to arrest sickness in the SME sector?
5. Is there any delay in rehabilitation of sick units? If so, what are the reasons therefore?
6. Is promoters' margin required for rehabilitation a cause for delay? If so, how this can be mitigated?

ANNEXURE II

RESULTS OF THE SURVEY CONDUCTED BY THE GROUP

The Group conducted a survey on the various causes of poor growth and the ameliorative measures required for improving the growth and flow of credit, causes of sickness and the corrective actions required etc. The Questionnaire given in Annexure 1 was circulated to all public sector and private sector banks, select 9 RRBs, a large number of MSME Associations, Director of Industries of all states and some Entrepreneurship Development Institutes. The answers given by the respondents have been grouped in about 10 categories. All answers not forming a part of the major categories have been clubbed under the head Others.

As the respondents gave more than one answer to the questions, the sum total of answers exceeds the number of respondents.

Do you consider that the growth in MSME sector is adequate? If not, what are the major reasons responsible for poor growth? Please give in order of importance?

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
YES	7	0	3	1	0	11
NO	15	9	11	3	2	40
INADEQUATE MARKETING CAPABILITY	11	5	6	1	1	24
LACK OF INFRASTRUCTURE	10	5	2	4	1	22
TIMELY AND ADEQUATE FINANCE	8	1	8	3	1	21
LACK OF MANAGERIAL COMPETENCE	8	2	5	1	2	18
TECHNOLOGY	10	2	5	0	0	17
TOUGH COMPETITION FROM SPECIALLY IMPORTS	5	3	5	0	1	14
HIGH COST OF FUNDS	4	1	6	1	1	13
DELAY IN GOVT CLEARANCES	5	1	7	0	0	13
DELAYED REALISATION	4	1	2	0	0	7
CREATION OF AWARENESS	4	1	0	0	2	7
OTHERS	29	7	29	5	6	76

What are your suggestions for growth of MSME sector? What is required to be done to enhance their productivity and make them more efficient?

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
ORGANISED MARKETING EFFORTS	8	6	5	1	1	21
PROPER INFRASTRUCTURE	8	6	3	2	1	20
TECH UPGRADATION	13	1	5	0	1	20
SKILL DEVELOPMENT	9	4	2	1	0	16
TRG FOR MANAGRIAL COMPETENCE	7	2	3	1	1	14
ADVISORY/ TECH SERVICES	9	1	3	0	0	13
PROMPT SANCTION AND ADEQUATE FINANCE	5	1	4	2	1	13
ENTREPRENEURSHIP DVPT	6	0	2	1	2	11
CHEAP LOANS	5	0	5	0	0	10
SINGLE WINDOW CLEARANCE	3	2	3	1	0	9
OTHERS	28	11	30	7	3	79

What steps are required to be taken for improving the flow of credit to MSMEs?

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
CHEAP LOANS	5	1	5	3	0	14
PROMPT SANCTION	3	2	3	3	1	12
TRG TO BANK STAFF FOR CREDIT AND REHAB	5	1	2	1	0	9
CREDIT GUARANTEE ORGANISATION	4	1	2	1	0	8
SPECIALISED BRANCH EXPANSION	5	1	0	0	0	6
SPECIAL CREDIT PRODUCTS FOR MSMEs	3	0	3	0	0	6
COLLTERAL FREE LOANS	1	1	3	1	0	6
DELEGATION OF POWERS TO BRANCH MANAGER	5	0	0	0	0	5
CREDIT RATING INSTITUTION	3	0	1	0	0	4
SIMPLIFIED APPLICATION/ APPRAISAL FOR LOAN UPTO 1 CRORES	3	0	1	0	0	4
OTHERS	0	4	6	0	1	11

What in your opinion is most important for MSMEs as regards the banks? Please state in order of priority.

