



Credit Gap Mapping in 10 MSME Clusters in India

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Study Background and Objectives

GIZ (or “the client”), under Micro, Small & Medium Enterprises Financing and Development Project (“MSMEFDP” or “the project”), desired to undertake a study on Gap in Credit Supply & Demand, and Development of Alternate Modes of Credit Delivery in select MSMEs Clusters’ (“the study”). Dun and Bradstreet Information Services India Pvt. Ltd. (“D&B India”) undertook the aforementioned study.

The World Bank’s parent project, ‘the Multi-Donor Micro Small and Medium Enterprises Development Project (MSMEFDP) for MSME financing and development became effective on April 4, 2005. SIDBI is the implementing agency for the project supported by international partners - The World Bank, DFID, KfW, and GIZ. Department of Financial Services, Ministry of Finance Government of India is the nodal agency for the project. The objective of the project has been to improve MSME access to finance and business development services, thereby fostering MSME growth, competitiveness and employment.

As a part of MSME umbrella programme, GIZ and SIDBI aim to provide improved access to financial and non-financial services that are innovative and tailored to suit market needs under the component MSME Financing and Development. In order to improve financial and non-financial services to MSMEs, it is important to understand the current schemes implemented by SIDBI for MSME financing, the finance support structure in the cluster and evaluate the finance need gap. Basis this need gap, the study developed directional inputs to eliminate such gap by proposing alternate financing products and delivery mechanisms for the same. The study aims to facilitate enhanced and improved services to the MSME sector.

Objectives of the Study

- To develop a suitable methodology framework for estimating Credit Gap in any industry cluster across India
- To map the credit demand and supply status, measure the credit gap and reasons for the current status in the select identified clusters (*10 clusters in 7 subsectors*)
- To suggest tailor made specific financial products, alternate delivery models and institutional mechanism for implementation in the clusters

D&B India identified 10 MSME clusters, in consultation with GIZ, where SIDBI is active under MSMEFDP, basis discussion with GIZ and selection parameters such as size (*turnover, employment, etc.*) and geographical spread.

The current report is a detailed account of the credit gap assessment in the 10 Identified MSME clusters.

Executive Summary

Indian MSMEs are a diverse and heterogeneous group but broadly face a common set of problems. Longer asset conversion cycles, limited market access, and the relative absence of modern technology and quality control, to name a few, are problems plaguing the sector. Access to finance is often limited due to issues such as the inability to furnish adequate collateral for institutional credit and high interest required to be paid on credit from non-institutional sources. Besides, a majority of MSMEs also self-exclude themselves from the formal financial system as they are unaware of their eligibility for credit from banks. According to the Fourth All India Census of MSMEs (2006-07), mere 11.2% enterprises in India have access to loans from formal financial institutions.

Micro and Small Enterprises Face Greater Financial Exclusion

The size of enterprises and the scale of their operations is often also a gauge of the extent of financial exclusion faced by them. Small and, more specifically, micro enterprises (MSEs) typically suffer from greater barriers to institutional credit access, relative to medium enterprises. The credit appraisal processes adopted by lending institutions typically lead to the exclusion of MSEs.

Lending institutions have internal rating models for assessment of project proposals. The risk involved in a project is assessed based on various parameters such as project details (project concept, location, sector type, project strength through DSCR, project IRR, payback period etc.), borrower background, fixed asset information, cash conversion cycle, previous relationship of the bank with borrower, and details of existing and proposed credit facilities.

Due to less favorable conditions existing at MSEs, loan approval either takes longer or gets altogether rejected. Security in the form of collateral, guarantees and fixed assets, are not always available. The cash conversion cycle is generally unfavorable leading to unstable cash flows. This is also compounded by absence of credit ratings, basic financial information and a coherent business plan. Awareness of banking processes and modern technical knowledge is also often found to be lacking.

The current report, therefore, concentrates on the credit gap faced by the Micro and Small enterprises, which has often been described as the 'missing middle' on evaluating the status of their access to finance. The financial requirements of MSEs are often considered too large for microfinance institutions to fulfill. At the same time, they cannot be effectively served by applying lending models that pertain to large corporations.

Definition of Credit Gap

Credit gap can be defined as unmet credit requirement of MSEs, over and above the available access to credit from formal institutional sources of finance. The same measures are used by international institutions like IMF and the World Bank.

Non-users of formal financial services amongst MSMEs are either involuntarily excluded or voluntarily exclude themselves from the institutional loan market. Involuntary exclusion, as explained above, is due to ineligibility based on loan approval criteria. Amongst MSMEs who self-exclude themselves, are those who:

- Currently use informal sources of credit
- Lack awareness of their eligibility for loan from formal sources
- Have no need

The first two categories of MSMEs do have a need for credit, which is not being catered to by institutional sources. Hence, the credit requirement of such MSMEs would form a part of the credit gap.

MSME Clusters under Study and Nature of Data Collection

The credit gap was estimated for 10 MSME clusters, identified by D&B India in consultation with GIZ and SIDBI. The 10 clusters represent all four regions and six sub-industries.

A quantitative questionnaire survey was conducted across the 10 identified clusters. At least 50 MSME respondents (*enterprises*) were identified for each cluster and well distributed across micro, small, and medium enterprises. The questions in the questionnaire included queries on financial information (*such as assets, turnover, profit etc.*), nature of credit requirement, and perception/experience with the banking system.

The quantitative survey was coupled with qualitative interactions with stakeholders in each of the clusters. This included discussions with District Lead Banks, Industry Associations, District Industries Centers (DICs), SIDBI officials, large enterprises, as well as MSMEs. The objective of the qualitative interactions was to obtain an understanding of status of institutional credit supply to MSMEs, sources of credit demand, specific credit-related challenges faced by enterprises and to collate ideas on innovative loan products and credit delivery mechanisms.

Industry	Clusters
Engineering	Faridabad, Coimbatore, Rajkot and Rourkela

Industry	Clusters
Leather	Kolkata and Chennai
Fruits & Vegetables Processing	Pune
Textile and Garments (Knitwear)	Ludhiana
Dyes and Chemicals	Ahmadabad
Pharmaceuticals	Hyderabad

Credit Demand Estimation

The demand for credit arising from both working capital requirements as well as long-term investment requirements has been estimated. The estimation method for working capital credit requirement broadly follows the method outlined in the Nayak Committee Report (1991). Of the broad contours set for the committee, one of the key requirements was to examine the adequacy of institutional credit for the SSI sector (now MSE sector).

In the process of examining the adequacy of institutional credit, the committee, outlined methods for developing credible demand estimates for credit. While the committee stressed on strong quantitative methods for working capital credit estimation, term credit estimation was fairly qualitative in nature. For estimating working capital requirements, the committee suggested the use of the 'Forecasted Sales Approach'. 25% of the forecasted sales for the enterprises could be considered as requirement for working capital. It was recommended that working capital bank credit could be as much as 80% of the estimated working capital requirements.

Working capital credit demand for the MSME clusters under the current study has been estimated by applying the Nayak Committee method to the cluster turnover estimated on the basis of the cluster survey.

Term Credit requirements have been estimated by applying fixed asset growth forecasts to current 'Investments in Plant and Machinery', which in turn has been estimated on the basis of the cluster survey.

D&B also studied the report prepared by the National Commission for Enterprises in the Unorganized Sector (NCEUS) under the chairmanship of Mr. Arjun K Sengupta. Under this method, the average credit needs of the unorganized units were obtained from a survey. Average credit need was then multiplied by the total number of estimated unorganized units to obtain the Total Credit Demand.

While the commission's method was most effective for estimating credit requirements of unorganized enterprises (mostly micro proprietary units), extrapolated estimates of credit

requirements are prone to outliers in the sample surveyed. Existence of detailed diagnostic studies on the clusters (see Annexure A.3) and a detailed survey among a limited but representative sample enabled D&B India to rely on the 'Forecasted Turnover Approach' for estimating WC requirements and its own method (explained above) for estimating Term Loan requirements, separately.

Credit Supply Estimation

Scheduled Commercial Banks (SCBs) account for the bulk of the institutional lending to MSMEs, with Non-Banking Financial Corporation's (NBFCs), Cooperative Banks, State Financial Corporation's (SFCs) and other Financial Institutions playing a minor role as well. The estimation of credit supply to the MSME clusters under the current study considers lending by the SCBs. Lending by large and dominant Cooperative Banks, SFCs and SIDBI has been added to the total credit supply to clusters where available and where their contribution to the cluster is significant.

The proportion of cluster turnover to state turnover in the same industry is first computed. Thereafter, the ratio is applied to the outstanding lending by SCBs in the state to that particular industry, to arrive at the credit supply estimate to a specific MSME Cluster.

D&B India also contacted various Lead Banks for the identified district clusters under the current study and obtained aggregated (*of financial institutions*) credit supply data at district level. The estimates for Credit Supply Outstanding for each cluster computed by D&B were matched with Lead Bank data on Outstanding Total Advances, Priority Sector Advances and MSE/SSI Advances, in order to ensure consistency.

Sources of Credit Demand in the 10 MSME Clusters under Study

Nature of Raw Material Procurement and the Asset Conversion Cycle

Procurement of raw materials takes place in bulk and typically during certain times of the year. Raw-material suppliers, in most cases, need to be paid on the spot. Considering the fact that many primary commodities are prone to market fluctuations, maintaining competitiveness in terms of end-product prices demands that MSEs buy their raw material supplies at reasonable prices, whenever available.

While the raw-material suppliers hardly provide any credit and sell in bulk, realization from sale of end-products in most MSME industries takes place over a longer period. In some cases, the seasonal nature of end-product demand requires that raw-materials are procured and stored for a significant period before they are further processed.

The need for raw-material procurement in large quantities at discrete intervals and the longer asset conversion cycles gives rise to a significant need for working capital among MSEs.

Examples include the:

- Fruit and vegetable procurement at mandis / market yards in the Pune Food Processing cluster
- Knitting and garmenting units in Ludhiana, which are dependent on suppliers of yarn, chemical, accessories and packing materials, fabricating units and distribution networks
- Tanneries in Kolkata and Chennai Leather clusters that have to procure the raw hides and skins from traders / local suppliers who source the skins from across the country
- Procurement of commodities such as pig iron, coke, copper, aluminum, etc. by MSMEs at uncertain prices in engineering clusters from retailers, unlike larger firms who buy in bulk directly from raw material manufacturers at pre-determined prices

Subcontracting Arrangements

Contract manufacturing is common in many industrial clusters, especially in the Engineering clusters.

- Micro and small units (many of which are foundries) in the Rajkot Engineering cluster produce sub-assemblies for more organized manufacturers of automobile parts, diesel engine, pump-sets and machine tools in the cluster. Usually, the manufacturers or middlemen purchase their goods directly from their doorsteps.
- Large scale industries like Hero Motor Company, New Holland, JCB, Escorts etc. in the Faridabad Light Engineering cluster rely on MSMEs for contract manufacturing. Further, many medium and small auto-ancillary units in the cluster rely on micro-units for activities such as electro-plating.
- Micro enterprises in the Coimbatore Engineering Cluster (mainly foundries), act as sub-contractors to small and medium enterprises in the business of manufacturing pumps, motor and automobile components

Credit cycles of greater than 30 days and the absence of discipline among large buyers in meeting payment deadlines, typically lead to working capital shortages among MSMEs

Manpower-related Expenses

Most MSME clusters across the country employ technologies that are manpower intensive and are plagued by productivity issues and labor issues. Therefore, the requirements of the working capital to make continuous labor payments increase.

Specialized skills required in many MSME clusters are procured at high prices and lead to working capital requirements. This includes payment for services rendered by external GMP consultants in the Hyderabad Pharmaceutical cluster, CNC programmers in engineering clusters and quality consultants in the Pune Food Processing cluster.

Technology Up gradation and Compliance with Quality and Environmental Norms

The need for technology up gradation has led to an increase in Term Credit requirements in many MSME clusters. The trend is being driven by the following factors:

- The need for improving productivity and reducing reliance on labor-intensive technologies
- Aspiration to access global markets requires greater competitiveness. Besides, adherence to global quality, safety and environmental standards, has become a pre-requisite for exporting to many developed countries of the world
- The need to reduce costs of maintaining aging machinery that are faced with frequent breakdowns.

Medium enterprises in the Pune F&V cluster are exploring newer business models for technology up-gradation and newer products. Like the pharmaceutical industry, in other parts of the world, Indian pharmaceutical units also intend to increase investments in ensuring Good Manufacturing Practices (GMP) is followed. This would require investments in setting up Effluent Treatment Plants (ETP) that typically require large upfront investments. ETPs also need to be installed in the Dyes and Chemicals cluster in Ahmadabad, if enterprises intend to tap funds from institutional sources in the future.

Other Sources of Demand for Credit

The need for credit can also arise from factors such as unregistered units looking to get registered and rated, MSME units trying to meet tax payment deadlines, availing services of a Common Facility Center (such as a Tool Room), availing skill training from a Business Development Services (BDS) provider, export marketing and associated documentation, etc.

Summary Table: Credit Gap Estimates for Micro and Small Enterprises (MSEs) Across Clusters *			
Cluster	MSE Credit Gap: Nayak Committee Method - In Rs. Crores	MSE Turnover (Year 2010-11) - In Rs. Crores	
Pune	98	846	
Coimbatore	1,231	4,739	
Rajkot	1,248	9,157	
Faridabad	1,989	10,240	
Rourkela	42	316	
Ahmadabad	441	2,730	
Kolkata	121	2,876	

Summary Table: Credit Gap Estimates for Micro and Small Enterprises (MSEs) Across Clusters *			
Cluster	MSE Credit Gap: Nayak Committee Method - In Rs. Crores	MSE Turnover (Year 2010-11) - In Rs. Crores	
Ludhiana	1,235	11,905	
Chennai	275	3,060	
Hyderabad	105	1,378	

Source : D&B India Estimates

Recommended Products and Delivery Mechanisms

Financing of Raw Material Procurement

A scheme for financing raw material procurement by banks and financial institutions is recommended for almost all clusters, where raw materials need to be purchased in bulk during certain months of the year and where bulk purchase enables MSEs to benefit from discounted prices. The scheme and its variants would be applicable to the following clusters:

Cluster	Potential Implementation Agency
Pune Fruit and Vegetables	Agriculture Produce Market Committee
Ludhiana Knitwear	Knitwear Club / KAMAL / LAKMA
Rourkela Engineering	Orissa State Industrial Corporation (OSIC)
Kolkata Leather	Indian Leather Products Association (ILPA) / Central Leather Research Institute
Chennai Leather	

The salient features of the proposed raw-material purchase financing scheme are as follows:

- A group of banks catering to the cluster can form a consortium and enter into a common Memorandum of Understanding (MoU) with an implementation agency for the scheme in the cluster.
- The implementation agency has to be an existing integral stakeholder in the raw material procurement process or an agency implementing a cluster-specific government scheme.
- A forecast of annual production of the MSE units and their corresponding annual raw material requirements needs to be prepared. This can be prepared on the basis of inputs from individual MSEs, industry associations (say, Mahratta Chambers of Commerce and

Industry – MCCIA in Pune), large sub-contracting industrial buyers (say, Khadims / Sreeleathers in Kolkata), as well as cluster sector-specific research institutions (say, Central Leather Research Institute – CLRI in Chennai).

- The implementation agency would procure the raw material with the MoU banks / FIs financing the purchase. The raw material procured would serve as collateral with the implementation agency serving as the facilitator / guarantor. The industry association could charge a nominal fee for providing this service.
- The implementation agency, effectively, becomes the primary raw material supplier. The discount obtained by acquiring the raw material in bulk may be passed on to the MSEs after deducting a fee towards costs of provision of the service by the implementation agency. The interest charged by the bank for financing the purchase will be the predominant cost of service. For the raw material financing scheme to be economically viable, the costs of service must be less than or equal to the difference in procurement price and sale price to MSEs

Factoring

Factoring (or reverse factoring) has been recommended in all clusters, where strong inter-linkages and sub-contracting of manufacturing activities exist. Open account sales are the preferred arrangement between larger buyers and smaller sellers in the Rajkot and Coimbatore Engineering Clusters, the Hyderabad Pharmaceutical Cluster and the Kolkata Leather Cluster. Banks should embrace products that enable them to extend working capital finance on an ongoing basis against invoices raised by their clients on their buyers.

Factoring is a method, in which the ‘factor’ (bank / FI offering the service) obtains control over the sales ledger of the client. In effect, the entire receivables management is taken over by the factor and disclosed to the client’s customer (buyer). The offerings of a ‘Factor’ are far more than just the discounting of individual bills by a bank.

As opposed to Cash Credit, under ‘Factoring’, there is scope for flexibility as to quantum of potential funding. The credit line is based on the financial strength of the borrowing client’s debtors, as well as on the borrower’s own financial strength. In many industries, it is observed that the sales do not occur on a uniform basis, but fluctuate from month to month. Hence the predominant system of receivable financing through ‘Cash Credit’ is found to be inappropriate, leading to intermittent over-financing or under-financing. Factoring is more appropriate for MSMEs with potential for rapidly expanding sales and units with unpredictable cash flows and a high proportion of receivables in their working capital cycle.

In cases, where banks are hesitant towards extending Factoring products to cluster units (as the case may be for Kolkata Leather and Hyderabad Pharmaceutical clusters), ‘Reverse Factoring’ can be looked at as an alternative mechanism, where banks purchase accounts receivables only from high-

quality buyers. The bank only needs to collect credit information and calculate the credit risk for buyer (in this case a large transparent, internationally accredited firm). In Reverse Factoring, the credit risk is equal to the default risk of the high-quality customer, and not the risky SME.

Factoring ensures the following benefits for MSEs:

- Improved cash flows
- Fixed assets freed up for collateralization for other credit requirements
- Benefit of sales ledger management
- Increased ability to extend open account terms to clients
- Improved receivable days and current ratio

The use of 'Factoring' can be further encouraged if Non-Recourse Factoring is introduced. This would enable the complete elimination of default risk.

Pre-approved Collateral-free Equipment Finance Scheme

MSMEs are often faced with situations when certain equipments need to be acquired urgently, either because the supplier is offering a discount or because the acquisition is required to comply with a norm. Moreover, these enterprises need to acquire a number of small-value equipment that aggregate to significant value through the year. Applying for loans to make these purchases is considered tedious and time-consuming with no certainty of sanction and disbursement. Hence, either unsecured loans are sourced at high interest or working capital credit is employed for the purpose of acquisition of such equipment.

In order to overcome this challenge, under the MSME-FDP programme, SIDBI along with FSIA (a dominant industry association in the Faridabad Auto Components and Engineering cluster) designed a special scheme. Under the scheme, a collateral-free line of credit upto Rs. 50 lakh is sanctioned to enterprises, which can avail this facility any time during the year, either in full or in parts, for purchasing equipment. Disbursals are typically made within three days on a pre-approved loan. The association is responsible for processing of application, doing appraisals, recommending limits as per prescribed norms and providing it to SIDBI, as well as verifying the pro-forma invoice, ensuring margin payment, asset value, etc.

Similarly, SIDBI currently has a credit delivery arrangement with the Gujarat State Plastic Manufacturers Association (GSPMA) for meeting the capital expenditure requirements of the member MSME plastic manufacturing units.

Enterprises in the Rajkot and Coimbatore Engineering clusters have significant credit needs arising from a need to upgrade technology. Similarly, enterprises in the Hyderabad Pharmaceutical cluster are under pressure to implement technology-intensive Good Manufacturing Practices (GMP), while units in the Ahmadabad Dyes and Chemicals cluster are expected to invest heavily to comply with

state pollution control norms, both of which will involve acquisition of Effluent Treatment equipment.

It is recommended that banks and financial institutions, which are currently catering to the four clusters, can approach the major industry associations to proceed with a MoU that will enable a FSIA-SIDBI type of arrangement.

Up-scaling of Microfinance to Meet Credit Requirements of Micro Enterprises

A number of unorganized micro enterprises in the Coimbatore, Rourkela and Kolkata clusters that carry out sub-contracted work for larger enterprises face a high degree of financial exclusion. Most of these units do not even approach the banks for their requirements with the apprehension of excessive documentation, site-audits and inspections etc. Many do not have any tangible assets which could act as collaterals nor any formal work order and hence banks to refuse credit to the cluster.

Given this scenario, up-scaling of micro finance programs in these clusters would prove to a potent method to handle this issue. Microfinance has made significant inroads into Tamil Nadu, Orissa and West Bengal. The total number of microfinance clients in these states (Credit Self Help Group (SHG) members and MFI Client put together) stood at roughly 1.2 crore, 62 lakhs and 1.0 crore, respectively in 2010. The various microfinance models have been tried, tested and have met with success, creating an overall conducive environment for microfinance in these states. Microfinance loans in Tamil Nadu, Orissa and West Bengal aggregated to Rs. 13,000 crore, in 2010, with average loans outstanding per household standing at Rs. 21,602, Rs. 7,582 crore and Rs.8251 crore, respectively.

MFIs that upscale typically target the lower end of the SME spectrum that have more features in common with their existing microfinance clients, as reflected by the average loan size of micro firms. For micro firms operating on the verge of informality, up-scaling of micro-finance seems to have great potential. MFI active in and around the three clusters can modify their microfinance business models to incorporate SME operations by taking advantage of their market knowledge and network, and by adapting their microfinance methodologies. The benefits of up-scaling may encourage a transition from an informal to a formal enterprise.

Refinancing (or on-lending) and other support from development finance institutions, such as SIDBI, would be critical for helping MFIs adapt their current lending practices to serve the new clientele, as well as in building the MFIs' capacity in staff training and information management.

Further, a few issues need to be addressed before up-scaling of MFI can become a sustainable model:

- New Product Development
- Collection Cycle

- Recovery Mechanism
- Capacity Building for MFIs and Borrowers

Typically, MFIs have daily/weekly collection cycle, which calls for modification while serving micro and small manufacturing units. MFIs need to understand the borrower's business and particularly "Asset Conversion Cycle" and revise its credit collection cycle to suit the needs of borrowers and simultaneously ensure profitability of the lending business model. Suitable loan products and associated attributes (interest rate, tenure, and credit amount) need to be developed keeping in mind the nature of borrowers business. This shall be particularly important because the product and its attributes shall govern the efficacy of collections affecting top-line growth. Further, training would be needed both for MFIs and borrowing micro units on the business cycle, lending model, and practices adopted to ensure smooth implementation.

Historically, the MFI lending model had been successful despite the high borrowing rate of MFI from Banks. Companies in this space had built a sound base of foot-workers, creating an effective credit delivery and recovery mechanism and with the help of SHG/JLG model, they could cut down on transaction costs. This was a unique differentiator for MFIs compared to banks that did not have such effective mechanisms for credit delivery and reducing transaction costs. However, MFIs charged very high interest rate and allegedly followed coercive credit collection practices to make the lending model economically sustainable and these cast serious doubts on socially driven objective of MFIs. This has led to widespread criticism from different corners and threatened the very existence of MFIs. What followed was Andhra Pradesh MFI Act to regulate MFIs in the state and RBI Committee (Malegam Committee) Report on MFI sector detailing issues, concerns, and recommendations on the prevailing ill-effects of the MFI lending and recovery practices. The committee also reviewed the proposed Micro Finance (Development and Regulation) Bill 2010 and recommended few changes to it along with its own set of recommendations on MFI regulation.

Though, the recent MFI regulation in AP, and the more recent draft bill on MFIDR have put the MFI lending model under a scanner, the potential for such model to work effectively does exist.

Up-scaling MFI Lending – A Success Story under MSME-FDP Programme

Under the GIZ portion of MSMEFDP, an innovative financial product and delivery model for the upstream apparel supply chain had been worked out in association with a Delhi-based MFI named Satin Creditcare Network Ltd (SCNL). SIDBI had sanctioned a line of credit to SCNL for onward lending to the MSEs in the apparel supply chain. Capacity building support involved:

A. Assistance to design and develop a special credit scheme with the following features:

1. Loan ticket size in the range of Rs.50000/- to Rs.200000/-;
 2. Loan to be available for investment in machinery or for work capital needs;
 3. Repayment period up-to 2 years;
 4. Repayment in fortnightly/monthly installments instead of daily installments depending on cash flow of the borrower;
 5. No collateral security;
- B. Assistance in HR development for appraising and risk assessment of credit to MEs
- C. Interactive sessions were held with apparel supply chain MEs to understand their needs followed by sensitization workshops to motivate them to borrow from SCNL. They were given an orientation course in accounting, finance, quality improvement and marketing after working hours.

The results of pilot intervention (started in late 2008) are as under:

1. SCNL granted loans to 60 MEs. Each ME, on an average, employed 40 workers and therefore this intervention impacted the lives of around 2400 families and around 12000 people at pilot stage;
2. The enterprises financed under the scheme have shown much better financial discipline and have been repaying installments in time with no default.

Purchase Order Financing

Enterprises in almost all the MSME clusters under study indicated the absence of appropriate collateral as a reason for their loan applications to be rejected. In some cases, the units were already over leveraged and did not have any collateral based on which they can take fresh loans.

In such a scenario, enterprises can still borrow against the purchase orders placed by their credit worthy buyers. One of the primary requirements for this system to work from the bank's perspective is for the buyer to furnish a comfort letter to the bank detailing the seller information and credibility. This allows the seller to receive funds far sooner than if it had to wait for the buyer to pay on the invoice and even sooner than if the invoice is discounted. POF allows the seller to receive funds even before the goods are shipped and the invoice is issued. The seller procures the raw materials, manufactures the goods and ships the products to the buyer. Purchase Order Financing allows the unit to take on multiple orders and deliver them successfully.

Typically, the seller prepares and submits an invoice directly to the bank and the buyer pays the invoice according to the payment terms, usually directly to the bank. When the bank receives payment on the invoice from the buyer, the bank withholds the amount it advanced to the seller as repayment on the POF loan, and also deducts the agreed amount of interest and fees. The balance is then remitted to the seller.

Purchase Order Financing (POF) is indeed an effective product for easing working capital shortages where strong linkages exist between large and established buyers and a host of small and medium enterprises that carry out sub-contracted work for them.

Working Capital Term Loan

Working capital term loans (WCTL) are intended to cover the core (permanent) part of the working capital. Cash credits and overdraft facilities are generally understood to assist enterprises through transitory (fluctuating) part of working capital requirements. While larger enterprises are offered Working Capital Term Loans (WCTLs), sometimes even carved out of their WC limits, MSMEs do not enjoy the same luxury. It is generally believed that MSMEs possess lower control over their working capital and therefore lack the expertise in managing loan funds intended for meeting working capital requirements.

Most units in the Ludhiana Knitwear cluster do business through buyer seller meets organized during certain months of the year, where traders from across India come and place orders at a pre-determined price. Based on the orders placed, the units forecast the demand of raw materials and buy the raw material from the yarn suppliers in bulk. Also, most of the units tend to buy raw material in bulk so as to get competitive prices for the same.

While the orders are booked at the buyer-seller meets, payments are only realized after the goods are finally sold in the end-market. The buyers of these products deposit only 10-20% of the total value of goods as advance payments, which leaves the unit owners to arrange for working capital for the intermediate period. Often, enterprises have to extend credit of more than 120 days to their clients, which ties up the working capital finance. The credit limit set by the banks in the cluster is often not sufficient for the units to cover their working capital expenses.

Such shortages of credit in the Ludhiana cluster could be provided through a Working Capital Term Loan (WCTL) accounts. Although this arrangement is presently applicable to borrowers having working capital requirement of Rs.10 crores or above, this service can be extended to small enterprises with needs less than Rs. 10 crores as well.

Receivables-linked Bridge Financing for Working Capital Needs

One of the major factors inhibiting Bills Discounting in the cluster is the lack of payment discipline amongst buyers. This creates a serious and endemic problem in the cluster for MSEs of inability to procure future orders. The issue of post-dated cheques (PDCs) by buyers can bring about payment discipline, especially because dishonor of cheques is a criminal offence under the Negotiable Instruments Act. However, buyers from MSMEs typically do not agree to issue of PDCs.

A possible way through which receivables bills can be made to work in favor with MSEs will be to club it with the 'bridge financing' concept, where funding can be extended with bills as collateral to enable the units to take further order and not suffer from the delayed payment from debtors (customers).

Bridge financing is used to maintain liquidity in the scenario of anticipated cash inflows. This can be seen as temporary loan that shall map the sales receivables cycle to future order procurement to facilitate continuous operation of MSEs. Under this method, banks can finance MSEs on procurement of new orders, based on the bills issued by them for executed orders. At around the same time, the bank may be repaid out a payment received by the MSE from an earlier transaction.

Small units, such as those in the Rourkela Engineering Cluster, would find this as an effective method for overcoming difficulties with the current bill-discounting schemes.

Apart from the above credit products and delivery mechanisms, a number of innovative products based on specific purposes (such as the Quality Testing and Registration-linked Financing scheme in the Pune F&V cluster) and renewed application of standard products (such as Lease Financing) to clusters where such products are generally unavailable, have been recommended in the current report. Where appropriate, new credit delivery mechanisms, such as the formation of Joint Liability Group (JLG) for MSE lending in the Coimbatore Engineering cluster has been recommended.

Financial Inclusion through BDS Initiatives under the MSME-FDP Programme

Apart from the successes of the BMO-centric model in Faridabad Engineering cluster and the MFI-centric model among micro enterprises in the Delhi Apparel industry, there have been other successes from motivating cluster level financial institutions to lend to MSMEs under the MSME-FDP Program.

In Coimbatore, four interaction meets were organized with financial institutions, which were attended by nearly 200 cluster firms. As a consequence, many firms have obtained loans from TIIC and Banks and SIDBI. Coimbatore implemented the Faridabad financial model for the benefit of MSMEs. 24 cluster firms got financial support from Bank of Baroda and 3 firms got financial support from SIDBI.

Similarly in Rourkela, BDS initiatives under the MSME-FDP have helped establish linkages among SBI, SIDBI and a local Micro-finance Institution (MFI) named Sambandh Financial Services. 37 microenterprises are in the process of obtaining loans under the initiative. Further, access to finance has also been facilitated through Special Purpose Vehicles (SPVs) such as the Rourkela Techno-Park Self Help Cooperative Limited (RTPSHCL).

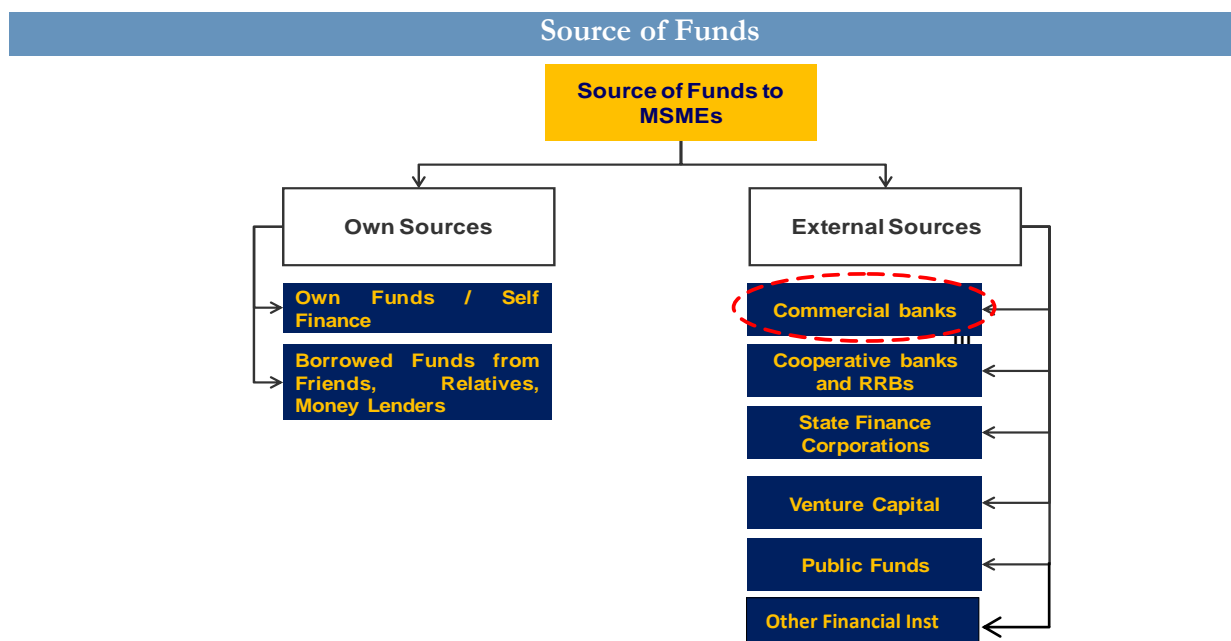
Credit Gap Definition under the Current Study

Overview of Credit Flow to the MSME Sector

The micro, small, and medium enterprise (*MSMEs*) sector is an important and integral part of Indian economy, contributing significantly to the industrial output, employment, and exports. The sector acts as an incubator of entrepreneurship and helps spread the wealth at the grass-root level. According to the “PM Task Force Report on MSME”, released in early 2010, MSME sector contributes 8% of country GDP, 45% of the industrial output, and 40% of total exports. Additionally, it provides employment to approximately 60 million people through 26 million enterprises. The report also mentioned that 94% of total MSMEs are unregistered, with a large number of them being informal or unorganized. Recognizing the significant contribution of the sector, there has been special emphasis on its growth and promotion by government.

To shore up the MSMEs in the country, financial inclusion has been identified as one of the critical requirements as none/inadequate/delayed supply of credit has been a major impediment to the growth of this sector. There is a growing awareness and agreement towards financial inclusion and it has become a national and a government imperative in the last few years. Several nationalized banks in public and private sector extend loans to MSME sector through their branches/specialized centers across India but the services are restricted and limited. The direct intervention of banking the unbanked is fraught with challenges for financial institutions that include high barriers to entry, long gestation period, and high go-to market and servicing costs. This is further aggravated with a lack of awareness and trust amongst the financially excluded regarding the benefits of banking system.

According to Fourth All India Census of MSMEs (2006-07), only 11.2% of the registered units availed institutional finance, while only 4.8% of the unregistered units had limited access to bank finance. Most of SMEs, for their credit needs, depend on self-finance, borrowed funds from friends, relatives, and moneylenders charging high interest rates.



Source: Report on Trend and Progress of Banking in India 2008-09 and Ministry of MSMEs, Annual Report 2009-10

Taking note of the significant contribution of the sector towards national GDP, exports, and employment coupled with lack of sufficient credit supply, Government of India and Reserve Bank of India have been taking appropriate policy measures for promotion of these enterprises.

To analyze the impact of policy initiatives taken to improve the flow of funds to SSI (*now MSE*) sector, including complexities of the system and related procedures, RBI has constituted various committees since the nineties decade. Prominent among these are Nayak Committee, S.L Kapur Committee, and Ganguly Committee. These committees have given a number of recommendations covering various aspects relating to Credit Demand estimation and Credit flow to MSE/SSI sector. Subsequently, a number of recommendations of these committees have been translated into policy guidelines by RBI and Government of India for financial and other support service institutions engaged in the development of this sector. Below is the summary of each committee's recommendation and relevance for current project.

Summary of Committee Recommendations		
Committee Name	Key Recommendations	Relevance to the current assignment
Nayak Committee Report (1991)	<ul style="list-style-type: none"> Estimated the working capital need for the enterprise as 25% of the forecasted sales. Endorsed the Tandon committee views that 80% of the working capital need be 	<ul style="list-style-type: none"> Method of estimation of working capital finance Insights for estimation of term credit

Summary of Committee Recommendations		
Committee Name	Key Recommendations	Relevance to the current assignment
	funded by banks i.e. 20% of the forecasted sales.	
Abid Committee Report on Small Enterprises (1997)	<ul style="list-style-type: none"> • Setting up of a Rs. 2500 crores fund to help enterprises that are negatively affected by the recommended abolition of reservations for small scale industry. • Setting up specialized branches catering to needs of small scale industry 	<ul style="list-style-type: none"> • Insights on channels and medium of credit delivery
Kapur Committee Report on Credit (1998)	<ul style="list-style-type: none"> • Recommended training for branch managers for appraising small projects. • Increasing the limit for composite loan to Rs. 5 lakhs (currently limit is Rs. 1 crore). • Opening more specialized branches for MSME sector. • Urging banks to pay more attention to backward states. 	<ul style="list-style-type: none"> • Credit Delivery Mechanisms
Gupta Committee Interim Report on Development of Small Enterprises(1999)	<ul style="list-style-type: none"> • Recommended that MSME sector be given the same importance as agriculture sector under priority sector lending. • Urged banks to directly lend to the MSE/SSI sector instead of adopting soft approaches like subscription to bonds of SFCs, NABARD, etc. 	<ul style="list-style-type: none"> • Priority Sector Lending and Delivery Mechanisms • Emphasis on direct Lending

Summary of Committee Recommendations		
Committee Name	Key Recommendations	Relevance to the current assignment
Chakraborty Committee Report on Rehabilitation of Sick SMEs (2008)	<ul style="list-style-type: none"> Recommended to simplify procedures in preparing techno-economic feasibility Suggested setting up single point credit processing cells Stressed the need for simplification of financial reporting requirements Legislation to encourage factoring, refinance at concessional rates. Setting up a rehabilitation fund for revival of sick MSMEs and a National Fund Equity scheme that can be utilised for Greenfield or expansion projects. 	<ul style="list-style-type: none"> Effective credit delivery Timely disbursements and process simplifications
Prime Minister Task Force's Sub-Group on Credit to MSMEs	<ul style="list-style-type: none"> Urged SEBI to expedite the process of setting up an MSME exchange. Recommended that all scheduled commercial banks should achieve a year-on-year credit growth of 20% to micro and small enterprises and strictly adhere to allocation of 60% to micro enterprises under the priority sector lending. Suggested changes in bank lending norms for innovation start-up firms. Recommended increasing mandatory coverage under CGTMSE from Rs. 5 lakh to Rs. 10 lakh for MSMEs. 	<ul style="list-style-type: none"> Insights on methodology for estimation of credit gap Effective credit delivery mechanisms

The details on each committee's report and different credit related schemes can be found in the Annexure A.3.

Comparison of MSEs and Medium Enterprises w.r.t Financial Inclusion

Indian MSMEs are a diverse and heterogeneous group but broadly face common set of problems. They are primarily in the areas of:

- ❖ Credit
 - Unable to provide collateral required for institutional credit
 - High interest rate incurred on credit borrowed from non-institutional money-lenders
 - Delay in institutional credit disbursement upon loan approval
- ❖ Long Asset Conversion cycle
- ❖ Lack of suitable quality control facilities and non-awareness of new technology.
- ❖ Hard to procure raw materials without credit
- ❖ Limited end markets access
- ❖ Not equipped to suitably manage financial books on their own

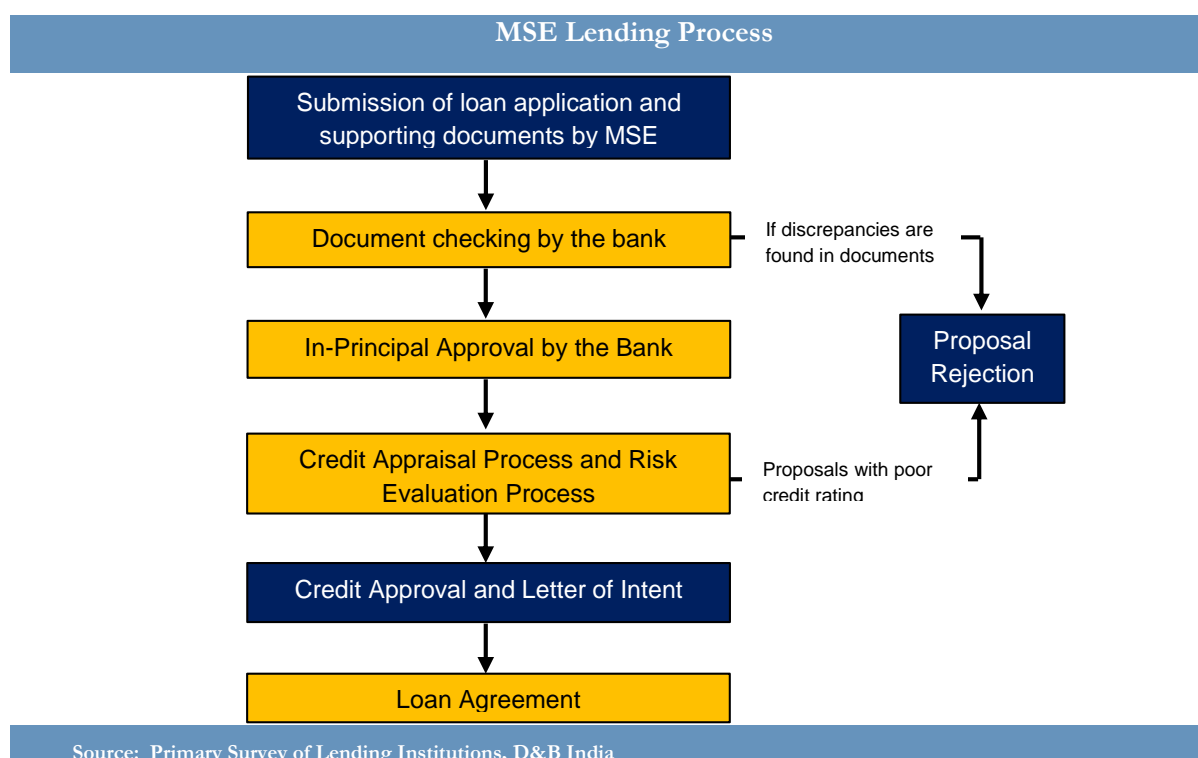
As we set out to identify the Credit Gap in the identified clusters, it is imperative to understand where Micro and Small enterprises stand vis-à-vis Medium enterprises, when it comes to financial inclusion. This understanding will also help us in defining the credit gap.

Further, to gain a better understanding of the status on financial inclusion of various forms of enterprises, we need to understand how the credit appraisal process works and the typical characteristics associated with MSEs and Medium-sized enterprises.

Credit Appraisal Process

Once the loan application is received, the bank assesses the risk involved in the project based on various parameters such as project details (*project concept, location, sector type, project strength through DSCR, project IRR, payback period etc.*), borrower background, fixed asset information, cash conversion cycle, previous relationship of the bank with borrower, and details of existing and proposed credit facilities. Lending institutions have internal rating models for assessment of project proposals, and few lending institutions accept ratings of external credit rating agencies.

The proposal acceptance rate is relatively high (*almost 90-95%*) in case of Public Sector Banks compared to Private Sector and Foreign Banks. The lower rate of acceptance in case of Private Sector and Foreign Banks is mainly due to their focus on large corporates and perceived risk in MSE sector

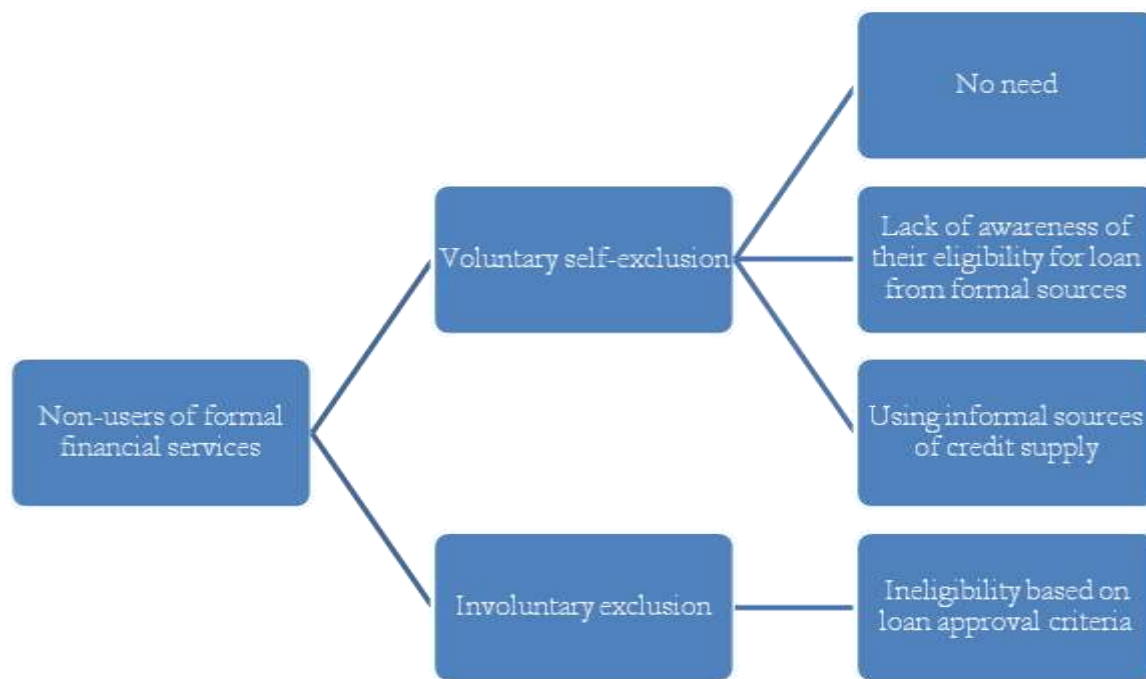


The table below provides a comparison of characteristics of MSE vs. Medium enterprises in terms of certain parameters that determine their likelihood of being financially excluded.

	Criteria	MSEs	Medium-size Enterprise
1 Bank's Requirement for Loan Approval			
1.a	Collateral Presence	Absent-Low	Acceptable
1.b	Guarantee	Not Always Available	Available
1.c	Fixed Asset	Not Always Available	Available
1.d	Credit Rating	Not Always Available	Available
1.e	Cash Conversion Cycle	Not Favorable	Favorable
1.f	Stability of cash flows	Low-Mid-High	High
1.g	Business/Project Plan	Not Always Available	Available
1.h	Accounting Information	Not Always Available	Available
1.i	Previous Relationship with the Bank	None-Low	Yes
2 Other Factors			
2.a	Banking System Awareness	None-Low	High
2.b	Borrowing from-Non Institutional Sources	Low-High	Low
2.c	New/Upcoming Technology know-how	None-Low	High

Due to unfavorable conditions existing at MSEs end, the loan approval either takes longer or gets rejected compared to that of medium size units.

Enterprises that do not use formal financial services fall into two categories viz., Voluntary self-exclusion and involuntary exclusion. The figure below illustrates the difference between the two.



Non-users of formal financial services, who fall under involuntary exclusion is definitely a critical parameter for defining credit gap. Equally important are those who fall under voluntary self-exclusion bracket. Enterprises that do not need credit can be safely assumed to be self-sustainable w.r.t credit requirement and is not a serious concern to policy makers. However, those enterprises “*who do tap funds from informal source of credit supply at higher interest rate*” and “*those who curtail production rather than borrow, because they perceive themselves as being ineligible for loans from formal sources at reasonable interest rates*” needs attention due to lack of credit supply from formal financial institutions.