- **(i) Rate of interest/pricing**
- **(ii) Prompt sanction and adequacy of limit**
- **(iii) Better service and simplification of procedures**
- **(iv) Others**

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
Rate of interest/pricing 1ST PRIORITY	4	4	2	1	1	12
Rate of interest/pricing 2ND PRIORITY	6	0	7	0	0	13
Rate of interest/pricing 3RD PRIORITY	11	5	4	3	1	24
Rate of interest/pricing 4TH PRIORITY	1	0	0	0	0	1
Prompt sanction and adequacy of limit 1ST PRIORITY	15	1	9	2	1	28
Prompt sanction and adequacy of limit 2ND PRIORITY	7	8	5	2	1	23
Prompt sanction and adequacy of limit 3RD PRIORITY	0	0	0	0	0	0
Prompt sanction and adequacy of limit 4TH PRIORITY	0	0	0	0	0	0
Better service and simplification of procedures 1ST PRIORITY	3	4	3	1	0	11
Better service and simplification of procedures 2ND PRIORITY	8	1	1	2	1	13
Better service and simplification of procedures 3RD PRIORITY	11	4	8	1	1	25
Better service and simplification of procedures 4TH PRIORITY	0	0	1	0	0	1
Others 1ST PRIORITY	0	0	1	0	0	1
Others 2ND PRIORITY	1	0	0	0	0	1
Others 3RD PRIORITY	0	0	2	0	0	2
Others 4TH PRIORITY	15	7	6	3	2	33

Whether the present norms on promoters' contribution / margin are in order? Do you think that there is a need to change these norms? If so, please indicate your considered views on such changes? (% of project cost, equity or unsecured loan, venture capital or subsidies / grants, etc.)

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
YES	19	8	4	2	1	34
NO	2	1	7	1	1	12
MARGIN SHOULD BE LOWER	3	1	6	1	1	12
VENTURE FUNDING	5	0	3	0	0	8
LIBERALISATION FOR TECHNICAL ENTREPRENEURS	3	0	3	0	0	6
SUBSIDY REQD	2	1	0	0	0	3
NO SIUBSIDY	1	0	0	0	0	1
LIBREALISATION BASED ON NATURE OF INDUSTRY	1	0	0	0	0	1
NOT RELEVANT	0	0	1	0	0	1
SME EXCHANGE	0	0	1	0	0	1

Entrepreneurship is the key to industrial progress. Are the present arrangements for entrepreneurship development sufficient? What steps are further required to be taken in this regard?

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
MORE EDPs	11	7	10	3	1	32
INCREASED ROLE OF GOVERNMENT	8	2	3	2	1	16
INSTITUTIOAL ARRANGEMENT	6	2	4	1	1	14
BAKS/ FIS TO PLAY A ROLE	5	0	6	0	1	12
SKILL DVPT FOR ENTREPRENEUR	4	2	4	1	0	11
PARTICIPATION OF NGOs AND CORPORATES	4	0	4	0	0	8
MAKE IT PART OF CURRICULUM	2	1	5	0	0	8
LINKAGE WITH PREMIER INSTITUTIONS	2	0	2	0	1	5
PRIORITY TO PROFESSIONALLY QUALIFIED ENTREPRENEURS	1	0	4	0	0	5
PRODUCT DESIGN AND POACKAGING	2	2	0	0	0	4
NETWORKING AND CLUSTERING	1	0	3	0	0	4
OTHERS	8	1	3	0	0	12

Are the large corporates playing an effective role in vendor development, marketing support, payment of dues of MSMEs etc.? What are your suggestions in this respect?

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
YES/ NO COMMENTS	8	2	3	2	0	15
NO	15	7	8	2	2	34
STRICT ENFORCEMENT OF MSMED ACT	5	1	5	1	0	12
30 DAYS FOR PAYMENT	1	0	2	1	0	4
PENAL INTT	1	0	2	0	0	3
MECHANISM TO ENSURE TIMEY PAYMENT BY GOVT BODIES	1	0	1	0	1	3
FACTORING TO BE INTORDUCED	1	0	2	0	0	3
CHANNEL FINANCE	2	0	0	0	0	2
FORMATION OF ASSOCIATION	2	0	0	0	0	2
INCENTIVES FOR TIMELY PAYMENT	1	0	1	0	0	2
DISCLOSURE IN QLY REPORTS	1	0	0	0	0	1
BILL CULTURE TO BE ENCOURAGED	1	0	0	0	0	1
MARKETING SCHEME BY GOVT FOR MSMEs	1	0	0	0	0	1

How, in your opinion, the Industry Associations can contribute more effectively in the growth of MSME sector?

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
LIAISON WITH GOVT	12	1	8	2	0	23
CAMPS FOR ENTREPRENEURSHIP	10	2	6	0	0	18
LIAISON WITH BANKS	8	1	7	1	0	17
AWARENESS OFR TECHNOLOGY	7	2	5	0	0	14
NETWORKING	2	1	5	2	2	12
MARKETING SUPPORT	5	4	2	0	0	11
DATA SUPPORT	5	0	3	1	1	10
EXHIBITIONS	3	1	4	0	0	8
AWARENESS CAMPS FOR FINANCIAL DISCIPLINE	3	1	0	0	0	4
SUPPORT FOR APPLICATION ETC	2	0	1	0	0	3
PREPARATION OF DIRECTORY OF UNITS	1	0	0	0	1	2
OTHERS	7	0	0	1	0	8

How to facilitate investment in Managerial talent, R&D and CRM in MSMEs?

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
GOVT SUPPORT	9	0	1	0	0	10
INCENTIVE/ SUBSIDY FOR RND	5	0	0	1	0	6
CLUSTERING	4	0	0	0	0	4
TIE UP WITH EDUCATIONAL INSTITUTES	4	0	0	0	0	4
AWARENESS CREATION	3	0	0	0	0	3
BANK SCHEMES FOR FINANCING	3	0	0	0	0	3
ED AS AN MBA COURSE	2	0	0	0	0	2
SISI ETC TO CONDUCT RND	2	0	0	0	0	2
BANKS TO CONDUCT AWARENESS PROGRAMMES	2	0	0	0	0	2
CGTMSE COVERAGE TO ALL MSMEs	1	0	0	0	0	1
INCENTIVES FOR UNITS EMPLYING THEM	1	0	0	0	0	1
TECH UPGRADATION FUND	0	0	0	0	0	0

Whether the same prescriptions in policies, finance, approach should be adopted towards SMEs engaged in manufacturing and engaged in service sector?

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
NO	9	4	10	1	2	26
YES	12	4	2	3	0	21
LOWER MARGINS	1	0	0	0	0	1
PBF ON CASH FLOW METHOD	1	0	0	0	0	1
DIFF POLICIES FOR MEDIUM AND SMALL AND NOT MICRO	1	0	0	0	0	1
MFG TO BE GIVEN THRUST	0	0	4	1	1	6

Does the existing definition of sickness require any modification?

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
NO	17	5	3	2	0	27
YES	5	0	4	2	0	11
SHOULD BE LINKED TO NPA	2	0	2	0	0	4
CHANGE LOSSES FROM CASH LOSSES	1	0	0	0	0	1
CHANGE IN SYSTEM OF RECOMPENSE	1	0	0	0	0	1
SAME DEFINITION FOR SMALL AND MEDIUM ENTERPRISES	1	0	0	0	0	1
LINK TO LOSS OF LIQUIDITY	0	0	1	0	0	1
INCREASE DELINQUENCY TO 12 MTHS FOR NPA	0	0	1	0	0	1
NPA OR 50% EROSION IN NET WORTH	0	0	1	0	0	1

Please give reasons which, according to you, contribute to sickness in MSME sector. In case any study has been done by your organization, please provide us a copy of the same.