Considering that MSEs suffer greater financial exclusion, as explained above, Credit Gap estimation under current study is aimed only at MSEs and the study shall not consider medium size enterprises for computation of credit gap.

Credit Gap Definition and Concerned Clusters

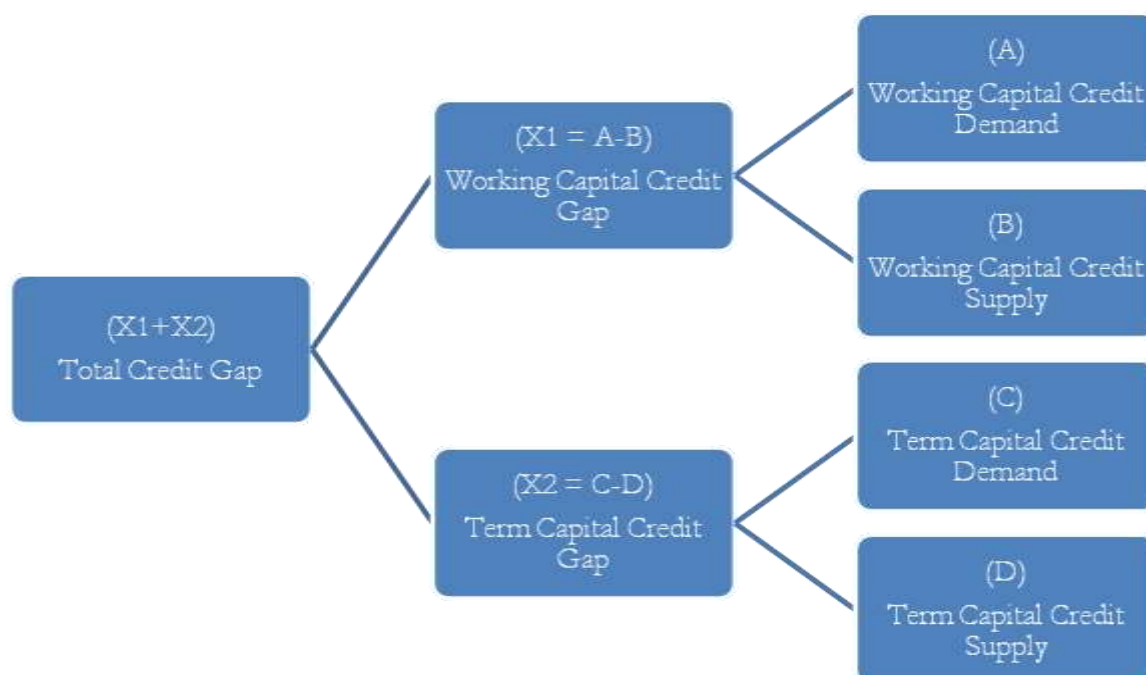
In light of the above, Credit gap can be defined as unmet credit requirement of MSEs, over and above the available access to credit from formal institutional sources of finance. The same measures are used by international institutions like IMF and World Bank.

Below is the list of selected clusters for the current study.

Selected Clusters				
Cluster	District	Industry	Lead Bank	
Faridabad	Faridabad	Engineering	Syndicate Bank	
Coimbatore	Coimbatore	Engineering	Canara Bank	
Rajkot	Rajkot	Engineering	State Bank of India	
Rourkela	Sundargarh	Engineering	State Bank of India	
Ahmedabad	Ahmedabad	Dyes & Chemicals	Dena Bank	
Hyderabad	Hyderabad	Pharmaceuticals	State Bank of India	
Ludhiana	Ludhiana	Knitwear	Punjab & Sind Bank	
Chennai	Chennai	Leather	State Bank of India	
Kolkata	Kolkata	Leather	United Bank of India	
Pune	Pune	F&V Processing	Bank of Maharashtra	
Source: RBI Annual Publications, Branch Banking Statistics				

Methodology for Credit Gap Estimation

Estimation of Credit Gap requires identification of Credit Demand and Credit Supply to MSEs. Further, these can be broken down into Working Capital gap (*demand, supply*) and Term Loan gap (*demand, supply*). Below is the schematic of credit gap estimation and discussion of suitable credit gap estimation methodologies.



Credit Demand Estimation

Credit Demand is defined as capital required for running a business – both for daily operation as well as in the longer term. The need for credit in case of MSEs arises from the following activities conducted by them:

- ✓ Raw materials purchase
- ✓ Labor cost
- ✓ Facility rent, and utilities cost.
- ✓ Machinery maintenance
- ✓ External facilities/units (*Manufacturing & Quality compliance*) usage.
- ✓ Credit rating approval
- ✓ Support & Development Services such as financial audit and monitoring, project development and report preparation etc.

- ✓ Excise tax
- ✓ Technology up-gradation
- ✓ Fixed Asset revision
- ✓ Construction of new facilities for manufacturing & quality compliance

Credit Demand for MSEs is broadly divided into two parts viz. Working Capital and Term Capital Demand

Working Capital Demand

It is the working capital required for managing day to day business operations and compliance activities.

The Cash Conversion Cycle plays a critical part in determining working capital requirements for enterprises. Cash Conversion Cycle-CCC (*also known as Asset Conversion Cycle*) is an important analysis tool to identify the need of cash at different stage of production cycle. It the number of days that an enterprise takes to convert resource inputs into cash flows. This metric looks at the amount of time needed to sell inventory, the amount of time needed to collect receivables, and the length of time to pay the bills. Effectively, it is the time gap between cash outlay and cash recovery.

$$CCC = DIO + DSO - DPO$$

Where:

DIO = days inventory outstanding

DSO = days sales outstanding

DPO = days payable outstanding

The shorter the cycle, lesser the time capital is tied up in the business processes.

Term Credit Demand

It is the demand that emanates from requirement for new facilities establishment, technology up-gradation, and fixed asset revision.

Methodology for Credit Demand Estimation

To determine an appropriate Credit Demand estimation methodology, D&B India conducted primary and secondary research that included the study of reports prepared by various committees (*constituted by RBI*), Diagnostic Study Reports prepared by various cluster implementation agencies,

the Arjun Sengupta Committee report on unorganized sector and various other sources. In addition, D&B India conducted a primary survey of enterprises in the 10 identified clusters. Below is a note on each source.

Nayak Committee

The Reserve Bank of India constituted a Committee under the Chairmanship of Shri P.R. Nayak, Deputy Governor during 1991 to examine the difficulties confronting (*the then small scale industries (SSI) and now MSE*) the MSMEs in the country in securing finance. Of the broad contours set for the committee, one of the key requirement was to examine the adequacy of institutional credit for the MSE sector, particularly, with reference to the increase in the cost of raw materials and locking up of the available resources due to delay in the realization of sale proceeds from large companies and Government agencies. The committee was an extension of the earlier work done by Tandon/Chore committee.

In the process of examining the adequacy of institutional credit, the committee, outlined methods for estimating the credit gap through developing credible demand estimates for credit. While the committee stressed on strong quantitative methods for Working Capital credit estimation, the term credit estimation was fairly qualitative in nature.

For estimation of working capital, the committee suggested using the forecasted sales approach. 25% of the forecasted sales for the enterprises would be considered as requirement for working capital. The working capital bank credit would be 80% of the estimated working capital requirements.

Arjun Sengupta Committee Report

D&B also studied the report prepared by the ¹National Commission for Enterprises in the Unorganized Sector (NCEUS) under the chairmanship of Mr. Arjun K Sengupta. The Government of India had setup the commission to recommend measures for bringing about improvements in the non-farm unorganized sector. The commission defined the non-farm unorganized units as, “all unincorporated private enterprises owned by individual or households engaged in the sale and production of goods and services operated on a proprietary or partnership basis and with less than ten total workers.”

The commission was setup with the objective of recommending necessary measures so as to improve the productivity of these enterprises, generate large scale employment opportunities on a sustainable basis, particularly in the rural areas, enhance the competitiveness of the sector in the emerging global environment, linkage of the sector with institutional framework in areas such as credit, raw material,

¹ Financing of Enterprises in the Unorganized Sector and Creation of a National Fund for the Unorganized Sector (NCEUS, Nov 2007)

infrastructure, technology up-gradation, marketing and formulation of suitable arrangements for skill development.

This commission had written a report on the financing needs of the unorganized sector wherein they had calculated and commented upon the credit gap that exists in the financing of enterprises in the unorganized sector. Under this method, the average credit needs of the unorganized units were obtained from a survey. Average credit need was then multiplied by the total number of estimated unorganized units to obtain the Total Credit Demand.

While the commission's method was most effective for estimating credit requirements of unorganized enterprises (mostly micro proprietary units), extrapolated estimates of credit demand are prone to outliers in the sample surveyed. Existence of detailed diagnostic studies on the clusters (see Annexure A.3) and a detailed survey among a limited but representative sample enabled D&B India to rely on the 'Forecasted Turnover Approach' for estimating WC requirements and its own method (explained below) for estimating Term Loan requirements, separately.

D&B India Survey

D&B India conducted a sample survey across 10 identified clusters, in discussion with GIZ and SIDBI stakeholders. At least 50 MSME respondents (*enterprises*) were identified for each cluster and well distributed across micro, small, and medium enterprises. The questions in the questionnaire included queries on financial information (*such as assets, turnover, profit etc.*), nature of credit requirement, and perception/experience with the banking system.

Please refer to the Annexure A.1 for the questionnaire.

Step-wise Credit Demand Estimation Method

D&B proposes to use two methods for estimation of credit demand². They are

❖ *Forecasted Turnover Methodology for **Working Capital Demand** based on Nayak Committee Report*

1. Cluster Turnover was estimated on the basis of the D&B Survey of 50 enterprises in each cluster. Turnover of the enterprises within the sample were extrapolated using the number of micro and small enterprises in the cluster. The number of enterprises was taken from the

² Credit Demand includes both working capital and term capital demand

Cluster Diagnostic Study (DS) Reports³. The details on DS reports can be found in the Annexure A.3.

2. The above values (*calculated in 1.*) were then projected to 2011-12 level using average growth in Index of Industrial Production (IIP)⁴ for the corresponding industry.
3. Using Nayak Committee guidelines (*20% of projected turnover as working capital funding requirement*), working capital estimates were arrived for micro and small units.

To estimate the **Term Credit Demand**, the following steps were employed

1. D&B Survey was used to obtain “Investments in Plants & Machinery” for the sample number of units covered for MSEs
2. Annual Survey of Industries (ASI) statistics⁵ was used to obtain the growth rates in Fixed Capital for different industries state-wise. Subsequently, this was used to forecast population estimates obtained in step 1.
3. The difference in values for 2011-12(*projected; calculated in step 2.*) and 2010-11 years is taken as Term Credit requirement and 80% of the same is termed as *Term Credit Funding requirement*.

Credit Supply Estimation

According to 4th All India Census of Micro, Small, and Medium Enterprises-MSME (2006-07), only 11.2% of the registered units availed institutional finance, while only 4.8% of the unregistered units had limited access to bank finance. Most of the MSMEs, for their credit needs, depend on self-finance, borrowed funds from friends, relatives, and moneylenders charging high interest rates.

With the motive of effective implementation of social objectives, RBI implemented lead bank scheme in year 1969 as per a recommendation from SKF Nariman and Prof. Gadgil. Under the scheme, one of the commercial banks in the district functions as a lead bank and acts as consortium leader for coordinating the efforts of all financial institutions operating in the district. The lead bank is expected to take the lead role in identifying the potential areas for banking and banking development and expanding credit facilities in the district. There is reporting hierarchy under which

³ DS turnover estimates haven't been considered as the figures correspond either for year 2008 or earlier, thus preventing significant deviation. Number of micro and small units though have been taken from DS reports

⁴ Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug, 2011

⁵ ASI estimates on Fixed Capital for different industries within a state – MOSPI ASI Report

lead bank has to provide key lending statistics of the financial institutions to District Level Committees (DLCCs) and then further to State Level Banking Committees (SLBCs).

Step-wise Credit Supply Estimation Method

Enterprise turnover is one of the important criteria for loan appraisal process and it can be safely assumed that credit supply to the cluster is correlated with the turnover generated. Thus, D&B proposes to use a method involving the “Proportion of Cluster Turnover to Industry State Turnover” to arrive at cluster level credit supply. The methodology steps are:

1. Obtain state industry level advances from RBI – Basic Statistical Returns available till March 2010 ⁶
2. Obtain state industry turnover (*ASI*)⁷ and cluster turnover
3. Forecast both the advances (*obtained in 1.*) and turnover (*obtained in 2.*) to the current level (March 2011)
 - a. Using state total advances growth rate, obtain the state industry level advance (**SIA**) to current level (2011). State Total Advances is available for the period ending Mar, 2011⁸.
 - b. Using National IIP growth rates⁹, forecast the state industry turnover (**SIT**) and cluster turnover (**CT**) to the current level (2011)
4. Obtain the proportion (**P1 = CT: SIT**) of cluster turnover to state industry turnover (obtained in 3.)
5. Calculate the credit supply at Project cluster level using the above proportion (**Cluster Level Credit Supply-CLCS = P1*SIA**).
6. Credit supply from major non-SCB (SFCs, SIDBI, and Cooperatives) institutions is added to the above credit supply to get the supply level at the cluster level.
7. Further, total credit supply was broken down into Term Credit and Working Capital using “State Level Advances – Working Capital Advance and Term Loan Advance (SE) to Small

⁶Table 4.9- Annual-Basic Statistical Returns of Scheduled Commercial Banks, Mar '2010

⁷ Table 3 – Annual Survey of Industries (ASI), Government of India, MOSPI

⁸ Statement 9: RBI Quarterly-Basic Statistical Returns of SCB, Mar '2011

⁹Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug 2011

Enterprise (SE)¹⁰. Term loan advance proportion to total advance (obtained above) is termed as **P2**

- a. Working Capital supply is then arrived at using formula **(1-P2)*CLCS**
- b. Term Capital supply is **P2*CLCS**

D&B India also contacted various Lead Banks for the identified district clusters under the current study and obtained aggregated (*of financial institutions*) credit supply data at district level. The estimates for Credit Supply Outstanding for each cluster computed by D&B were matched with Lead Bank data on Outstanding Total Advances, Priority Sector Advances and MSE Advances, in order to ensure consistency.

The Lead Bank supply data included data from Scheduled Commercial Banks (SCBs), State Finance Corporation (SFC), SIDBI, and Co-operative Banks. However data of SFC, SIDBI, and Co-operative Banks was available for only few districts as provided by lead bank. Further, there were qualitative discussions with lead bank manager to get an estimate of credit supply at cluster level in each district.

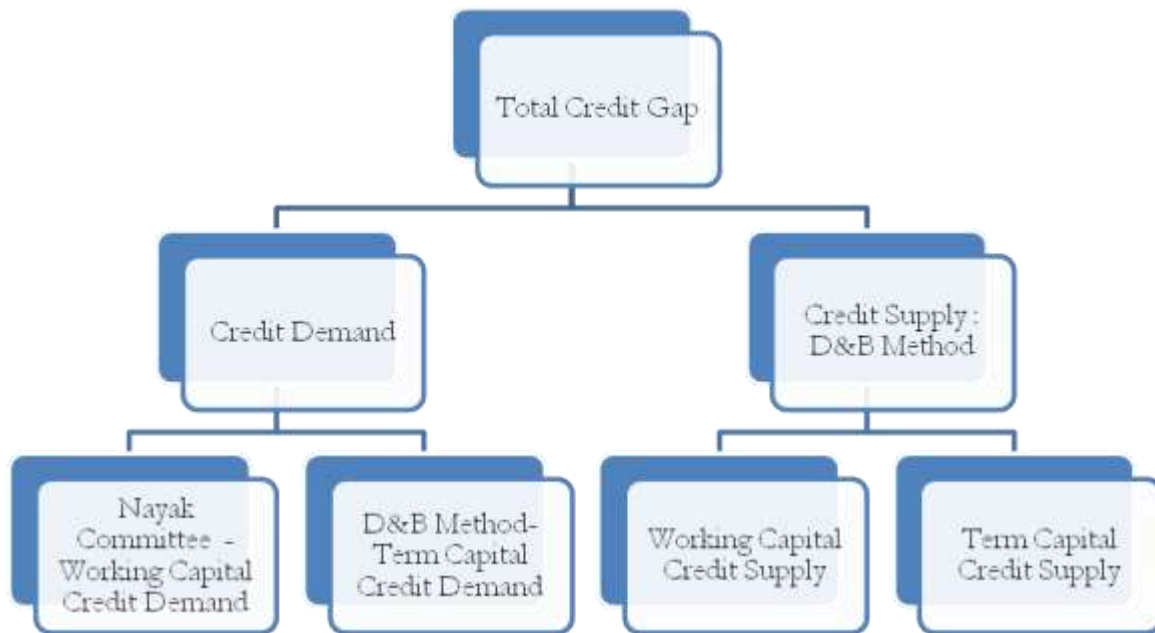
Credit Gap in the MSE Sector

The methodology discussed above has been applied to all identified clusters (MSEs) for credit gap estimation. The various end statistics reported for different clusters are:

- ❖ Working Capital Demand obtained from Nayak Committee Approach
- ❖ Term Capital Demand from D&B Approach
- ❖ Working Capital Credit Supply from D&B Approach
- ❖ Term Capital Credit Supply from D&B Approach
- ❖ Lead Bank data on District Level Advance (Total, Priority Sector, MSE/SSI)

After obtaining Credit Demand and Supply figures, Credit Gap was accordingly obtained and validated against lead bank data for each cluster. Below is the schematic representation of the Credit Gap estimation process.

¹⁰Table 6.1, Statistical Tables Relating to Banks in India, 2009-10ss



Further, D&B India has provided qualitative inputs on credit supply and demand for each cluster in the individual cluster reports.

As mentioned earlier, MSEs face greater financial exclusion compared to medium-sized enterprises. Credit Gap estimation for different clusters are obtained only for MSEs using above methodology. However, the methodology can be extended to MSMEs and as well as to clusters (*not undertaken in the current study*) for credit gap estimation.

Pune F&V Processing Cluster

Overview

The fruits and vegetables units cluster is located in the District of Pune and in and around Panchgani (District Satara). Proximity to urbanized markets such as Mumbai, Nasik, Nagpur, Aurangabad etc., changing food habits, cosmopolitan nature of the city, connectivity to JNPT and hence convenience of exports etc. are the factors that have given the required boost to make this segment a fast-growing one in Pune.

The products covered under various segments for the purpose of the project implementation are given below.

- **Spices and Pickles:** This segment covers basic raw spices, spice mixtures (powders and pastes), pickles as well as papads.
- **Fruit and Vegetable processing:** Products such as dehydrated vegetables, vegetable and fruit powders, jams, sauces, purees, etc. are included in this segment. All products covered in this segment require an FPO license.
- **Ready-to Eat (RTE) / Ready-to-Cook products (RTC):** Heat-and-eat products are classified as Ready-to-Eat or RTE products. These are in the form of cooked curries or frozen pulps, frozen foods on which no further processing is required. Ready-To-Cook or RTC products are those on which some final level of cooking is required before they can be consumed. Ready-to-cook spice mixes have been accounted for under the Spices category and not RTC because they are an ingredient rather than the final product.

Major products that account for a larger share in this cluster are spices and pickles. Therefore, larger representation of these products was ensured while developing the sampling criterion.

The following table summarizes the information about the fruit and vegetables cluster:

Pune Cluster Summary – MSEs				
Particular	Fruits and Vegetables Processing	Spices	RTE	Total*
Investment (Plant and Machinery) Rs. Cr	116	111	32	259
Turnover Rs. Cr	194	581	71	846
Employment (No's)	2988	8665	1560	13213
Source: Pune BDS website (http://www.punebds.com) – Cluster Diagnostic Study, D&B Survey				
Note: *Information pertains to only the F&V Segment and non-F&V items are not included above.				

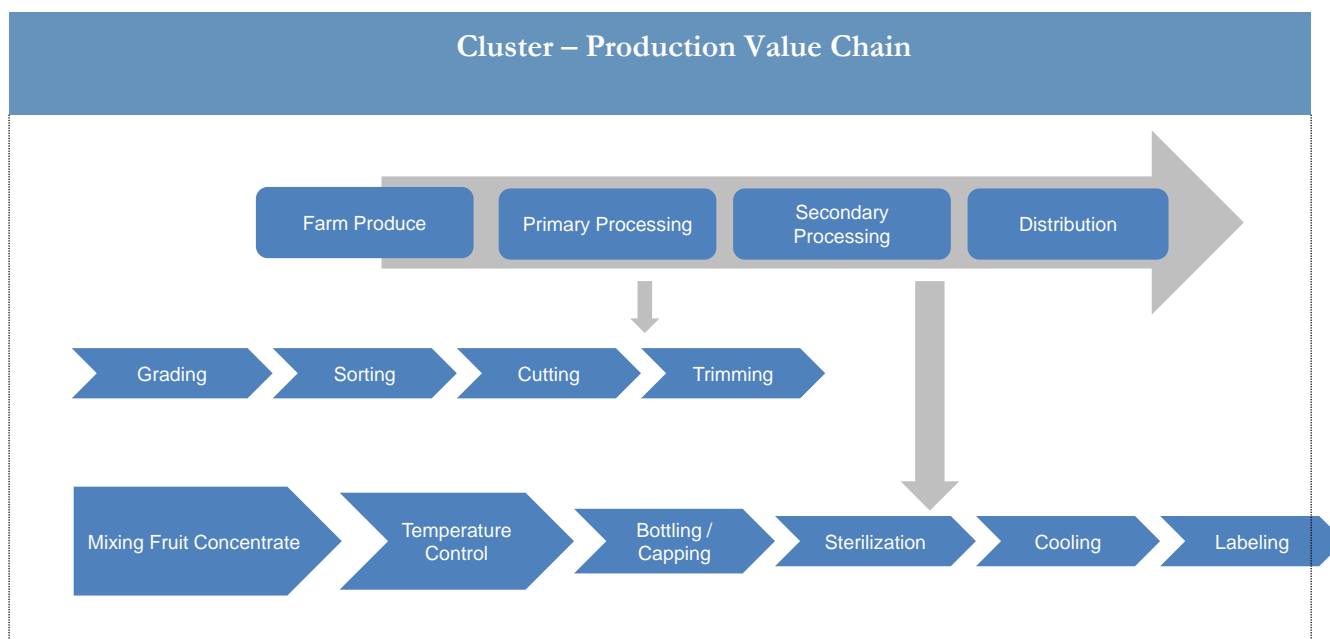
The estimates of “Investment (in Plant & Machinery)” and Turnover have been prepared on the basis of D&B Sample Survey, while cluster employment figure has been borrowed from Diagnostic Study (DS)¹¹ Report, prepared for SIDBI in 2007.

No statistical estimates of the number of units processing fruit and vegetable are known so far conducted through any of the published sources. A MCCIA study provides only the break-up of “Total Food Processing” in Pune district. However, MCCIA estimates have revealed the following tentative guesstimates on number of units within the defined geographical locations of this cluster:

- Micro – about 400 units
- Small/Medium – About 150 units

Sources of Demand for Credit – Opportunity and Risks

The food processing industry in Pune is highly heterogeneous. There is great diversity in terms of the range of products, technology used, and their production facilities. The cluster is highly disorganized and at a nascent stage. Inter-linkages among the firms by way of transmission of materials or process synergies are relatively lower. The chart below depicts the various stages of production for various products.