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
MANAGEMENT RELATED ISSUES	13	2	7	2	1	25
POOR MARKETING ABILITIES	7	7	8	0	0	22
TECH OBSOLESCENCE	11	2	3	1	1	18
DELAYED / INADEQUATE SANCTION BY BANKS	6	1	8	2	0	17
DELAYED REALISATION OF RECEIVABLES	13	1	2	0	0	16
LACK OF FUNDS	6	2	6	2	0	16
LACK OF MARKETING SUPPORT	6	2	4	2	0	14
DIVERSION OF FUNDS	9	1	1	0	0	11
POOR INFRASTRUCTURE	3	3	4	0	0	10
CHANGE IN GOVT POLICY	2	0	6	1	0	9
OTHERS	29	4	13	2	1	49

Whether, in your opinion, the SME units are getting timely payment from large corporates? If no, what steps are required to be taken?

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
NO COMMENTS	18	6	10	3	0	37
NO	9	3	8	2	0	22
30 DAYS TIME FOR PAYMENT	5	1	0	0	0	6
PENAL INTT FOR DELAY	1	1	3	0	0	5
DISCLOSURE IN AUDITED ACCOUNTS	2	0	1	0	1	4
IMPLEMENTATION OF MSMED ACT	1	1	1	0	0	3
CHANNEL FINANCE	3	0	0	0	0	3
INCREASED ROLE OF ASSOCIATION	2	0	0	0	0	2
TIMELY PAYMENT BY LARGE CORPORATES TO BE ENFORCED THROUGH THEIR BANKERS	1	0	1	0	0	2
GIVE STATUS OF SECURED CREDITORS TO MSMES	1	1	0	0	0	2
BILL DISCLUNTING	1	0	1	0	0	2
CONTINGENCY LOANS	1	0	0	0	0	1

What steps, in your opinion, are required to be taken to arrest sickness in the SME sector?

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
PROMPT SANCTION	9	3	3	1	0	16
PROMPT RESTRUCTURING/ REHABILITATION	4	2	7	2	0	15
ADVISORY/ TECH SERVICES	6	3	4	0	1	14
ADEQUATE FINANCE	7	3	3	1	0	14
ORGANISED MARKETING EFFORTS	7	3	1	0	0	11
INTERACTION BETWEEN STAKEHOLDERS	1	0	7	1	1	10
CHEAP LOANS	4	0	4	0	0	8
EDI TO IMPART TECHNICAL TRAINING	6	0	1	1	0	8
MONITORING OF PROJECT IMPLEMENTATION	1	1	4	2	0	8
CLUSTER APPROACH	7	0	0	0	0	7
IMPLEMENTATION OF MSMED ACT	2	1	2	1	0	6
OTHERS	10	3	8	2	0	23

Is there any delay in rehabilitation of sick units? If so, what are the reasons therefore?

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
YES	12	1	12	3	0	28
LATE IDENTIFICATION OF SICKNESS	8	2	8	0	0	18
BANKS' APPREHENSIONS	4	0	7	1	0	12
NON AVAILABILITY OF MARGIN	10	1	0	1	0	12
DELAYED VIABILITY STUDY	2	2	7	0	0	11
DELAYED SANCTION OF PACKAGE	1	0	9	0	0	10
LACK OF KNOWLEDGE OF BANK STAFF	3	4	2	0	0	9
NON SUBMISSION OF INFORMATION BY BORROWERS	5	1	1	0	1	8
POOR COORDINATION BETWEEN BANKS AND TERM LENDERS	3	0	1	1	0	5
NON AVAILABILITY OF COLLATERAL	3	0	0	1	0	4
IMPRACTICAL CONDITIONS BY BANKS	1	0	3	0	0	4
OTHERS	6	0	3	1	0	10

Is promoters' margin required for rehabilitation a cause for delay? If so, how this can be mitigated?