¹¹ Diagnostic Study Report on Pune F&V Processing Cluster prepared by “Apex Cluster Development Services Pvt. Ltd.”, Aug-2007 (<http://www.punebds.com/thecluster.asp>) under MSMEFDP

The value chain in the cluster is relatively simple with a large focus on traditional and domestic methods. The technology though not obsolete, is however orthodox. Credit requirements arise from each of the activities in the value chain.

Procurement of Farm Produce and Primary Processing

Procurement involves accessing the *mandis* to procure the required farm produce through networks or knowledge of the exact product requirements. Market yards are used exhaustively by the enterprises for sourcing raw-materials. Procurement of farm produce at the reasonable prices is important for all further processes and the competitiveness of the end-products. The owners within micro and small enterprises do these themselves in order to have greater control on the production costs in the firm. **Payments for raw-materials procured at market yards need to be made on the spot. Besides, many of the raw-materials are seasonal, while the demand for their end-products is not. Hence, payments on finished products are realized long after the inputs are procured.**

A few enterprises have also developed linkages with the farmer to get assured supply of the required standard of raw material. There is the need to not only develop linkages with the raw material supplier but also ensuring availability of the post-harvest infrastructure necessary to keep the produce in a standardized form which is cost efficient to the industry. **However, there has been very little investment in post-harvest infrastructure in the cluster.**

Post procurement, the production activity also includes smaller activities like cleaning, sorting, grading, processing, grinding/ homogenizing or temperature controlling. Whilst most of these are elementary processes, **inadequate automation of primary processing** reduce process efficiency and result in the risks of contamination and rejection of supplies.

There is also improper synchronization in production planning, which results in inaccuracies in material requirement assessment. Therefore, the **enterprises face the risk of market price fluctuations**, because of which economies of scale cannot be reaped by the enterprises.

Secondary Processing

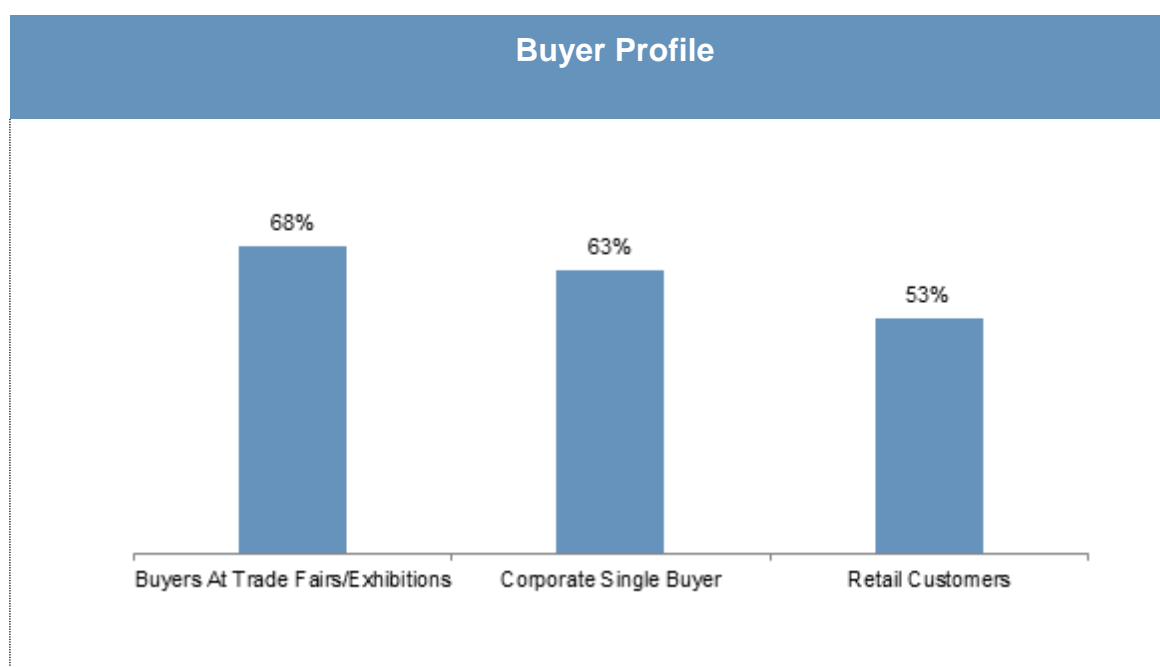
A large proportion of the output from medium enterprises is met through sub-contracting to smaller or micro units. These include the large spices and pickles manufacturers and some players in the RTC segment. However, process quality checks are conducted by these enterprises themselves before initiating the sub-contracting agreement. Most of the times, the basic raw material is provided. For example, in making the onion-garlic spice, the onion-garlic paste in ground format as required is provided to the smaller firm. The risk of poor quality and contamination is attempted to be eliminated at the first stage itself.

Secondary processing in the cluster typically involves use of heat and temperature controls effectively for processes such as sterilization and pasteurization. While, the level of knowledge of these techniques was found to be low, certain organizations have invested in expert food technologists for controlling their unit. These enterprises have been successful in terms of cost control, productivity improvement and hence, remained competitive in the cluster. This demonstrated success is encouraging other enterprises to follow suit.

Marketing and General Management

Most of the enterprises in the cluster are heavily dependent on trade fairs (see chart below). At such fairs / exhibitions, buyers typically get multiple options for bargaining with various exhibitors. Hence, the orders are booked at buyer's prices, with the enterprises wielding very little bargaining power.

As the Pune cluster has wide variety of companies competing with each other, every company has positioned itself differently with respect to different segments and has different branding strategies for different products. Most of the micro and small enterprises are not concerned about developing their own brands. These firms largely rely on sub-contracted orders received from medium enterprises. As a consequence, the products manufactured by these firms have a limited regional market restricting their revenue potential.



Export marketing is also limited in the cluster, largely due to the lack of awareness. There is low to moderate awareness amongst the cluster firms with respect to documents for export, customs duty

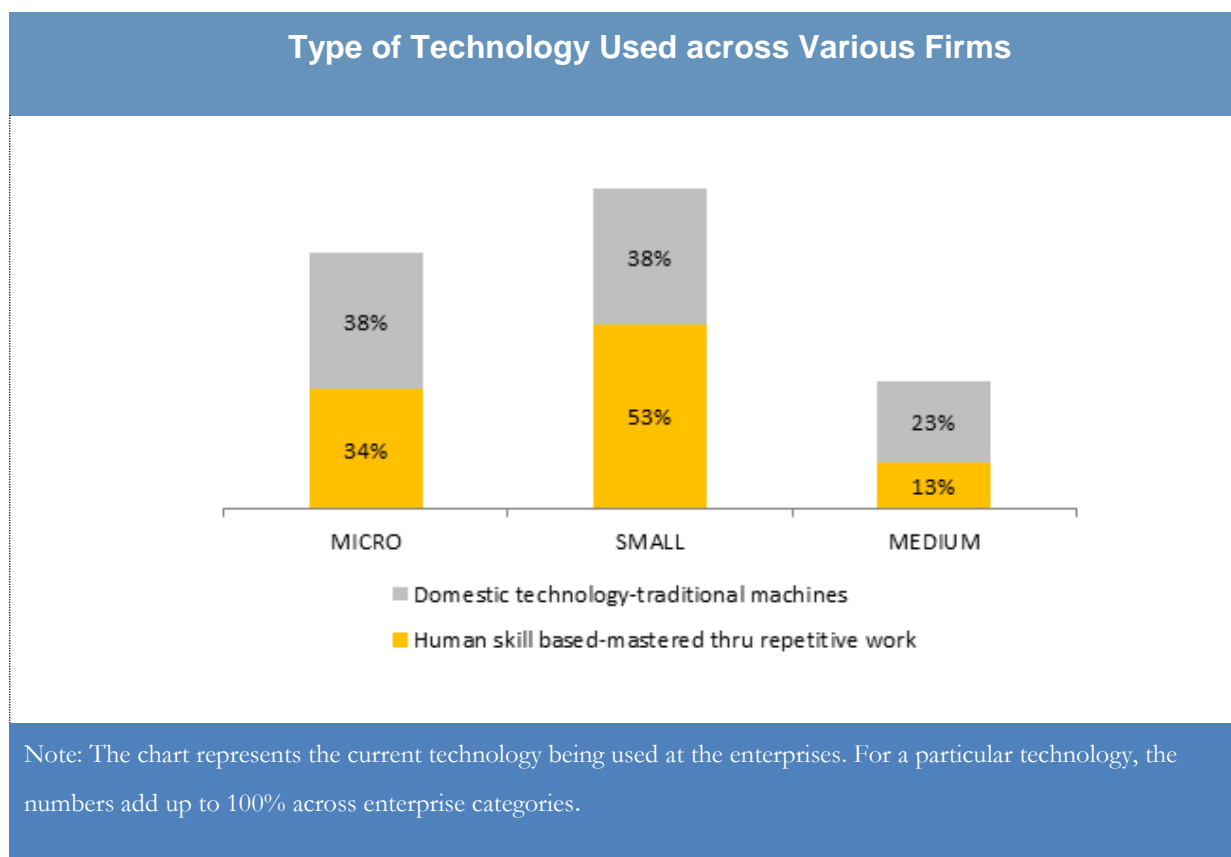
and IEC number. This need of providing the adequate information on export regulations is currently therefore serviced by the BDS providers in the cluster and are available within the reach of only the larger enterprises.

Finance as a function typically faces a lack of skilled staff, for using and analyzing TDS, other tax related issues like CENVAT and Duty Drawback schemes. Another challenge is the usage of IT in the finance function as well. While most of the activities of the finance function involve usage of IT for filing returns, maintaining regular records, audit related documents etc. need automation. The knowledge of IT in most of the firms is elementary and is now beginning to be focused upon.

Nature of Technology Used

There is minimal interaction among the units in the cluster. Every firm intends to preserve its unique identity through its well-crafted and developed recipes. This has led to enterprises remaining traditional since access to modern technology and sources of knowledge is only available either through material suppliers or from buyers.

The nature of technology used is skill and labor intensive. There are issues with respect to labor availability and wage bargaining. Highly irregular work force makes entrepreneurial involvement higher and at the same time. The following chart depicts the nature of technology used:



Excessive dependence on labor-driven technology causes cyclical production, with production impacted as and when availability of labor is altered. Also, the enterprises face pressure from local administration like the Gram Panchayats since these enterprises operate on lands procured from these bodies.

Supply of Credit to MSEs

Estimate of Outstanding Credit to MSEs in the F&V Cluster

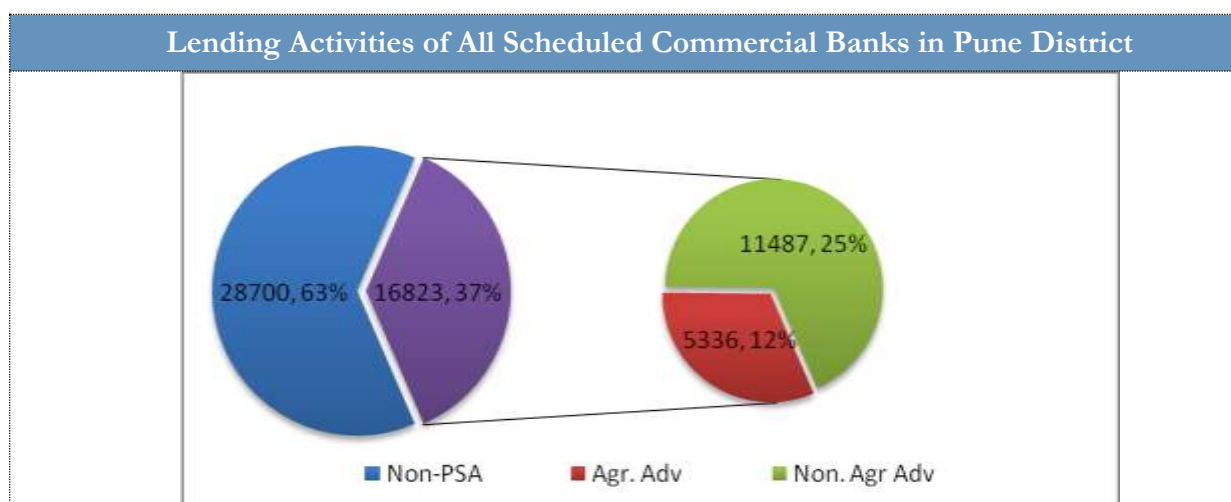
The credit supply to the Pune F&V cluster is estimated to be Rs. 137 crores out of which Rs. 29 crores (21%) is term credit and Rs. 109 crores (79%) is working capital supply.

Enterprise turnover is one of the important criteria for loan appraisal process and it can be safely assumed that credit supply to the cluster is correlated to the turnover generated. Thus, D&B proposes to use the “Cluster Turnover proportion to Industry State Turnover” method to arrive at cluster level credit supply.

The steps for computation under the identified Methodology are detailed [Annexure I](#).

The data obtained through above methodology was further validated against the data on Outstanding Advances collected from the lead bank in Pune district.

The RBI Lead Bank Scheme is implemented by Bank of Maharashtra as the lead bank in the cluster. According to the RBI Banking Statistical Returns, the outstanding credit for Pune district stood at an aggregate of about Rs. 57,780 Crores (as of March 31, 2010)¹². Information obtained from the lead bank suggests that the outstanding credit to the priority sector could stand at Rs. 22,167 Crores (38.5% of the total credit). The following exhibit depicts the banking flow of credit in the Pune District. It can be clearly seen that the Priority Sector Advances in the Pune District are close to the prescribed lending norm of 40% (of total advance).



¹² Table 5.9, District Wise Classification of Outstanding Credit of SCBs, Basic Statistical Returns of SCBs in India, Vol 39 – Mar, 2010

Amount in Rs. Crores

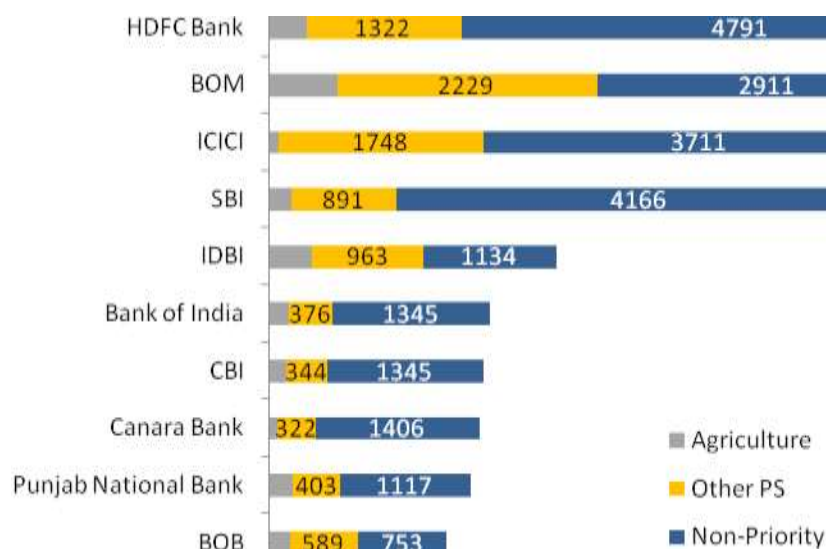
Source: Data from Pune Distt. Lead Bank - Bank of Maharashtra as of June 30, 2011

Performance of Banks

Public sector banks contribute to 59% of the total credit and 50% of the priority sector credit. In contrast, private sector banks contribute to 34% of the total credit, and 33% of the priority sector credit. The predominant focus for the private banks is the MSME sector, further reinforcing the increasing role of these banks in MSME financing.

The following is the composition of Agriculture, Other Priority Sector and Non-Priority Sector credit in Pune as of June 30, 2011, for the top ten banks. The top 10 banks contribute to 75% of the outstanding credit in the Pune district. HDFC Bank has the largest outstanding credit portfolio. The Bank of Maharashtra leads among the Public Sector Banks and has the largest priority sector lending portfolio. Private sector banks have relatively smaller agricultural loan portfolios, but have relatively larger Other Priority Sector loans outstanding in the Pune district.

Lending of Major Banks across various categories in Pune District

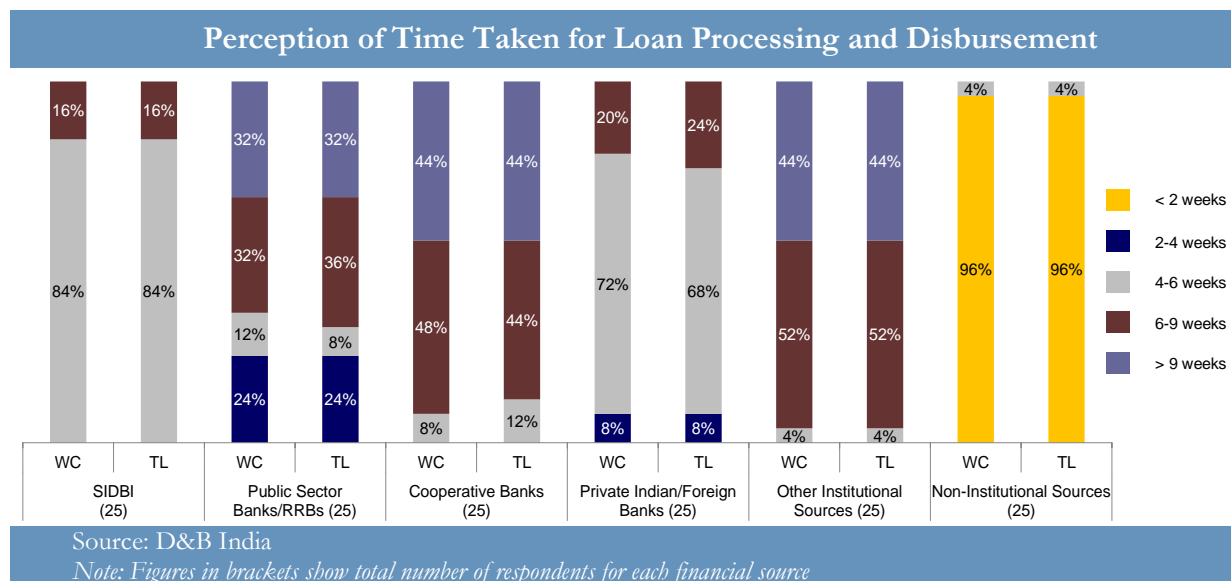


Notes: Amount in Rs. Crores

Source: Data Obtained from Bank of Maharashtra as of June 30, 2011

60 MSMEs were interviewed on the overall perception of their association with various institutional (including SIDBI) and non-institutional sources w.r.t to time taken for loan disbursement and collateral requirement.

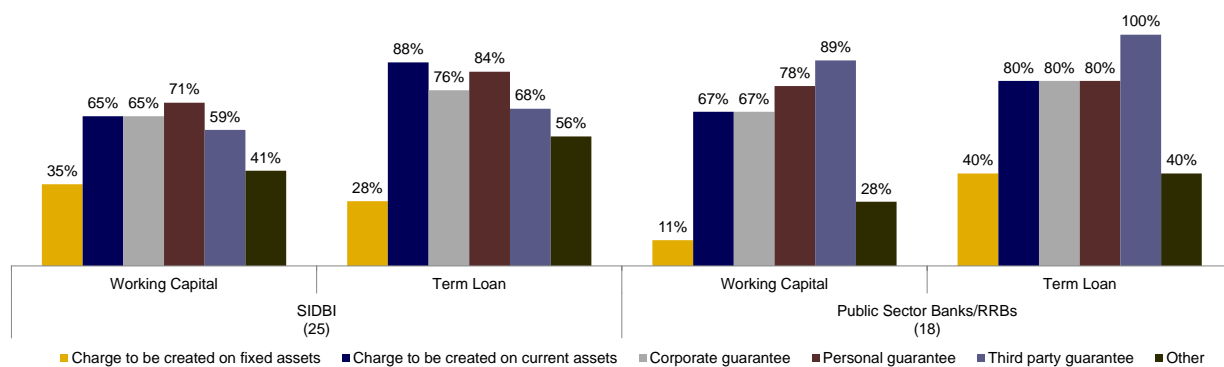
The following chart depicts perception among respondents of time taken for loan processing and disbursement by various financial sources.



Based on the survey, it is perceived that SIDBI takes 4+ weeks to process and disburse loans. However, it is important to note the underlying reason for this perception. With the introduction of CART software, SIDBI has been able to markedly improve the loan approval and disbursement process upon successful loan application, and fair better than the most banks. During a loan application process, usually, there is a lag between dialogue initiation (between borrower and bank) for loan application and acceptance of relevant documents/loan application by bank. Borrowers, sometimes, do consider this time lag also in loan processing and disbursement process time and thus forming their perception on different banks. This is not an ideal scenario. However, financial institutions need to make prospective borrowers more aware of the loan application process, so that customer perception is more realistic and positive. There are mixed responses regarding perception of time taken for loan processing and disbursement for financial sources such as Public Sector Banks, Private and Foreign Banks, Cooperative Banks and other institutional sources. The non-institutional sources are perceived to disburse loans largely within 2 weeks.

The following chart shows the nature of collateral requirements across various financial sources.

Nature of Collateral Requirements



Source: D&B India; Note: Figures in brackets show total number of respondents for each financial source

Public Sector Banks seem to demand a marginally higher amount of collateral than SIDBI. However, the type of collateral in case of both the financial sources ranges across charge on fixed and current assets, corporate, personal and third party guarantee, and other types.

Demand for Credit by MSEs

Estimate of Credit Demand by MSEs in the F&V Cluster

D&B India has employed Nayak Committee approach to arrive at Total Credit Demand at cluster level, as mentioned in the methodology section. The methods involved are:

Nayak Committee-D&B Approach

- Working Capital Demand - Turnover Based Approach (Basis – Nayak Committee Guidelines)
- Term Capital Demand - D&B Approach (Basis – Growth in Fixed Capital)

Below are the highlights of the credit demand estimates in the cluster:-

- ❖ Total number of Micro and Small units in the cluster is 530
- ❖ The turnover for the Pune F&V MSE cluster is pegged at Rs. 846 crores during 2010-11 from the D&B survey at cluster level.
- ❖ The turnover is estimated to rise by an annual average growth rate of 13.4% (IIP estimate) to Rs 960 crores in the year 2011-12.
- ❖ Working Capital Requirement (Basis-Nayak Committee Guidelines) is estimated to be Rs 192 crores
- ❖ Term Credit Requirement (Basis-Growth in Fixed Capital) is estimated to be Rs 42 crores

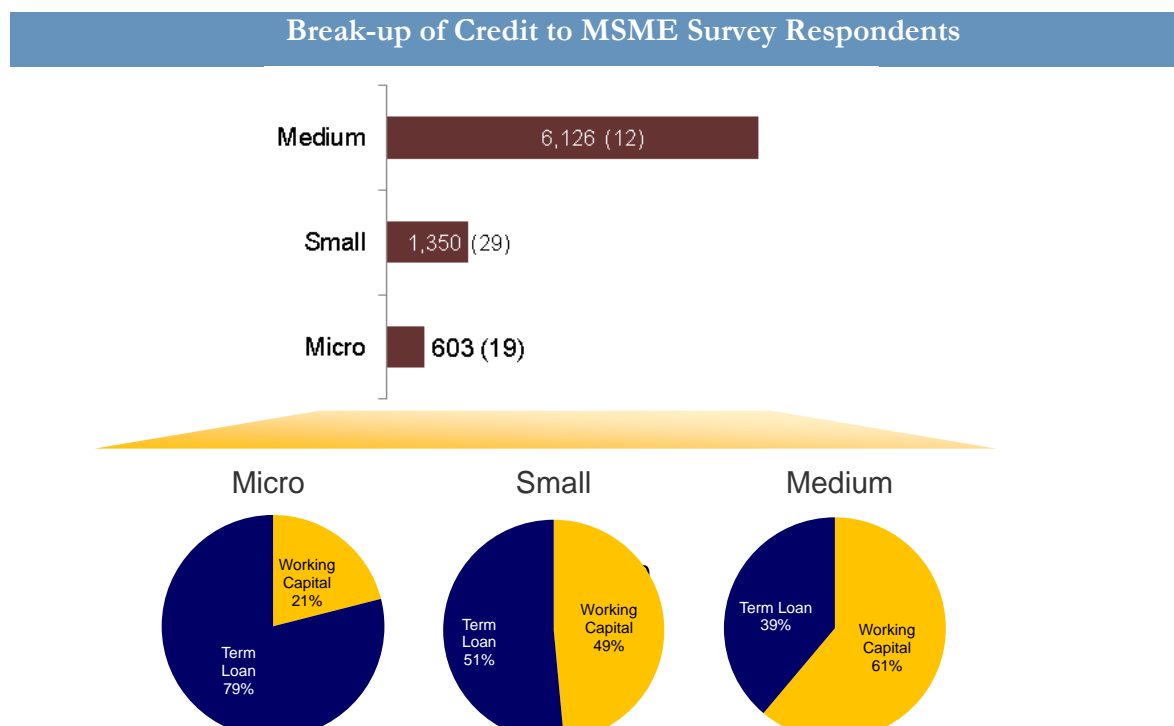
❖ Total Credit Demand is thus obtained from above $[(192) + (42)]$ and is Rs 234 crores

Most banks including the lead bank have indicated that for appraisals of working capital loan requirements, Nayak Committee Recommendations are being followed. The equity margin expected from promoters as per the recommendations is 20% of the working capital loan. It was observed from the survey that across categories of Micro, Small and Medium Enterprises, this ratio though has varied; the average margin requirement is marginally lower than the prescribed Nayak Committee Norm of 20% at around 17% of the working capital gap. While the average is 10% for small enterprises, it is equal to the prescribed 21% and 20% for micro and medium enterprises in the sample.

Micro enterprises are not able to provide adequate collaterals to support their financing needs and hence are required to provide a relatively higher equity margin. Also, since major products produced by the micro units are seasonal in nature, the risk perception of bankers is higher. Also, most enterprises require cooling facilities or freezers for transportation of orders. The orders are rejected and no payments are realized if the necessary conditions are not met. This increases the risks of default further, especially for products like frozen corn, frozen peas etc.

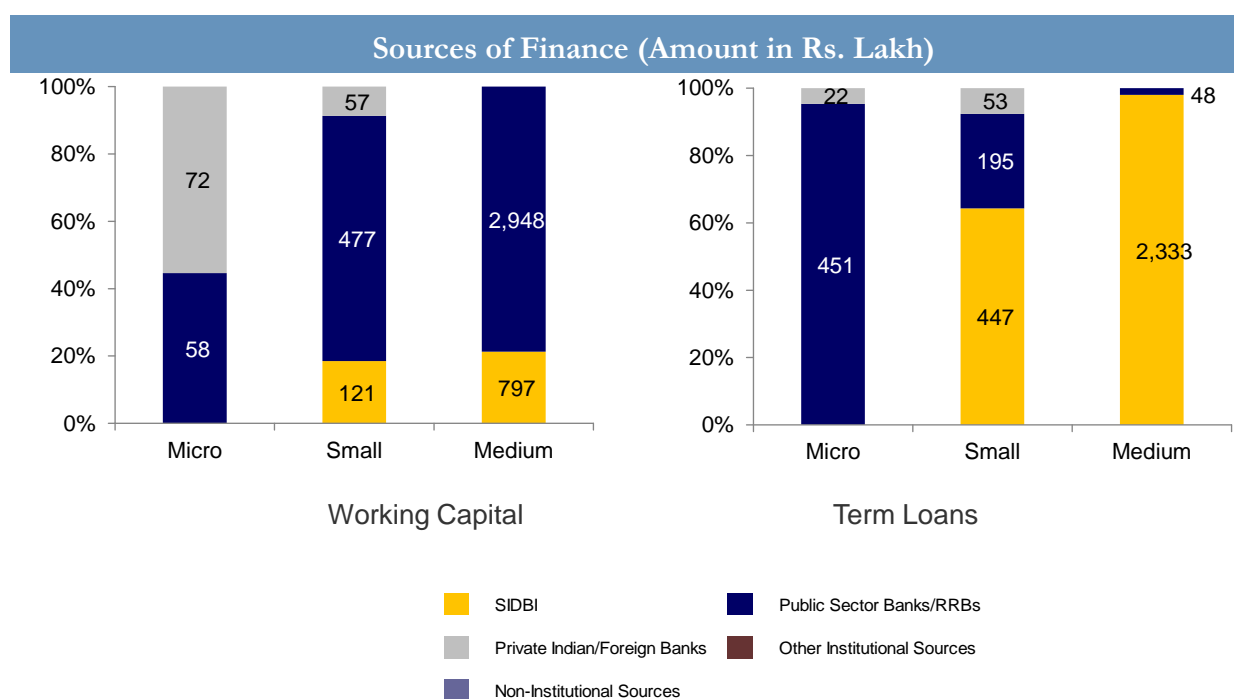
Medium enterprises in the cluster are exploring newer business models for technology up-gradation and newer products. For example, entrepreneurs are exploring vegetable juices and vegetable juice instant mix. These products are not tested in Indian markets and hence, face issues with respect to providing adequate comfort levels to the bankers.

The following charts show the composition of credit among the 60 respondents interviewed in the survey. While medium firms avail largely working capital, micro and small firms avail higher value of term loans than working capital, although the primary requirement in the cluster is for working capital.



Source: D&B India (Amount in Rs. Lakh; number of respondents in parentheses)

The following chart shows composition of working capital and term loans for the 60 respondents by sources of finance, separately for Micro, Small and Medium enterprises. In case of working capital, the major sources of finance for micro and small firms are Public Sector Banks, and Private and Foreign Banks, while the major sources of Finance for medium firms are Public Sector Banks and SIDBI. In case of term loans, while micro firms largely avail the facility from Public Sector Banks and Private and Foreign Banks, small and medium firms avail the facility largely from SIDBI and Public Sector Banks.



Source: D&B India

In summary, the total working capital credit requirement across the surveyed 60 (48 MSEs) enterprises is around Rs. 46 crores (Rs 7.8 crores in MSEs) while the term credit is around Rs. 35 crores (Rs 12 crores in MSEs). It is also important to note that SIDBI finances micro enterprises for working capital advances through SIDBI-IDBI partnership route, while for term loans it is actively financing small and medium enterprises directly.

Thus, there is a higher credit requirement for working capital needs. The following can be summarized as major reasons for the same:

- Largely seasonal and demand driven business involving in higher stocking of finished goods
- Dependent on seasonality of cropping season as well (e.g. pickles) which are made only once a year and hence, larger working capital gets locked in while realizations occur only over a period of year or even more at times
- Quality considerations with respect to Food Safety and banks asking for these certifications increasingly now requires larger investments to be made in the quality process

From the various methods employed and explained before, the demand and supply side estimations of the cluster have been provided in the next section.

Credit Gap in the MSE Segment

For the current study, D&B considered the credit supply data of only scheduled commercial banks that form the major source of credit supply. The table below contains the estimated Credit Gap in the cluster on the basis of the two methods.

Method	Total Gap	Credit Supply	Total Credit Demand	Working Capital Demand	Term Capital Demand
Nayak Committee-D&B Method (In Rs. crores)	98	137	234	192	42

Summary of Credit Gap Assessment

The greater working capital need in the Pune F&V cluster (compared to term credit need) also translates into a significant gap in working capital credit. D&B India has, through its primary & secondary research, identified possible reasons for why the credit demand is not being met, despite the fact that there are ample financial institutions in the district. A summary of the findings are mentioned below:

- Linkages between micro and medium or small enterprises do not exist, primarily due to absence of any sub-contracting agreements which reduces bankers' confidence in micro unit financing, since the realization of payments is riskier
- Most of the raw material procurements happen either from direct farmers or *mandis*. At both these touch points for enterprises, credit is rarely available. All payments have to be made on the spot. The only way the units can borrow is by describing the order book. Banks do not accept these order books since payments are not realized. Therefore, lower turnover is used as a basis

for working capital estimations. On the basis of this, the size of working capital loan appraised for the unit is relatively lower than their requirements.

- Enterprises themselves refrain from obtaining bank credit, since there are no instances available in the cluster for collateral free or credit guarantee loans. Further, CGTMSE loans increase the cost of borrowings for the units.

Absence of collateral free lending and seasonal nature of business coupled with absence of forward and backward linkages in the cluster are main reasons for the credit gap

- Most of the enterprises do not tend to maintain their books of accounts and hence, it is practically impossible for banks to provide credit.
- Banks at times also ask for quality certifications for the product being manufactured and sold. In absence of these certifications, loans are not provided, since the proposition for the banks becomes riskier.

Additionally, quality of credit received by various enterprises can be judged from three factors viz., time taken for loan processing, loan interest rate, and adequacy of credit. Though many enterprises are unable to avail bank finance, those which do so are also not obtaining adequate and timely loans

It has been observed that 80-90% of the lending to Pune F&V cluster is routed through SIDBI or PSB/RRBs, the perception of other banks is that they tend to take higher time for loan processing. It has also been observed that private sector banks are getting more active due to passive approach of major public financial institutions and banks. These banks provide finance to the cluster at relatively higher rates.

The food processing sector is a fast growing industry. The enterprises in the Pune cluster also enjoy proximity to a large number of urbanized markets. Despite the challenges faced by enterprises in the cluster, the favorable location and good growth of the industry presents a significant opportunity for financial institutions (FIs) and banks to cater more actively to the cluster in terms of their credit requirements. This shall go a long way in growth of the cluster and establishment of its foot-print in Food Processing Industry at the national level.

Recommended Products and Delivery Channels

Requirement of Capital

The greater working capital need in the Pune F&V cluster (compared to term credit need) is primarily borne out of three reasons stated below:

- Raw material procurement and absence of credit cycle
- Quality certifications
- Delay in payment from buyers

Major products that account for a larger share in the cluster are spices, pickles, and papads. Most of the units in the cluster are micro or small (>80%) and majority of them (70%) is based on proprietorship model. The units mainly operate on leased lands and the operation/processes are labor driven, and there exist no fixed asset collateral to avail institutional finance.

There is an absence of linkage of units with farmers; the raw material has to be purchased mostly from mandis, where spot payment needs to be made. Only few large units have been able to develop linkage with farmers to procure raw materials. Further, the linkage between different units is mainly limited to supply of preservatives, packaging, and primary processing such as cutting, and cleaning. There are instances where there is credit cycle of one month for raw material procurement, but it is mostly available to medium and large units. However, there exists significant advantage of buying raw materials in bulk at the mandis/farmers with cash as there is a discount of 2-2.5%, which is mostly availed by bigger units as production scale is much higher. The bulk of the raw materials purchase (> 60%) is in the months of March, April, and May. And the sale takes place throughout the year and more specifically in the festive season (October), and wedding seasons (December, January & June).

Raw materials availability at reasonable price is a major problem for the micro F&V processing firms in Pune. Because of a lack of a proper backward supply chain infrastructure, there is a lot of wastage and pilferage in raw materials leading to wide fluctuation in their prices. In the Agricultural Produce Market Committee (APMC) markets, the farmers face problems like high commission charges, high transportation and loading and unloading charges, no guaranteed remunerative prices, delayed payment by commission agents etc., which adds to the costs of the processing units ultimately. Also, almost all units face problems in procuring raw material of uniform quality. The impact of rising raw materials prices is not felt by the medium type firms due to scale advantages whereby they can

operate even on thin margins, and it is the small & micro firms that are feeling the pinch of thinning margins in a highly competitive market.

Further, it has been noticed that there is lack of order agreement and there exist the endemic problem of delayed payment from customers, who are mainly industrial canteens, hotels, distributors, and marriage event organizers/caterers.

The inherent nature of the industry requires quality testing procedures at every level in the value chain right from primary processing, secondary processing to packaging. However, there are only few private laboratories that carry out upper end tests for exports. NAFARI (National Agriculture & Food Analysis & Research Institute) is the only institute providing a full range of testing and analysis services. It was set up jointly by MCCIA and COFIT. The certification consultants and agencies are also in short supply with not more than 10-15 agencies in Pune. There is also a lack of adequate facilities in Pune cluster for training in hygiene, HACCP, and risk management. Moreover, existing consultants are an expensive proposition for MSMEs due to short supply.

The cluster is in growth phase and there is little cooperation on process parameters. Most of the units are looking to develop uniqueness of their products leading to minimal sharing of information on processes. However, BDS programmes under the MSMEFDP have played a critical role to foster market development. A note on the impact of the MSME Finance and Development Project in the Pune cluster is provided below.

A Note on the Impact of MSMEFDP in the Pune F&V Cluster

BDS activity in the Pune Fruit & Vegetable cluster under the MSMEFDP project primarily focused on quality improvement and related skill enhancement in the cluster.

To reposition the traditional food cluster from local ethnic food base to a national and international one, the ready-to-eat and ready-to-cook was focused upon. This was achieved by enabling adoption and adherence to quality standards like ISO, GMP, GHP and HACCP etc. and using the services of marketing consultants to enable firms to reach out to national and international markets.

The project used all types of tools to institutionalize the best practices like sensitization workshop and awareness building programmes and creation of a broad partnership base with BMOs. This resulted in to the significant improvement in the cluster ecosystem in terms of awareness of BDS and functioning of the BDS market.

Training of firms as well BDSPs has been the most important component of the project. Around 2000 persons were trained in various skills under the project. The cluster has significantly improved in terms of quality of production as result of adoption of various standards like ISO, GMP, GHP

and HACCP, etc. There is also an improved level of awareness on food laws, marketing techniques, export markets, etc. As a result around 20% MSME units in the cluster reported quality improvement and 60% MSMEs seeking training on quality related issues thus creating a market for such services.

Firms were also linked and sensitized on government schemes including National Horticulture Mission (NHM). With increased awareness level pack house units were able to connect to National Bank of Agriculture and Rural Development (NABARD) and Bank of Maharashtra for the financial requirements.

Working of Government Schemes

Credit Linked Capital Subsidy Scheme (CLCSS)

Aimed at technology up gradation of the small scale enterprises, the Government (Ministry of SSI, now Ministry of MSME) has been operating a Credit Linked Capital Subsidy Scheme since the year 2000. The scheme aims at facilitating technology up gradation for improvement in productivity of the MSE units, by providing them 15 per cent (initially it was 12 per cent) upfront subsidy.

Since there is insufficient linkage in the cluster and frequent delayed payment, the micro/small units have less timely repayment capacity. This makes the micro/small units reluctant to go for machinery up-gradation due to increased financial burden with unpredictable and untimely cash inflows. Most of the requirement comes for working capital and only growing units seek term loan demand.

Credit Guarantee Trust Scheme for Micro & Small Enterprises (CGTMSE)

The Credit Guarantee Fund Trust Scheme (term loan and working capital loan both) for Small Industries was introduced by the Government (Ministry of Small Scale Industries) in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.25 lakh without collateral/third party guarantees. The scheme is being operated through the Credit Guarantee Fund Trust for Small Industries (CGTSE) set up jointly by the Government of India and the Small Industries Development Bank of India (SIDBI).

The players in the cluster suffer from the unpredictability in their end products prices and due to seasonality of raw materials and insufficient linkage, it becomes difficult to map the cash flows and profitability. There is absence of CGTMSE loan facility disbursement due to lack of awareness and increased cost of borrowing. Historically, there have been repayment defaults from micro/small enterprises, FIs also do refrain from collateral free loan.

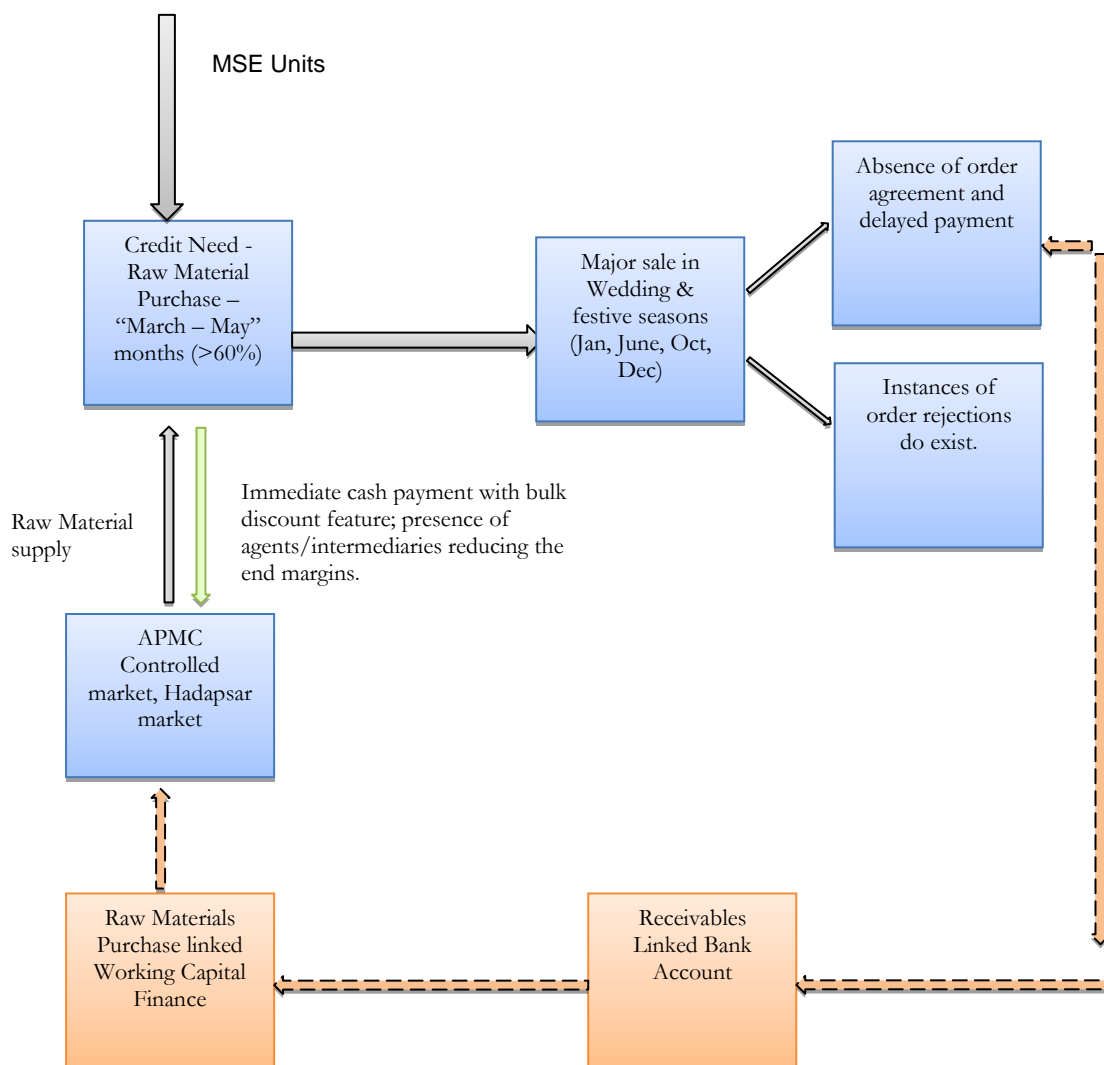
Other Schemes

The Ministry of Food Processing Industries, GOI provides loans to private sector organization for capital equipment. Through another scheme, entrepreneurs are given grants for creation of common irradiation facility in food parks. APEDA (Agriculture & Processed Food Products Export Development Authority) also provides assistance for setting up of irradiation facilities

There are also general term/working capital loans, bills discounting facilities available from different financial institutions but they are not of much use given the fact that most of MSEs operate out of illegal land premise and cannot furnish fixed asset collaterals. Applicability of bills discounting facility is less as there is low linkage in the cluster across units. Most of the units prefer to maintain their uniqueness and this leads to less cooperation and sub-contracting.

Descriptions of Products and Delivery Mechanisms

In light of the above discussion, one of the major problems associated with MSEs in the cluster is the lack of fixed asset collateral. This becomes a major huddle for units to procure working capital loan, which is the major requirement in the cluster. Further there are limited linkages across the value chain, limited sub-contracting between units, lower level of cooperation to preserve uniqueness of products, limited affordable quality test facilities, and seasonality (non-seasonality) of raw materials (end products). Affordable and economically viable working capital financing is the need of the hour in the cluster. Loan products need to be structured to match the payments to the borrower’s cash flow cycle and address specific credit needs that exist in the cluster. Further, financial institutions need to have a greater focus on providing credit based on cash flow rather than based on collaterals, which is mostly absent with the MSEs, and also create a mechanism to evaluate the economic viability of the project. Below is the representation of MSEs critical credit needs and suitable financial products to address the same



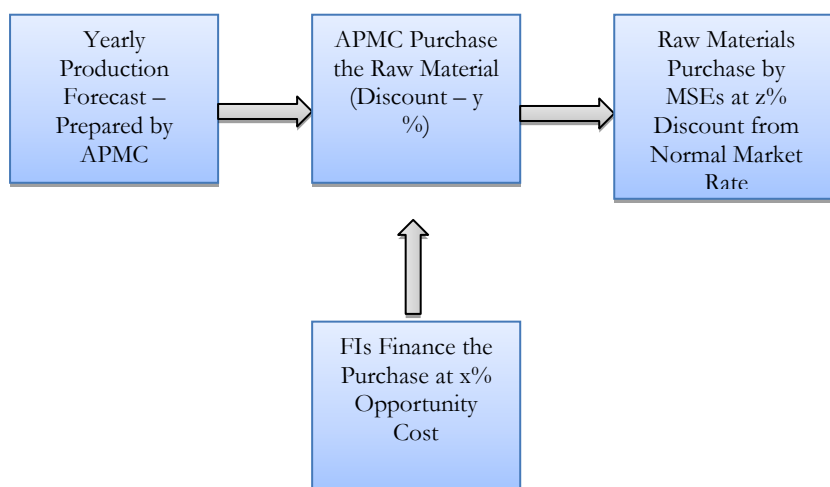
The dotted line indicates potential future linkages (basis the use of recommended financial products) and orange box indicates the type of products that may be introduced to cater to specific needs of the cluster

Raw Materials Purchase Linked Working Capital Finance

Since the majority of raw material procurement happens during March to May months, the credit requirement is maximum during this period and survival/growth is dependent largely on the ability to procure raw materials at a discounted price with less restriction on amount of purchase due to limited credit access.