PARTICULARS	BANKS (22)	RRBs (9)	MSME ASSNS (16)	DIR OF IND (4)	ENTREPRENEURSHIP DVPT INSTITUTES (2)	TOTAL (53)
YES	14	2	11	1	1	29
NO	6	4	2	0	0	12
CREATION OF REHABILITATION FUND	11	0	1	0	0	12
VENTURE FUNDS	4	1	4	1	1	11
WAIVER OF MARGIN	2	0	4	0	0	6
REDUCTION OF MARGIN	3	0	2	1	0	6
CHANGE OF MANAGEMENT	3	0	1	0	1	5
MUST FOR REHABILITATION	0	2	0	0	0	2

ANNEXURE III

SUMMARY RESULTS OF THIRD CENSUS OF SSI SECTOR 2001-02

Characteristics	Registered SSI Sector	Unregd. Sector	Total SSI Sector
1. Size of the sector	13,74,974	91,46,216	1,05,21,190
2. No. of rural units	6,09,537 (44.33 %)	51,98,822 (56.8 %)	58,08,359 (55 %)
3. No. of SSIs	9,01,291 (65.55 %)	35,44,577 (38.75 %)	44,45,868 (42.26 %)
4. No. of SSSBEs	4,73,683 (34.45 %)	56,01,639 (61.25 %)	60,75,322 (57.74 %)
5. No. of ancillary units (% age of no. of SSIs)	45,797 (5.08 %)	86,516 (2.44 %)	1,32,313 (2.98 %)
6. No. of tiny units among SSIs	8,82,496 (97.9 %)	35,43,091 (99.9 %)	44,25,587 (99.5 %)
7. No. of women enterprises	1,37,534 (10 %)	9,26,187 (10.13 %)	10,63,721 (10.11 %)
8. Nature of activity :			
Manufacturing/ Assembling/ Processing	8,72,449 (63.45 %)	33,03,366 (36.12 %)	41,75,815 (39.69 %)
Repairing & Maintenance	28,843 (2.10 %)	16,92,663 (18.50 %)	17,21,506 (16.36 %)
Services	4,73,682 (34.45 %)	41,50,187 (45.38 %)	46,23,869 (43.95 %)
9. Type of organisation :			
Proprietary	12,21,702 (88.85 %)	88,62,548 (96.9 %)	1,00,84,250 (95.8 %)
Partnership	99,190 (7.21 %)	1,03,662 (1.13 %)	2,02,852 (1.9 %)
Pvt. Company	33,284 (2.42 %)	38,153 (0.42 %)	71,437 (0.68 %)

Cooperatives	4,715 (0.34 %)	9,854 (0.11 %)	14,569 (0.14 %)
Others	16,083 (1.17 %)	1,31,999 (1.44 %)	1,48,082 (1.41 %)
10. No. of units managed by :			
SC	1,07,934 (7.85 %)	9,43,969 (10.32 %)	10,51,903 (10 %)
ST	48,560 (3.53 %)	4,74,271 (5.19 %)	5,22,831 (4.97 %)
OBC	5,29,406 (38.50 %)	38,11,372 (41.67 %)	43,40,778 (41.26 %)
Others	6,89,074 (50.12 %)	39,16,604 (42.82 %)	46,05,678 (43.8 %)
11. No. of units managed by women	1,14,361 (8.32 %)	8,80,780 (8.37 %)	9,95,141 (9.46 %)
12. Main source of power :			
No power needed	3,60,611 (26.23 %)	38,55,035 (42.15 %)	42,15,646 (40 %)
Coal	28,841 (2.10 %)	2,95,165 (3.23 %)	3,24,006 (3.1 %)
Oil	40,401 (2.94 %)	5,55,416 (6.07 %)	5,95,817 (5.66 %)
LPG	7,222 (0.53 %)	55,237 (0.60 %)	62,459 (0.59 %)
Electricity	8,99,657 (65.43 %)	40,25,262 (44.01 %)	49,24,919 (46.8 %)
Non-conventional energy	7,142 (0.52 %)	60,539 (0.66 %)	67,681 (0.64 %)
Traditional energy/ Firewood	31,100 (2.26 %)	2,99,562 (3.28 %)	3,30,662 (3.14 %)
13. No. of units having outstanding loan as on 31-3-2002	2,76,333 (20.1 %)	5,01,306 (5.48 %)	7,77,639 (7.39 %)