Under this scheme, the financial institutions (FIs) shall finance the raw material purchase and Agricultural Produce Market Committee (APMC) shall be the implementing institute as it controls the major trading hubs except for Hadapsar market. Below are the salient points of the scheme:

- APMC shall assist in the preparation of agricultural supply and demand forecast
- Based on the above forecast, APMC shall purchase the raw materials in bulk, get heavy discount, and get financed by FIs, with raw materials serving as collateral and APMC serving as guarantor.
- APMC becomes the major supplier of raw materials to the MSEs present in the cluster at a discount.
- For the loan facility to be economically feasible, the basic condition that may have to be checked at the cluster would be $(y\% - z\% > x\%)$



APMC is directly controlled by Maharashtra State Agricultural Marketing Board (MSAMB) and APMC regulate the marketing of different kinds of agriculture produce in the assigned market by issuing license to traders (sellers) and buyers to participate in the APMC controlled market such as Hadapsar market in Pune district. On talking with official in MSAMB, APMC indicated that they can take the role of implementing agency for raw material bank as it already has oversight control on the market participants (sellers and buyers) and sufficient workforce especially in APMC Pune. Additionally, few FIs need to form a consortium to facilitate the raw material finance. It is recommended that a pilot project be initiated with only few FIs in the consortium with one FI serving as facilitator/implementing agency.

Receivables Linked Bank Account

Since there have been instances of payment defaults by micro/small units, there has to be significant risk control system on financing the raw material purchase. One way is to introduce specialized bank account product where receivables of MSEs (who availed “Raw Material purchase linked Working Capital Finance”) are directly payable to bank account the control of which resides with the bank. Specific covenants (interest rate, repayment tenure etc.) can be worked keeping in mind the working of earlier product (Raw Materials linked Working Capital Finance).

The major challenge would be to encourage MSE units to use bank account for their transactions, since many micro units prefer cash transactions for both purchase and receivables from customers.

Micro Finance – SHG Bank Linkage Model

It is important to note here that during year 2006-07, 15230 SHGs were financed a loan amount of Rs. 42 crores by banks in the Pune district averaging into an amount of Rs. 27,500 per SHG. For repeat finance, a maximum of Rs. 50,000/- per SHG has been envisaged under the plan for a target of 5000 SHGs. There is also a provision of cash credit limit finance of Rs. 25,000/- through the Savitri Credit Card (Bank of Maharashtra) for marketing initiatives of these SHGs, from where these SHGs can meet their working capital needs. This SHG linkage model is highly successful with a 100% recovery record. The private banks are not much into the SHG linkage micro finance model, except HDFC bank which is financing the NGOs. However, such a model of finance does not fulfill the requirements of progressive units who wish to move into a higher turnover loop.

The historical success of SHG model provides significant opportunity to increase lending on a similar approach. Further, there is significant women workforce (in the cluster) which has been a unique feature for Bangladesh Grameen model and SHG model to be successful in different parts of the world.

Annexure I – Estimation Method for Credit Supply

ESTIMATION OF CREDIT SUPPLY TO THE PUNE FRUIT AND VEGETABLE CLUSTER			
	Item	Mar, 2011 Estimate	Remarks/Assumptions
1	Estimated Maharashtra F&B Industry Advances Outstanding - March, 2011 (Rs crores, Projected at an expected annual growth rate of 31%)	14,303	Expected growth rate is estimated from State Level Advances (SLA) growth Rate using SLA figures ending Mar, 2010 & Mar, 2011) Source - Table 4.9- Annual-Basic Statistical Returns of SCB, Mar '2010 Source - Statement 9: RBI Quarterly-Basic Statistical Returns of SCB, Mar '2011
2	Estimated Maharashtra F&B Industry Turnover - Mar, 2011 (Rs crores, Projected at an expected annual growth rate of 1.4% and 14.4% for Year 2009-10 and 2010-11)	67,405	Expected growth rate is estimated from National IIP growth rates Source - Table 3 - ASI, Government of India, MOSPI, 2009 Source - Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug 2011
3	Cluster Sample Turnover (MSEs), Sample Size - 48 units in MSEs Sector (Rs crores)	136	D&B Survey
4	Total Number of MSE units (530) in Pune F&V Processing Cluster		From Pune F&V Cluster Diagnostic Study (DS) Report
5	Estimated the Cluster Total Turnover (MSEs, Rs crores) using (3) & (4) for year ending Mar, 2011	846	
6	Estimated Proportion (P1) of Cluster Turnover to State Industry Turnover using (2) and (5) [$P1 = (5) / (2)$]	1.3%	
7	Estimated the Cluster Level Credit Supply [(1) * (6)] - Rs crores	137	
8	State Level Advances – Term Loan Advance (Small Enterprise - SE) to Total Advance (SE) Proportion (P2)	21%	Estimation based on RBI's Statistical Returns-SCB Source - Table 6.1, Statistical Tables Relating to Banks in India, 2009-10
9	Using (7) and (8) Working Capital Supply is [(1-P2)*(7)].	108	
10	Using (7) and (8) Term Credit Supply is [(P2)*(7)].	29	

Annexure II – Estimation Method for Credit Demand

ESTIMATION OF CREDIT DEMAND IN THE PUNE FRUIT AND VEGETABLE CLUSTER					
	Method		Item	Mar, 2012 Estimate	Remarks/Assumptions
	Nayak Committee Approach - Working Capital	1	Cluster Sample Turnover (MSEs), Sample Size - 48 units in MSEs Sector		D&B Survey
		2	Total Number of MSE units (530)		Pune F&V Cluster Diagnostic Report
		3	Estimated the Cluster Sample Total Turnover (MSEs, Rs crores) for year ending Mar, 2011	136	D&B Survey
		4	Estimated the Cluster Total Turnover (MSEs, Rs crores) - Mar, 2012, Expected growth rate of 13.4%	960	Expected growth rate is estimated from National IIP growth rates Source- Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug, 2011
		5	Basis Nayak Committee Guidelines, Working Capital Funding Requirement is 20% of Projected Turnover calculated in (3)	192	
	D&B Approach - Term Capital	6	Cluster Sample "Investments in Plant & Machinery", Sample Size - 48 in MSE Sector (Rs crores)	49	D&B Survey
		7	Total Number of MSE Units (530)		Pune F&V Cluster Diagnostic Report
		8	Estimated the Cluster Total "Investments in Plant & Machinery" (MSEs, Rs crores) using (1) & (2) for year ending Mar, 2011	259	
		9	Value in (8) projected to Mar, 2012 level using moving average growth rate of fixed capital for Industry-state wise (21%)	313	Source - Annual Survey of Industries (ASI) estimates on Fixed Capital for different industries within a state – MOSPI ASI Report, 2009-10
		10	(9) - (8) gives the growth in fixed capital	53	
		11	80% of (10) is estimated to be Term Credit Funding Requirement	42	
	Total Credit Demand	12	Total Credit Demand [192 + 42] calculated above in [(5) and (11)]	234	

Coimbatore Engineering Cluster

Overview

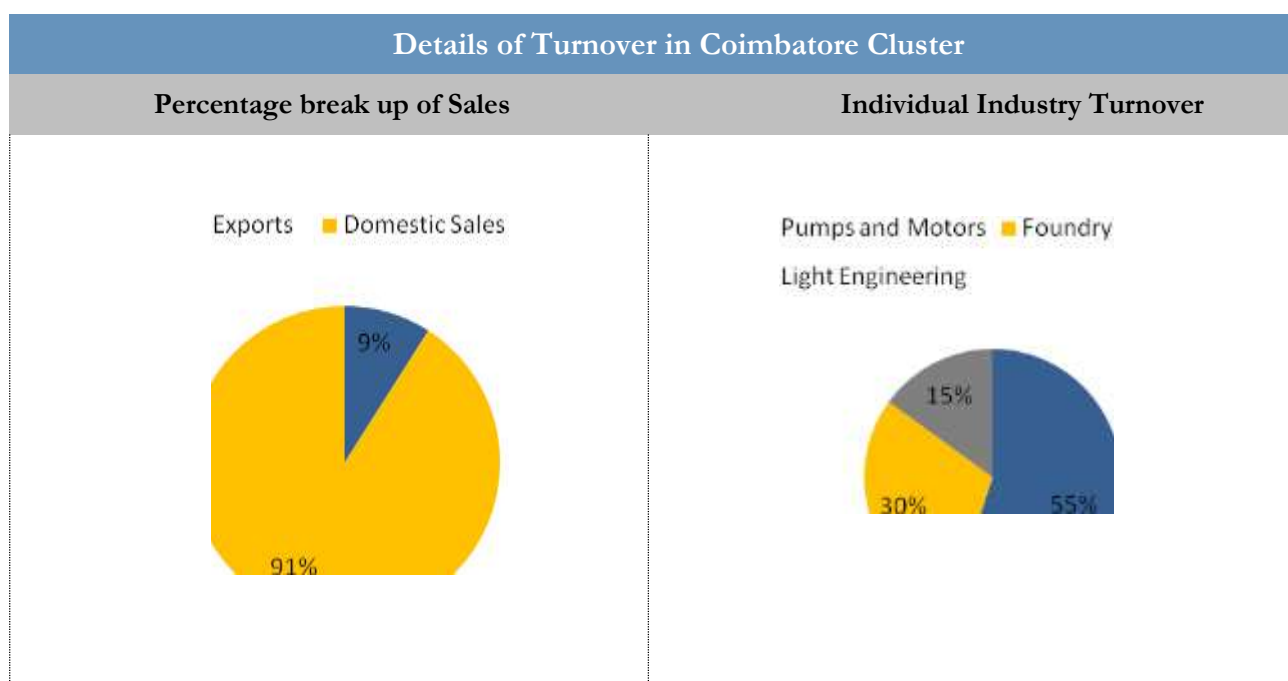
Coimbatore is one of the major industrial hubs of Tamil Nadu. It is well-known for its engineering units, with a large presence of foundry units, pumps and motors manufacturers, and light engineering enterprises. There is a strong inter linkage among engineering units in the cluster as pumps and motors manufacturers are one of the major customers for foundry units. The thousands of MSEs located in the cluster including ancillaries and jobbing units have helped Coimbatore to be recognized as an important industrial hub of South India.

The following table summarizes the information on the Coimbatore engineering cluster.

Estimated figures of Coimbatore Engineering Cluster			
Type of Industry	Type of Firm	No. of units	Employment
Pumps & Motors industry	Medium	4	4,500
	Small	500	50,000
	Micro	600	50,000
Light engineering units	Micro	25,000	75,000
Foundry industry		600	
	Total	26,704	1,79,500

Source: APITCO Diagnostic Study Report, July 2009

Base on D&B survey estimates, the turnover generated by MSEs in the cluster amounts to Rs. 4740 crores. The following table gives the break-up of turnover based on two parameters (Exports/Imports, and Sub-Sectors)



The success for the development of industries could be attributed to the innovative and technical skills of artisans, technocrats and industrialists. Apart from the engineering cluster, some of the other industrial clusters in Coimbatore are textile power loom, hosiery and agricultural implements. The product range of the engineering cluster includes foundry castings, machine tools, cutting tools, electric motors and pumps, wet grinders, textile machinery, washing machines, automobile spares, domestic electrical appliances, plastic spares and components, etc. The cluster largely caters to the domestic needs of the country as the export share of the cluster in the total sales is only 10%. There is a huge domestic demand for Coimbatore engineering products; because of this the firms have concentrated less on international markets.

The development of agricultural sector in Tamil Nadu state and strengthening of the industrial sector during the successive five year plan has played a significant role in the development of the cluster. The cluster was primarily dominated by Pumps and Motors sub-sector in 1990s but gradually diversified to different engineering segments. The foundry units present in the cluster caters mainly to the pumps and motor sub-sector in the cluster. Slowly, foundry units have been also catering to auto-components sub-sector. There is considerable inter-linkage in the cluster with micro units acting as sub-contractors to small and medium size firms. Though micro units play a critical role in the cluster, they are heavily dependent on small and medium units and lack the technology and marketing know-how to grow and expand. Further, most of them do not have access to institutional finance.

Despite the success of the cluster in engineering sector, there are threats to the foundry, pumps and motors industry due to growing environmental concern regarding pollution control, strong overseas competition from countries like China and the perennial problem of long power cuts. The prolonged power cuts have forced many units to rethink the option of relocation and because of this foundry units and micro units are getting badly hit.

The local support institutions in the cluster include

- Government support institutions that include DIC, NSIC, BIS, Export Promotion Council-Engineering (EEPC), Tamil Nadu Industrial Investment Corporation (TIIC) etc.
- Industries Associations include South India Engineering Manufacturing Association (SIEMA), The Coimbatore Tiny and Small Foundry Owners Association (COSMAFAN), Tamil Nadu Association of Cottage and Micro Enterprises (TACT), Tamil Nadu Pumps and Motors Spares Manufacturers Association (TAPMA), Coimbatore SIDCO Industrial Estate Manufacturers Association (SIDCOMA) etc.

- Private BDS providers in the field of financial advisory, skill development, technical knowledge etc.

While there are many private BDS providers, the extent of usage varies depending on information and type of services. Before MSMEFDP was implemented majority of MSEs lacked awareness of existing BDS facilities and therefore were foregoing the opportunity to leverage the services. There exist a great need for creating awareness of existing support system and make credit available to use those facilities. This has been appropriately taken care of by the BDS activities under the MSMEFDP.

Sources of Demand for Credit – Opportunity and Risks

Significant Micro Units and Lack of Technology Know-how

There are approximately 25000 micro units in the cluster and are present across different engineering segments in the cluster and lack the vision to modernize and grow their business. **These units have traditional manufacturing systems and little awareness about the new technologies and product developments.** Most of these units take orders from small and medium size units and lack the access to end market.

Purchase of Raw Materials

Commodities are the major constituents of raw materials going to different units in the cluster. These include Pig Iron, Coke, Copper, Aluminum etc. **While big players are able to purchase the raw materials in bulk, the micro and small players have to rely on retail traders and thus make the cost of purchase costlier.**

Manpower Intensive Manufacturing

Traditionally, the manufacturing process is manpower intensive. As per Diagnostic Study estimates, the cluster provides direct employment to about more than two lakhs people. **Therefore, the requirements of the working capital to make continuous labor payments increase.** It also increases the risk in the sector due to labor issues, varying productivity levels etc.

Technology Up-gradation

Since the cluster is well diversified in different engineering segments, the technology usage varies across firms and types. Traditionally, the output of the cluster has been consumed domestically, and there has been little stress on exports. Gradually, the cluster has started looking towards foreign markets and this has produced the challenge of upgrading their technology either for end products (such as Energy Efficient Pumps) or manufacturing set-up (such as Foundry units having Energy Efficient Furnaces Units)

Quality and Norms Compliance

The Bureau of Energy Efficiency (BEE) has unveiled improved energy efficiency norms for the electric motor and pump industry. The standards set are higher than BIS norms. Further, there are pollution norms, set by Tamil Nadu Pollution Control Board, to be adhered in the state. Even though the air pollutants released by foundries are within permissible limits, the increased number of units has increased the environment pollution significantly.

Skill Development and Common Facility Center Usage

The skill development services are either provided by private BDS providers or Industry Associations present in the cluster. Majority of micro units do not have advance skills and neither have information on improving their skill set. An enabling environment has, however, been created under MSMEFDP BDS programme for this. And even if they are aware of competency building facilities, the services are fee based. This puts upward pressure on their working capital need. Further, there are common test facility centers provided by different support institutions such as SIEMA, CONINDIA etc. for BIS certification, Energy Audit Services, Cleaner Production Audit, and Vendor Registration Services. But facility usage is subjected to a fee, which becomes a hindrance for the micro units as credit out working capital pool has to be allocated, putting extra pressure on micro units. Additionally, it increases the cost of their end products/services decreasing their profitability. Voucher support mechanisms, tried under the MSMEFDP, is an appropriate approach to cater to their expectations.

Supply of Credit to MSEs

Estimate of Outstanding Credit to MSEs in the Engineering Cluster

The credit supply to the Coimbatore Engineering cluster is estimated to be Rs. 704 crores out of which Rs. 162 crores (23%) is term credit and Rs. 542 crores (77%) is working capital supply.

Enterprise turnover is one of the important criteria for loan appraisal process and it can be safely assumed that credit supply to the cluster is correlated to the turnover generated. Thus, D&B proposes to use the “Cluster Turnover proportion to Industry State Turnover” method to arrive at cluster level credit supply.

The steps for computation under the identified Methodology are detailed [Annexure I](#).

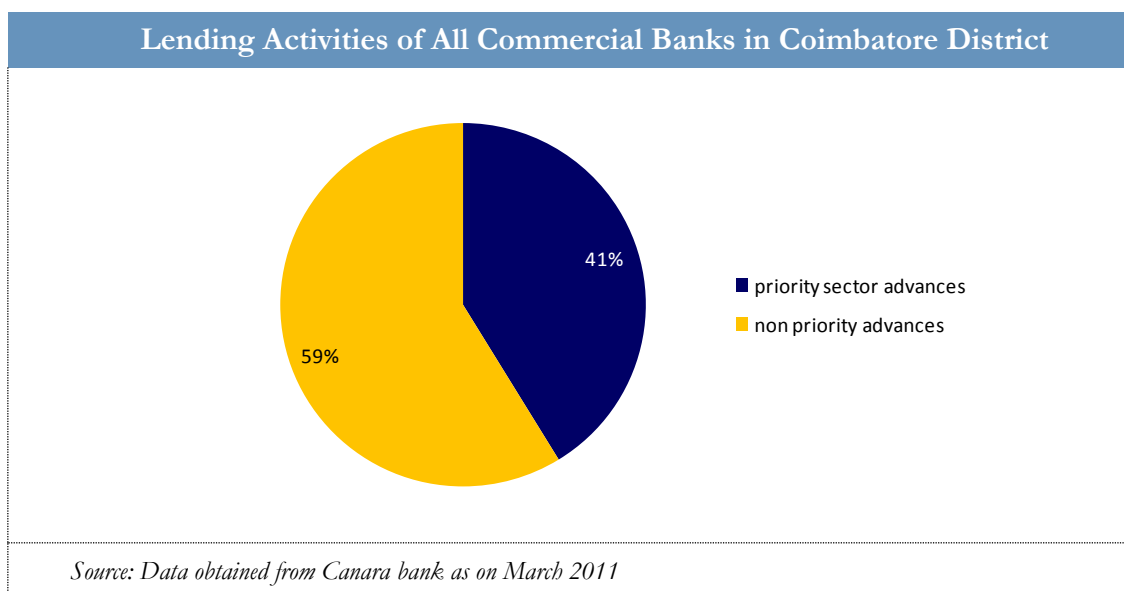
The data obtained through above methodology was further validated against the data on outstanding advances collected from the lead bank in Coimbatore district.

It is important to understand the credit supply environment in the state and the achievement of annual credit plan targets set by the State Level bankers Committee before the actual estimation of

credit supply to MSME's at district level. In Tamil Nadu, Indian Overseas bank is heading the SLBC and it reviews the various banking activities in the state. For the year 2010-11, as per the annual credit plan banks should achieve a credit target of Rs. 47,228 crores and the banks in Tamil Nadu have disbursed Rs. 52,224 crores at 110% achievement level and the credit outstanding increased by 21.83% during the year ended March 2011. In this the share of priority sector advances to total credit is 47.49% as of March 2011 against the RBI norm of 40%. So it can be clearly seen that the priority sector advances in the state are as per the prescribed lending norms of 40%. For the current year 2011-12, a target of Rs. 56,662 crores has been set as per the annual credit plan.

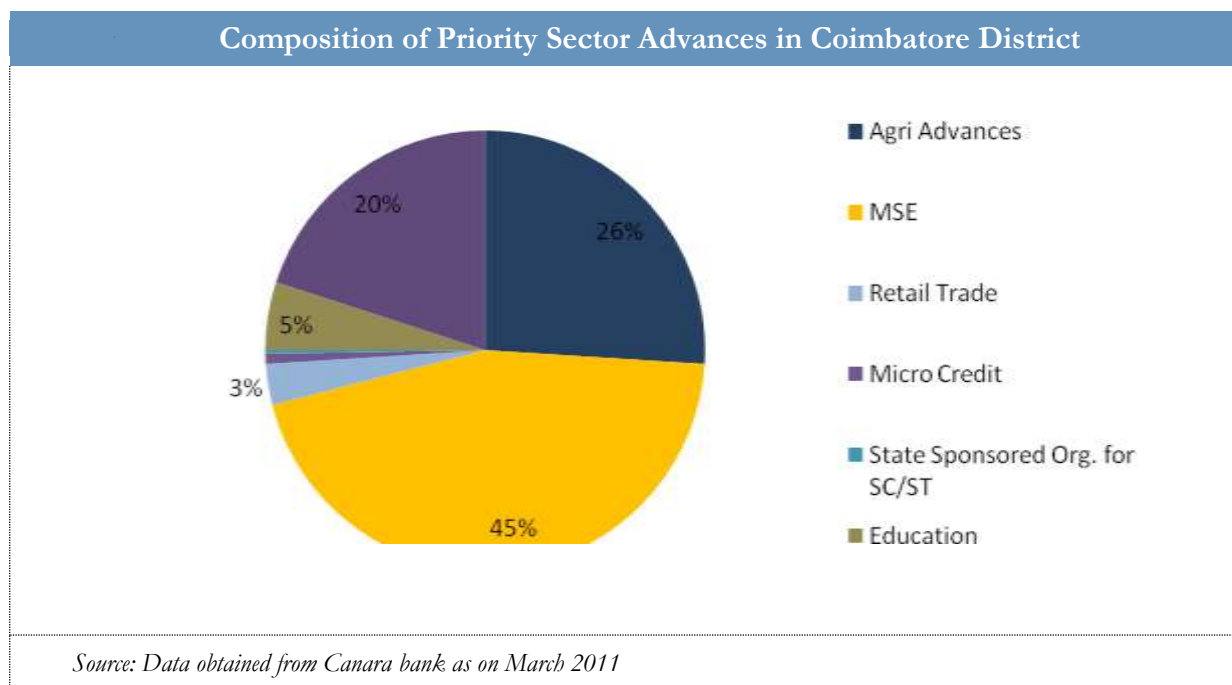
Performance of Banks

RBI lead bank scheme in the district is implemented by Canara bank, as Canara bank is the lead bank in the district. According to the lead bank, there are a total of 472 bank branches as on March 2011 and the total advances to priority sector at the district level is Rs. 13,262 crores as on March 2011. Priority sector advances stand at 41.20% of the total bank advances at district level which shows a healthy credit disbursement to priority sector. Out of the total priority sector lending, the total credit outstanding to MSE sector stands at 45.10% or 18.58% of the total net bank credit. The chart below indicates the credit outstanding in priority and non-priority sector advances at district level. The data includes scheduled commercial banks, regional rural banks, co-operative banks, state finance corporation and SIDBI. The total advances at district level stands at 32,190.76 crores.