14. No. of units having outstanding loan with institutional sources as on 31-3-2002	1,96,137 (14.26 %)	2,82,267 (3.09 %)	4,78,404 (4.55 %)
15. No. of sick units (with erosion of net-worth by more than 50 % or delay in repayment of institutional loan by more than 12 months)	46,431 (3.38 %)	58,338 (0.64 %)	1,04,769 (1 %)
16. No. of incipient sick units (decline in gross output over three consecutive years)	1,58,023 (11.5 %)	5,92,899 (6.48 %)	7,50,922 (7.14 %)
17. No. of sick units as per RBI criteria, i.e., those that are sick among units having outstanding loan with institutional sources	38,403 (19.6 %)	46,887 (16.61 %)	85,290 (17.8 %)
18. No. of sick/ incipient sick units (with erosion of net-worth by more than 50 % or delay in repayment of institutional loan by more than 12 months or decline in gross output over three consecutive years)	1,92,328 (13.98 %)	6,30,568 (6.89 %)	8,22,896 (7.82 %)
19. Reasons for sickness/ incipient sickness :			
Lack of demand	1,11,508 (58 %)	4,35,121 (69 %)	5,46,629 (66 %)
Shortage of working capital	1,09,844 (57 %)	2,69,648 (43 %)	3,79,492 (46 %)
Non-availability of raw material	23,493 (12 %)	76,029 (12 %)	99,522 (12 %)
Power Shortage	33,099 (17 %)	77,345 (12 %)	1,10,444 (13 %)
Labour Problems	12,182 (6 %)	26,282 (4 %)	38,464 (5 %)
Marketing problems	70,202 (37 %)	2,24,002 (36 %)	2,94,204 (36 %)
Equipment problems	16,995 (9 %)	76,038 (12 %)	93,033 (11 %)

Management problems	9,124 (5 %)	21,088 (3 %)	30,212 (4 %)
20. Per unit employment	4.48	2.05	2.37
21. Total employment	61,63,479	1,87,69,284	2,49,32,763
22. Per unit original value of Plant & Machinery (in Rs.lakhs)	2.21	0.27	0.52
23. Total original value of Plant & Machinery (in Rs.lakhs)	30,32,868	24,56,492	54,89,360
24. Per unit fixed investment (in Rs. Lakhs)	6.68	0.68	1.47
25. Total fixed investment (in Rs. Lakhs)	91,79,207	62,55,660	1,54,34,867
26. Per unit Gross Output (in Rs.lakhs)	14.78	0.86	2.68
27. Total Gross Output (in Rs. Lakhs)	2,03,25,462	79,01,536	2,82,26,998
28. No. of exporting units	7,344	43,262	50,606
29. Value of exports (in Rs. lakhs)	12,30,826	1,89,130	14,19,956
30. Employment per Rs. one lakh investment	0.67	3.00	1.62
31. Units maintaining accounts	4,04,672 (29.43 %)	5,98,333 (6.54 %)	10,03,005 (9.53 %)
32. No. of economic activities as per National Industrial Classification-1998, pursued in SSI sector	672	619	672
33. No. of products/ services as per ASICC produced/ rendered in SSI sector	5,983	2,680	6,003
34. No. of reserved products (as per the reserve list effective on 31-3-2001) produced in SSI sector	877	382	878

1.1 Details of Coverage etc.	
Registered SSI Sector	
Total no. of units surveyed	: 22,62,401
Number of working units	: 13,74,974 (61 %)
Number of closed units	: 8,87,427 (39 %)
Unregistered SSI Sector	
No. of villages/ urban blocks surveyed	: 19,579
No. of villages/ urban blocks for which data was received	: 19,278 (98 %)
No. of unregd. SSIs/ SSSBEs selected for survey	: 1,68,654
No. of unregd. SSIs/ SSSBEs actually surveyed	: 1,67,665 (99 %)
Estimated no. of units w.r.t reasons for non-registration	
Not aware of the provisions for registration	: 53.13 %
Not interested	: 39.86 %
Complicated procedures	: 3.87 %
Local laws/ regulations do not permit	: 1.76 %
Clearance not available from Municipality etc	: 1.38 %