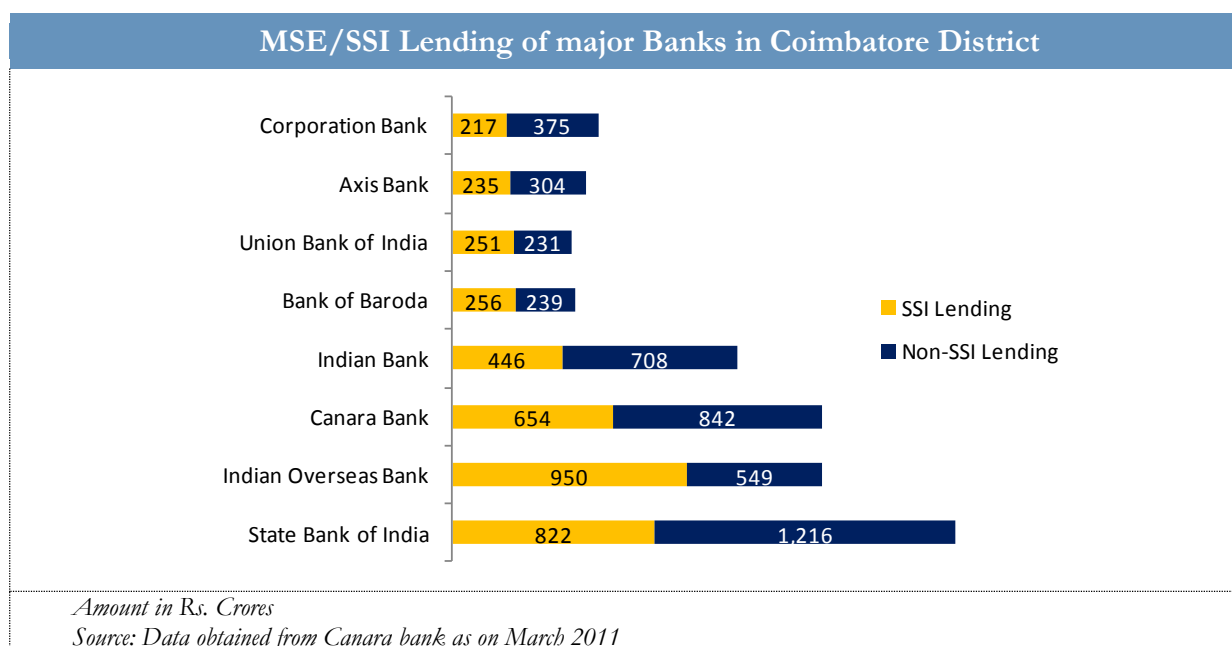


As MSEs fall under priority sector, it is important to understand the disbursement of credit and also the composition of priority sector lending/ advances. It acts as an important indicator of the banking sector's thrust on the agriculture and small industries sector. It is observed that of the total priority sector credit disbursements, around 45% of the credit has been provided to the small industries sector as on March 2011. The exhibit below represents the composition of priority sector advances

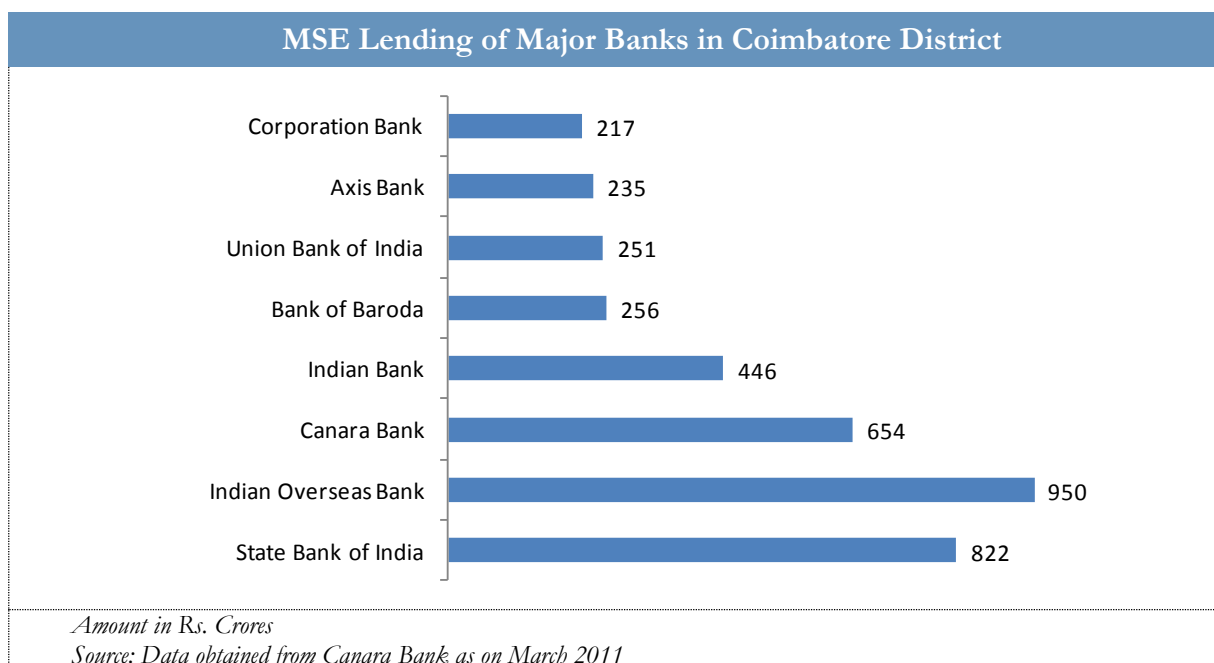
in Coimbatore. The data on priority sector include advances from scheduled commercial banks, regional rural banks, co-operative banks, SIDBI and TIIC. However the advances to micro credit under priority sector is minimal in the district despite the fact that around 25,000 micro units are present in the district.



It is known that there are no internal targets set for MSE lending under priority sector and the total priority sector lending should meet the target of 40% of net bank credit. As per the annual credit plan 2010-11, the priority sector lending target has been achieved and the total share of priority sector advances stands at 41.2%. In other words, the banks are able to meet the targets and the credit disbursement to important sectors of the district has been met. However it is to be noted that there are many micro units in Coimbatore, who do not have access to credit from formal financial institutional sources.



In terms of total credit disbursements, the top 8 banks account for 64% of the MSE advances in the district. Canara Bank is the lead bank in the district, and accounts for almost 11% of total MSE advances in the district and clearly it is leading from the front. It has a market share of around 11% next only to Indian Overseas Bank and State Bank of India. In Coimbatore, Indian Overseas Bank is the leading bank in MSE lending though it has a total loan book size which is less than that of State bank of India. The chart below presents the credit supply position in the district of Coimbatore across major banking institutions. The information includes credit disbursement information for development finance institution like SIDBI, State Finance Corporation; the information also includes co-operative banks and regional rural banks. It is evident that the active banks in the MSE lending are IOB with a market share of 16%, SBI with 14% and Canara Bank with 11%. Also, it is interesting to note that a private sector bank features among the top league in MSE lending, which indicates that the private sector banks are ready to lend to MSE's under the assumption that there is a huge potential untapped in Coimbatore engineering units business.

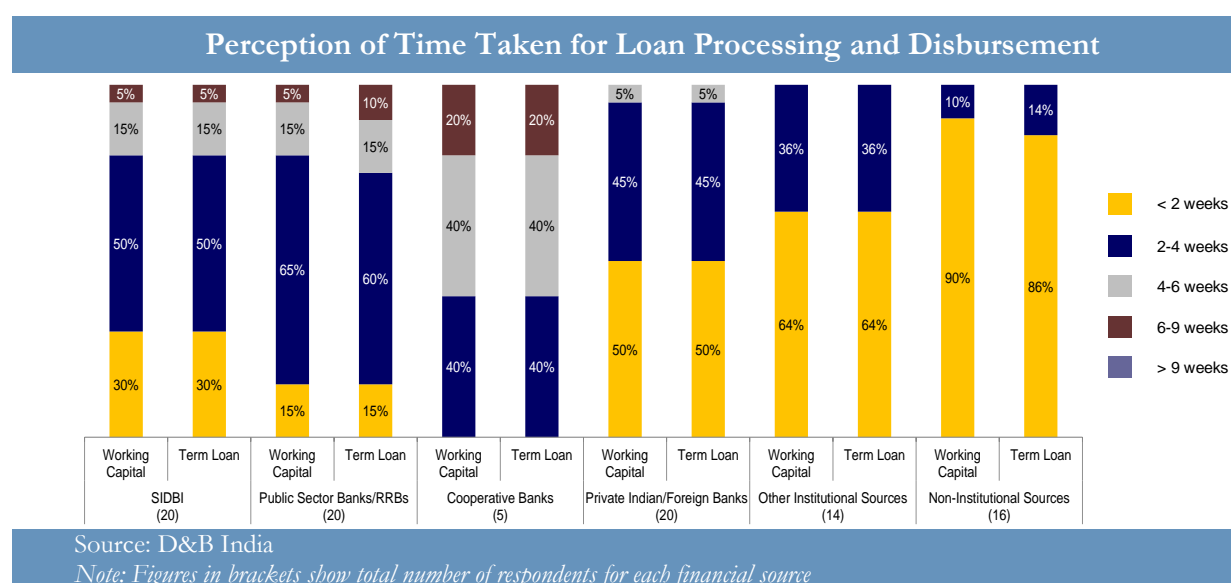


The 21 MSMEs were interviewed on the overall perception of their association with various institutional (including SIDBI) and non-institutional sources w.r.t to time taken for loan disbursement and collateral requirement. While 30% of the respondents believed that SIDBI would largely take less than 2 weeks, 50% indicated the timeframe to be 2-4 weeks to process and disburse loans. There were mixed views on other financial sources. The sources that are believed to take less than 2 weeks (by a greater proportion of respondents) for loan processing and disbursement are the private / foreign banks, other institutional sources and the non-institutional source.

The quality of credit received by various enterprises can be compared on two parameters:

- The loan documentation process for MSME's needs to be simplified in order to deliver credit in a timely manner. It is observed that there is a common perception among MSME's that PSB's take longer time to process and disburse loans and it is clearly reflected in the survey. Also, it is understood that entrepreneurs in Coimbatore are sensitive to interest rates and most of them prefer to avail loan from public sector banks as the interest rates are comparatively lower. So, there is a need for PSB's to simplify their loan documentation process especially for disbursing working capital loans.
- Perceptions on time taken for loan processing across bank groups indicates the timeliness of credit received. The following chart indicates the duration of loan processing for working capital and term loans across major bank groups. The processing is faster only in case of non-institutional sources of credit followed by private Indian banks. It is interesting to note that perceptions on SIDBI's loan processing time closely resemble some of the major private sector banks. Most respondents indicated that working capital and term loans were disbursed in less than 4 weeks.

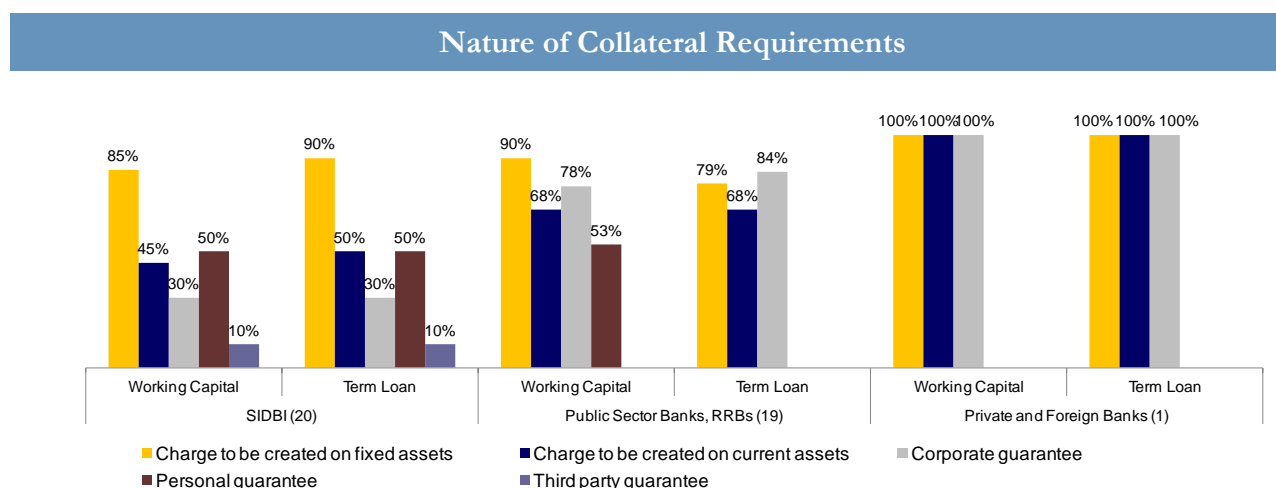
The following chart depicts perception among respondents of time taken for loan processing and disbursement by various financial sources.



While most of the banks follow their code of lending to MSMEs that stipulates faster processing of loan applications, it is observed that SIDBI processes its applications faster than public sector banks and cooperative banks. However, a marginally greater number of respondents felt that private Indian / Foreign banks process their applications faster than SIDBI.

Also, loans from non-institutional sources are usually perceived to get disbursed within 2 weeks due to lesser due diligence; however, their interest rates are highest.

The following chart shows the nature of collateral requirements across various financial sources.



Source: D&B India

Note: Figures in brackets show total number of respondents for each financial source

Private and Foreign Banks are perceived to demand more forms of collateral across all major types such as charge on fixed and current assets, and corporate guarantee, while SIDBI is known to ask for least collateral, usually charge on fixed assets.

Demand for Credit by MSEs

Estimate of Credit Demand by MSEs in the Engineering Cluster

D&B India has employed Nayak Committee approach to arrive at Total Credit Demand at cluster level, as mentioned in the methodology section. The methods involved are:

Nayak Committee-D&B Approach

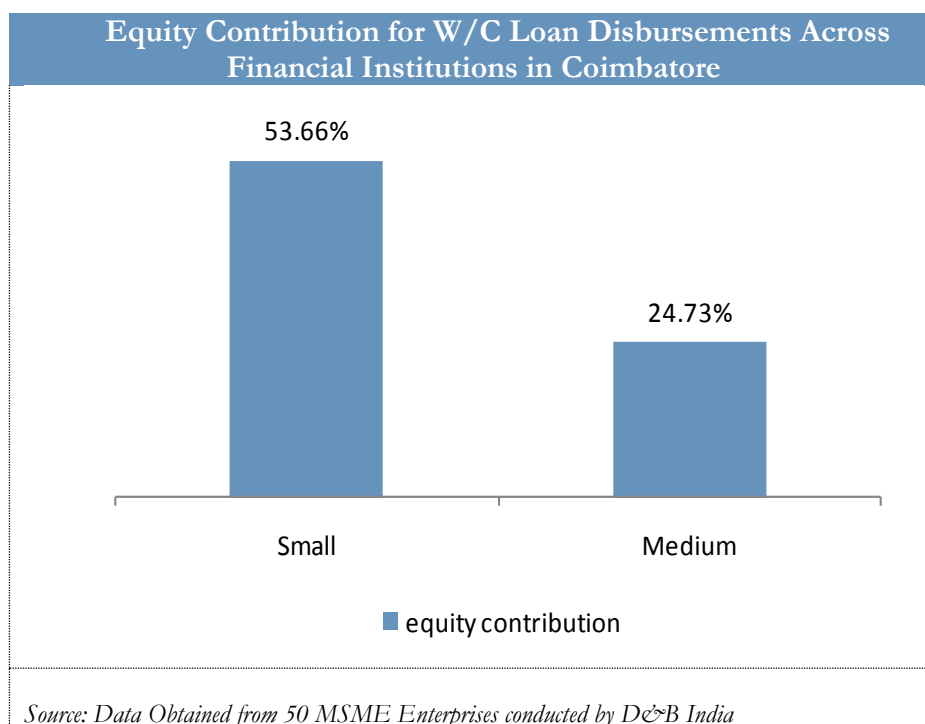
- a. Working Capital Demand - Turnover Based Approach (Basis – Nayak Committee Guidelines)
- b. Term Capital Demand - D&B Approach (Basis – Growth in Fixed Capital)

Below are the highlights of the credit demand estimates in the cluster:-

- ❖ Total number of Micro and Small units in the cluster is 26700
- ❖ The turnover for the Coimbatore Engineering MSE cluster is pegged at Rs. 4739 crores during 2010-11 from the D&B survey at cluster level.
- ❖ The turnover is estimated to rise by an annual average growth rate of 9.8% (IIP estimate) to Rs 5204 crores in the year 2011-12.

- ❖ Working Capital Requirement (Basis-Nayak Committee Guidelines) is estimated to be Rs 1041 crores
- ❖ Term Credit Requirement (Basis-Growth in Fixed Capital) is estimated to be Rs 894 crores
- ❖ Total Credit Demand is thus obtained from above $[(1041) + (894)]$ and is Rs 1934 crores

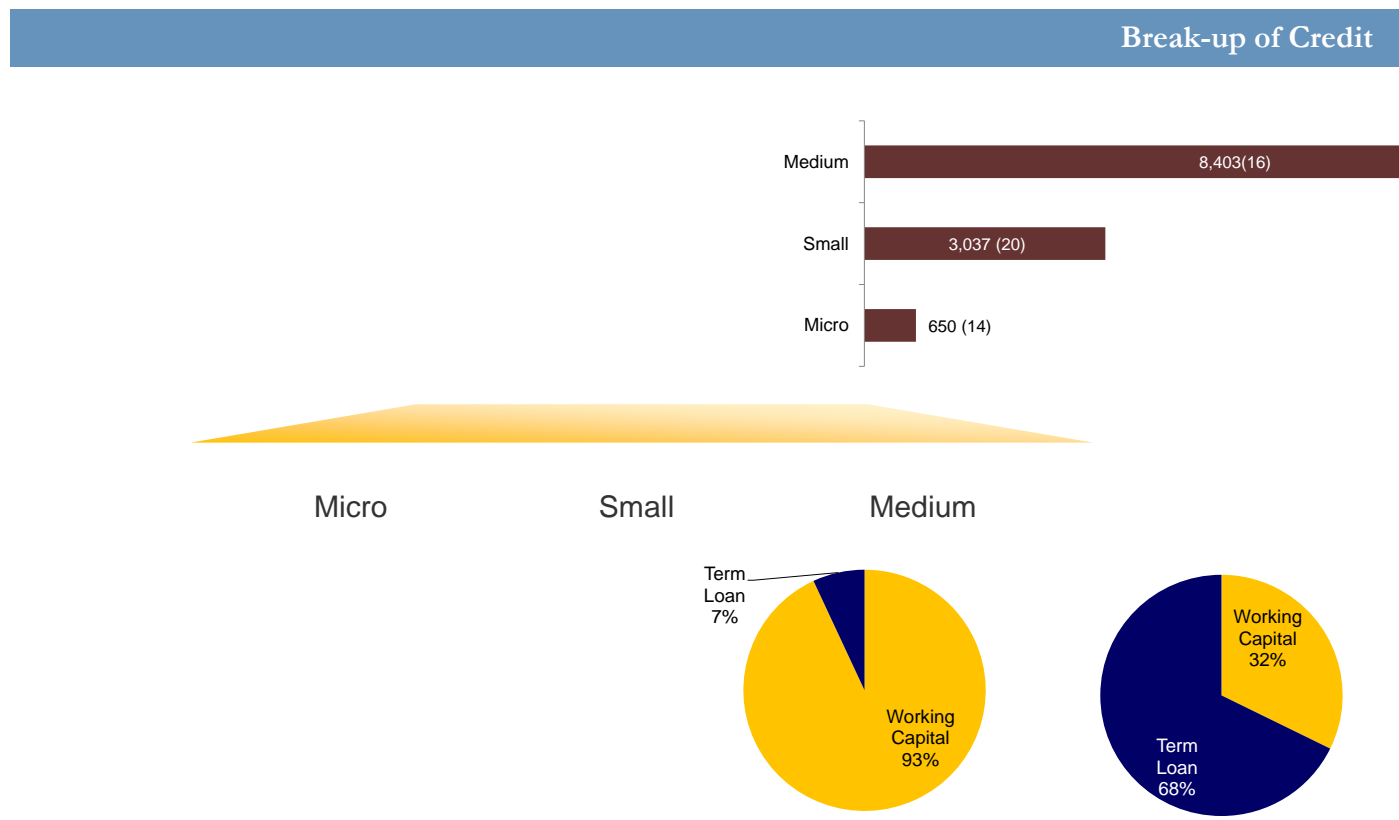
Credit Appraisal processes followed by various banks differs in terms of time taken for appraisals. However, most of the banks including the lead bank have indicated that for appraisals of working capital loan requirements, the Nayak Committee Recommendations are being followed. However, during the survey, it was observed that across categories of Small and Medium Enterprises, this ratio has varied considerably. The chart below presents the equity contribution of entrepreneurs for working capital loans indicated by a sample of 50 enterprises. It can be concluded that the Nayak Committee Recommendations are currently not being followed at least in the case of small enterprises where the contribution is comparatively high.



During the qualitative study conducted by D&B India in Coimbatore it is understood that SIDBI is providing working capital loans to enterprises in the cluster through SIDBI-IDBI partnership route, where IDBI provide the back-end support service to enable working capital finance. However, more promotion in the cluster may be required to enable more units to avail this facility.

The following charts show the composition of credit among the 50 respondents interviewed in the survey. While 66% of the total respondents were small enterprises, 2% were micro and 32% were

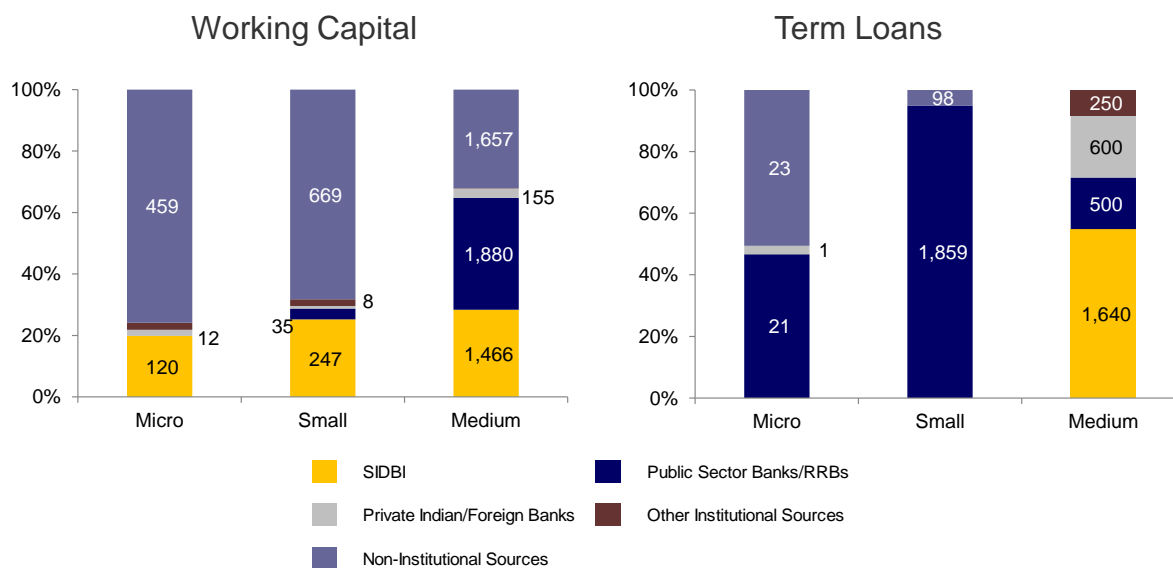
medium enterprises. As depicted below, major requirement in this cluster is for working capital loans, across all categories.



Source: D&B India (Amount in Rs. Lakh; number of respondents in parentheses)

The following chart shows composition of working capital and terms loans for the 50 respondents by sources of finance, separately for Micro, Small and Medium enterprises. It can be seen from the charts that MSEs depend heavily on non-institutional sources for finance, while SIDBI is the major lender for term loans to medium units.

Sources of Finance (Amount in Rs. Lakh)



Source: D&B India

Banks such as State Bank of India, Canara Bank, Indian Bank, United Bank of India etc. provide equipment finance and high value long term working capital support in the cluster. These banks have tie ups with NSIC for the same, wherein NSIC recommends the units to the banks. Since Coimbatore Engineering Cluster is one of the oldest clusters, there is an increasing trend towards machinery up gradation. Also, foundry enterprises require energy efficient equipments i.e., up gradation to CNC machines from conventional lathe machines or new machinery purchase for reducing energy consumption. All the units that go for purchase of energy efficient equipment are covered under the ‘Scheme for energy saving project in MSME sector’ wherein the units can avail loan at a subsidized rate of interest i.e., at a rate 0.75% lower than the normal lending rate.

Micro enterprises find it difficult to get loans from financial institutions / banks and instead source loan from private sources at a higher interest rate. Micro units are also unaware of specific schemes like CGTMSE and CLCSS.

The vendor development scheme is quite dominant in Coimbatore as most of these units supply to big firms such as Lakshmi Machine Works and C.R.I pumps. Most of the units which are acting as suppliers to big firms can avail loan under this scheme without any collateral and the units are not required to bring in any contribution for equipment purchase.

SIDBI Coimbatore branch lends to small and medium enterprises directly, whereas lending to micro units happens through TIIC where SIDBI, Chennai branch refines to TIIC every year for micro units lending purposes. Under term loans, SIDBI caters to both small and medium enterprises but bills discounting is currently availed by medium enterprises only.

Credit Gap in the MSE Segment

For the current study, D&B considered the credit supply data of only scheduled commercial banks that form the major source of credit supply. The table below contains the estimated Credit Gap in the cluster on the basis of the two methods.

Method	Total Gap	Credit Supply	Credit Demand	Working Capital Demand	Term Capital Demand
Nayak Committee-D&B (In Rs Crores)	1231	704	1934	1041	894

Summary of Credit Gap Assessment

While it is clear that there is a significant credit gap (Rs. 1027 crores) in the cluster, it is also important to note that working capital demand is more than term capital demand but both are significant. While working capital emanates from inherent labor intensive nature of the sector and quality & norms compliance, term capital demand emanates from technology up-gradation requirement.

D&B looked at possible reasons for the large credit gap in the cluster and identified the following reasons for the gap.

- Banks take a very conservative approach and are risk averse in sanctioning loans to MSEs. Bankers fail to take into account the track record of the entrepreneur and his credit history in sanctioning long term finance.
- It is understood that SIDBI prefers lending to units with credit requirement above 100 lakh. But the small units require credit in the range of 50-100 lakh to meet their working capital requirements and new machinery purchase. The reason for this situation is SIDBI has low staff to process and monitor loans and prefers to process high ticket size loans to meet annual targets. There are many small units that have a good track record in loan repayment and SIDBI indicated that they can look to increase the staff numbers to tap these small units. The knowledge level of bankers about CGTMSE, CLCSS and other government schemes is low and this suggests that there is a gap in credit delivery to MSME's.
- Majority of the micro units don't have access to bank finance. It is understood that around 40% of the micro units have access to current accounts in banks and approx. 5-7% have proper access to institutional credit. Most of the micro units depend on non-institutional sources of finance for capital requirements to run the business. These non-institutional sources charge interest rates in the range of 36 - 60% p.a.

- The micro units have credit needs in the range of Rs. 50,000 – 5,00,000 and majority of the financial institutions are not willing to lend to micro units. The reason for this is the high risk perception of bankers towards micro units despite the mandatory norm to cover under CGTMSE' and norms laid by RBI i.e., 60% of the MSME credit should go to micro units.
- The awareness level of MSME's on credit rating is high but the common opinion among MSME's is the perceived minimum benefit of the tool in availing credit from financial institutions.

Further analysis revealed that working capital requirements are met by banks for medium-size units as they can provide collaterals. MSEs find it difficult to furnish collaterals leading to the high credit gap. There is a large presence of micro and small units in the cluster and the need of the hour is to cater to their credit needs both in terms of working capital and term capital requirement. Coimbatore engineering cluster has the potential to be significant player in the engineering export market and financial institutions have a major role to play in timely and adequate fulfillment of credit demand, especially in MSEs sector.

A Note on BDS Programmes under MSMEFDP in the Coimbatore Engineering Cluster

BDS activity in the Coimbatore Engineering cluster under the MSMEFDP project primarily focused on interventions in four major areas, i.e. quality, skill trainings, Energy saving measures and technology up gradations. 45 new service providers were introduced to the cluster.

Associations and firms could realize the advantages of these interventions. The first milestone was achieved with the facilitation of quality certifications like BIS and BEE for 50 firms. Another major area covered was intervention through skill development training programme. As a result 500 semi-skilled persons upgraded their skills. Some of them were absorbed in larger firms and nearly 50 trained persons availed loans for purchasing CNC Machines.

Similarly, energy saving measures were adopted by 25 firms, out of 10 firms reaped large benefits. Energy audits have demonstrated that savings worth nearly Rs. 25 lakh accrued with a payback period of 3-5 years.

Six technology up-gradation programmes were organized during the project period resulting in installation of Divided Blast Technology. Improvement in terms of quality and saving of fuel was experienced. Standardization of components in Motors and Pumps with the help of BDS Project interventions resulted in a saving of Rs. 40 lakh per year. Standardization would continue in the cluster by leveraging government funds from the local MSME DI.

Recommended Products and Delivery Channels

Requirement of Capital

The requirement of units in the cluster is for both working capital and term capital. However, the working capital requirement is more. The nature of capital requirements are as follows:

- Purchase of raw materials
- Wage payments
- Quality and norms compliance
- Technology up-gradation

The units suffer from low awareness of new technology know-how and different financial services in the cluster. There are many micro units in the cluster who do not have collateral to fulfill the requirements of loan application process. This creates a perennial problem of units being unable to grow. There is a strong inter linkage among engineering units in the cluster as pumps and motors manufacturers are one of the major customers for foundry units. The thousands of MSEs located in the cluster including ancillaries and jobbing units have helped Coimbatore to be recognized as an important industrial hub of South India. There are many support institutions that are active in the cluster but there is low awareness amongst micro units of their existence in the cluster. The MSMEFDP BDS programmes have been able to address these issues effectively.

Further there are quality and norms compliance issues which units are unable to fulfill due to non-availability of capital. Majority of FIs serve mainly to medium size units and there is a significant financial exclusion of MSEs. Further, the micro units depend on retail traders to buy raw materials leading to their low profitability and inability to sustain longer without any capital support.

Working of Government Schemes

The current schemes that units can be availed by units are

Credit Linked Capital Subsidy Scheme (CLCSS)

Aimed at technology up gradation of the small scale enterprises, the Government (Ministry of SSI, now Ministry of MSME) has been operating a Credit Linked Capital Subsidy Scheme since the year

2000. The scheme aims at facilitating technology up gradation for improvement in productivity of the MSE units, by providing them 15 per cent (initially it was 12 per cent) upfront subsidy.

There are majority of micro units in the cluster and due to their lack of new technology know-how, makes the above scheme not much applicable to the cluster. For this scheme to take off micro units have to be made aware of the different upcoming technology and then units shall be able to reap the benefits of this scheme.

Credit Guarantee Trust Scheme for Micro & Small Enterprises (CGTMSE)

The Credit Guarantee Fund Trust Scheme for small industries was introduced by the Government in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.25 lakh without collateral/ third party guarantees.

The awareness of the scheme is low in the cluster and thus the benefits haven't reached as intended. This scheme is very much suitable to the cluster, since there is presence of large number of micro units, whose requirement is in the range of Rs. 50,000 – 5, 00,000. Cluster institutions have undertaken awareness programmes across the cluster to apprise the units of the benefits of this scheme. However, this needs scaling up.

Vendor Development Scheme

The scheme is quite predominant in Coimbatore as most of the firms supply to big firms such as Lakshmi Machine Works, CRI Pumps etc. Most of the firms who are acting as suppliers to these big firms can avail credit without any collateral and the firms do not need to bring in contribution for equipment purchase. Since the awareness for new technology amongst micro units is low, the usability of the scheme for new equipment purchase is not being utilized. It is recommended that industry association such as COTMA or TACT undertake the awareness programs to educate the micro/small units on the above scheme so that units reap the benefit of the same.

The other products that are available in the cluster includes bills discounting (medium size units), general working/term capital loan, open letter of credit (LC) for exporters, and equipment lease finance (small and medium size units).

Descriptions of Products and Delivery Mechanisms

Lease Financing

Most of the units in this cluster are micro and currently using conventional machines. In such cases, the formal financial institutions can help these units by financing their equipment purchase under lease financing. Based on promoter's record, the business's future potential in addition to unit's proven track record, banks can do lease financing for the acquisition of plant, machinery and the equipments for these units.

The typical term for the lease would be 5-10 years. The units would pay rentals to the bank for the period till when they have successfully repaid the cost of the equipment. The banks could also charge a processing fee and a lease management fee for the same. Till the time the entire amount has been paid back, the equipment/machinery would stand as the primary security. The possession of the equipment will remain with the borrower, while the bank would enjoy the full legal title. The equipment would become the property of the unit as soon as the debt is paid.

The major advantage of lease financing is that it enables the lessee (manufacturing unit) to plan its cash flows properly. The rentals can be paid out of the cash coming into the business from the use of the same assets

Factoring

There is a strong inter linkage among engineering units in the cluster as pumps and motors manufacturers are one of the major customers for foundry units. The thousands of MSEs located in the cluster including ancillaries and jobbing units have helped Coimbatore to be recognized as an important industrial hub of South India. Keeping above in mind, banks should embrace products that enable them to extend working capital finance on an ongoing basis against invoices raised by their clients on their buyers. Factoring is one such method, in which the 'factor' (bank / FI offering the service) obtains control over the sales ledger of the client. In effect, the entire receivables management is taken over by the factor and this disclosed to the client's customer (buyer). The offerings of a 'Factor' are far more than just the discounting of individual bills by a bank.

Further, as opposed to Cash Credit, under 'Factoring', there is scope for flexibility as to quantum of potential funding, as it is based on the level of debtors. Also, the credit line is based on the financial strength of the borrowing client's debtors, as well as on the borrower's own financial strength. The borrower's bank approves the list of debtors whose invoices, it is prepared to finance and accordingly, the level of funding varies as per the amount due from such approved debtors. In many industries, it is observed that the sales do not occur on a uniform basis, but fluctuate from month to month. Hence the predominant system of receivable financing through 'Cash Credit' is found to be inappropriate, leading to intermittent over-financing or under-financing. Factoring is

more appropriate for MSMEs with potential for rapidly expanding sales and units with unpredictable cash flows and a high proportion of receivables in their working capital cycle.

Factoring has the potential to emerge as a valuable alternative means of finance, because of the following benefits:

Improved cash flows: Majority of MSMEs in the cluster is not able to grow due to insufficient capital and long receivables credit cycle, factoring could be a viable solution for propelling the growth of MSMEs. Factoring solution provides instant cash on receivables, the funding problem of MSMEs can be easily solved.

Elimination of default risk: Factoring without recourse eliminates credit risk for the clients, which is transferred to the factor company. This is a valuable service for MSMEs, as their sensitivity to default risk is usually very high.

Fixed assets freed up for collateralization for other credit requirements: Since factoring generally does not use fixed assets for collateralizations against advances, these assets of the clients are freed up, which can be used as collateral against other loans, for other business needs.

Benefit of sales ledger management: With collections and sales ledger management being outsourced to the factoring companies, MSMEs would be able to utilize the freed up resources for marketing or other business development purposes. Besides, due to specialization, factor companies are better placed to conduct these functions effectively.

Increased ability to extend open account terms to clients: Since extending open account terms of credit involves higher risk, MSMEs are able to offer these terms only to long standing reliable clients, in the absence of open-account receivables finance and adequate credit protection. However with factoring, MSMEs can enjoy better cash flows and reduced default risks, which would enable them to offer open account terms of credit to their clients, which would in turn help their businesses to grow.

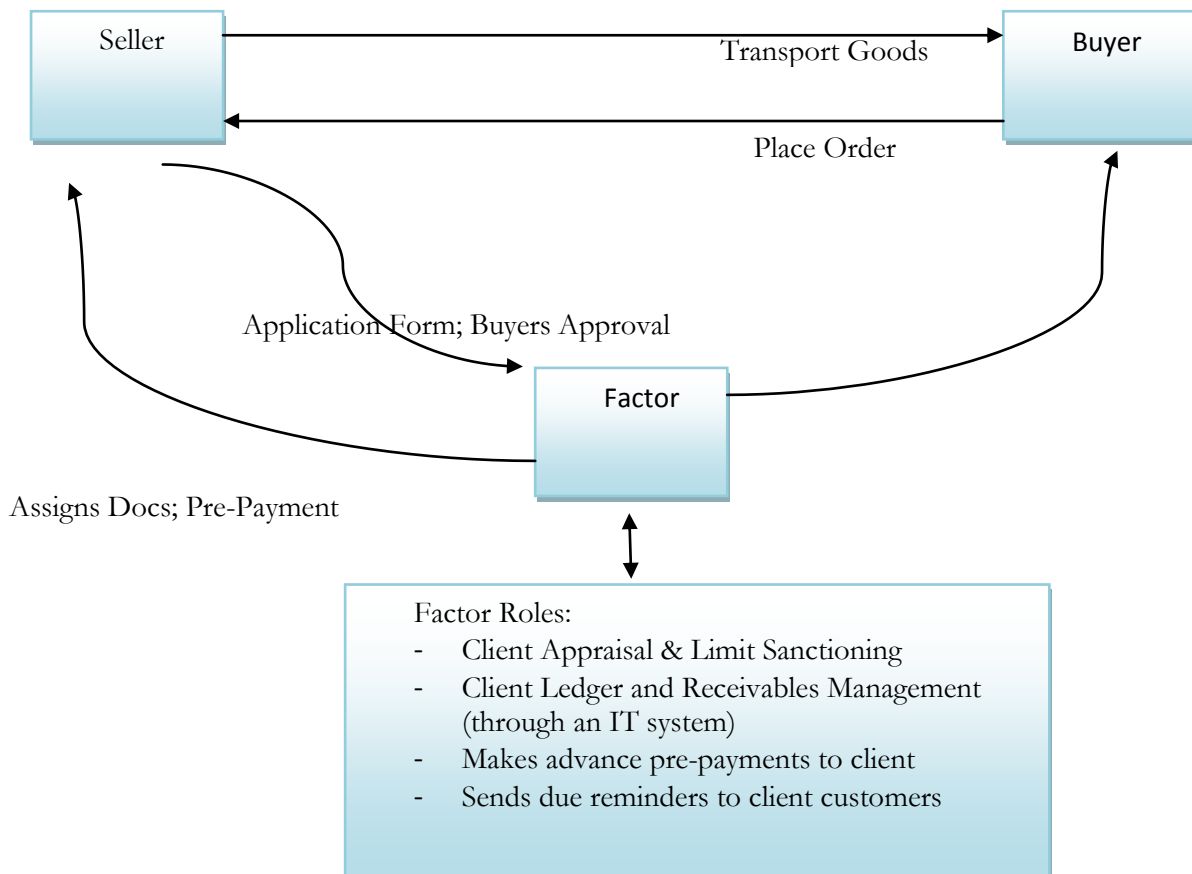
Improved financials: Factoring without recourse removes credit sales receivables from the balance sheets of clients, resulting in improved accounts receivable days and a better current ratio. Since factoring would also reduce the additional debt requirements for working capital, it helps in improving the debt-equity ratio and the debt service coverage ratio of the entities.

Factoring Mechanism

The parties involved in a factoring arrangement are:

- The Client, or the seller

- The Debtor, or the buyer
- The Factor (International factoring may have a correspondent factor in addition to the domestic factor)



Steps Involved:

- Client approaches factor company with last three year financial statements and fills the application form
- Factor conducts the client's appraisal (quantitative assessment of financial ratios etc. and qualitative assessment such as integrity and management capability etc.) and approves/disapproves accordingly
- Client submits the sales ledger of his customers to the factor and sanction limit is assigned based on the quality of customers.

- Factor sends the notification letter to client buyers and upon acceptance of notification a factoring agreement is signed between the client and factor
- Based on the invoices, factor makes advance prepayments (up to 80% of invoice value) and subsequently manage the client's ledger and sends due reminder to client customers. The whole process is taken care through a proper software system.

Pre-approved Collateral-free Equipment Finance Scheme

- Through MoU with Coimbatore District Small Scale Industries Association (CODISSA) / Tamil Nadu Association of Cottage and Micro Enterprises (TACT) / other associations active in the region

There is a unique credit disbursement mechanism in Faridabad Auto and Light Engineering cluster, where SIDBI and FSIA works in tandem to sanction a pre-approved loan facility that can be tapped anytime during the year. The association is responsible for processing of application, doing appraisals, recommending limits as per prescribed norms and providing it to SIDBI, as well as verifying the pro-forma invoice, ensuring margin payment, asset value, etc.

In the Coimbatore engineering cluster, a similar initiative can be taken where Banks / SIDBI can form a MoU with CODISSA / TACT to form a special cell taking care of the initial due-diligence of the units by CODISSA / TACT. Subsequently, based on the recommendation of CODISSA / TACT, Banks / SIDBI can approve the loan either for working capital or term capital requirement. The credit limits, margin payment, collateral requirement etc. can be discussed between Banks / SIDBI and CODISSA / TACT, so that a suitable and workable arrangement can be made specific to the cluster.

Financial Inclusion Initiatives under the MSME-FDP Programme

There have already been a few successes from motivating cluster level financial institutions in Coimbatore to lend to MSMEs under the MSME-FDP Program. Four interaction meets were organized with financial institutions, which were attended by nearly 200 cluster firms. As a consequence, many firms have obtained loans from TIIC and Banks and SIDBI. Coimbatore implemented the Faridabad financial model for the benefit of MSMEs. 24 cluster firms got financial support from Bank of Baroda and 3 firms got financial support from SIDBI.

Up-scaling of Microfinance to Meet Credit Requirements of Micro enterprises

Microfinance has made significant inroads into Tamil Nadu. The total number of microfinance clients in Tamil Nadu (Credit Self Help Group (SHG) members and MFI Client put together) stood at roughly 1.2 crores in 2010, next only to Andhra Pradesh. The various microfinance models have been tried, tested and have met with success, creating an overall conducive environment for microfinance. Microfinance loans in Tamil Nadu aggregated to Rs. 6,286 crores in 2010, with average loans outstanding per household standing at Rs. 21,602.

There are roughly 25,600 micro units in the Coimbatore Engineering cluster. Micro units act as sub-contractors to small and medium size firms. Roughly, 40% of the micro units have access to current accounts in banks and approximately 5-7% has proper access to institutional credit. Most of the micro units depend on non-institutional sources of finance for capital requirements to run the business. These non-institutional sources charge interest rates in the range of 36 - 60% p.a.

The micro units have credit needs in the range of Rs. 50,000 – 5,00,000 and majority of the financial institutions are not willing to lend to micro units. The reason for this is the high risk perception of bankers towards micro units despite the mandatory norm to cover under CGTMSE⁷ and norms laid by RBI i.e., 60% of the MSME credit should go to micro units.

Up-scaling MFIs would prove to be a potent method to handle this issue. MFIs that upscale typically target the lower end of the SME spectrum that have more features in common with their existing microfinance clients, as reflected by the average loan size of micro firms. For micro firms operating on the verge of informality, up-scaling of micro-finance seems to have great potential. In such cases, up-scaling would comprise offering financial services/products that cater to the special needs of a micro enterprise. The benefits of up-scaling may encourage a transition from an informal to a formal enterprise.

MFI active in and around Coimbatore can modify their microfinance business models to incorporate SME operations by taking advantage of their market knowledge and network, and by adapting their microfinance methodologies.

Refinancing (or on-lending) and other support from development finance institutions, such as SIDBI, would be critical for helping MFIs adapt their current lending practices to serve the new clientele, as well as in building the MFIs' capacity in staff training and information management.

Further, a few issues need to be addressed before up-scaling of MFI can become a sustainable model:

- New Product Development
- Collection Cycle
- Recovery Mechanism

- Capacity Building for MFIs and Borrowers

Typically, MFIs have daily/weekly collection cycle, which calls for modification while serving micro and small manufacturing units. MFIs need to understand the borrower's business and particularly "Asset Conversion Cycle" and revise its credit collection cycle to suit the needs of borrowers and simultaneously ensure profitability of the lending business model. Suitable loan products and associated attributes (interest rate, tenure, and credit amount) need to be developed keeping in mind the nature of borrowers business. This shall be particularly important because the product and its attributes shall govern the efficacy of collections affecting top-line growth. Further, training would be needed both for MFIs and borrowing micro units on the business cycle, lending model, and practices adopted to ensure smooth implementation.

Historically, the MFI lending model had been successful despite the high borrowing rate of MFI from Banks. Companies in this space had built a sound base of foot-workers, creating an effective credit delivery and recovery mechanism and with the help of SHG/JLG model, they could cut down on transaction costs. This was a unique differentiator for MFIs compared to banks that did not have such effective mechanisms for credit delivery and reducing transaction costs. However, MFIs charged very high interest rate and allegedly followed coercive credit collection practices to make the lending model economically sustainable and these cast serious doubts on socially driven objective of MFIs. This has led to widespread criticism from different corners and threatened the very existence of MFIs. What followed was Andhra Pradesh MFI Act to regulate MFIs in the state and RBI Committee (Malegam Committee) Report on MFI sector detailing issues, concerns, and recommendations on the prevailing ill-effects of the MFI lending and recovery practices. The committee also reviewed the proposed Micro Finance (Development and Regulation) Bill 2010 and recommended few changes to it along with its own set of recommendations on MFI regulation.

Though, the recent MFI regulation in AP, and the more recent draft bill on MFIDR have put the MFI lending model under a scanner, the potential for such model to work effectively does exist.

Up-scaling MFI Lending – A Success Story under MSME-FDP Programme

Under the GIZ portion of MSMEFDP, an innovative financial product and delivery model for the upstream apparel supply chain had been worked out in association with a Delhi-based MFI named Satin Creditcare Network Ltd (SCNL). SIDBI had sanctioned a line of credit to SCNL for onward lending to the MSEs in the apparel supply chain. Capacity building support involved:

A. Assistance to design and develop a special credit scheme with the following features:

1. Loan ticket size in the range of Rs.50000/- to Rs.200000/-;

2. Loan to be available for investment in machinery or for work capital needs;
 3. Repayment period up-to 2 years;
 4. Repayment in fortnightly/monthly installments instead of daily installments depending on cash flow of the borrower;
 5. No collateral security;
- B. Assistance in HR development for appraising and risk assessment of credit to MEs
- C. Interactive sessions were held with apparel supply chain MEs to understand their needs followed by sensitization workshops to motivate them to borrow from SCNL. They were given an orientation course in accounting, finance, quality improvement and marketing after working hours.

The results of pilot intervention (started in late 2008) are as under:

1. SCNL granted loans to 60 MEs. Each ME, on an average, employed 40 workers and therefore this intervention impacted the lives of around 2400 families and around 12000 people at pilot stage;
2. The enterprises financed under the scheme have shown much better financial discipline and have been repaying installments in time with no default.

Formation of Joint Liability Groups (JLG)

It has been found that most of the micro units in Coimbatore do not have access to institutional finance and the entrepreneurs of micro units borrow from private money lenders at exorbitant interest rates. The major reason behind this practice is the high risk perception of bankers towards micro units. Banks perceive lending to micro units as risky investment and it incurs high monitoring, administrative and transaction costs. In order to overcome this issue D&B India recommends forming Joint Liability Groups (JLG) among micro unit entrepreneurs. The group should consist of 5-7 members each from micro units located in Coimbatore. The group should get registered with one of the micro units association in Coimbatore i.e., either with COTMA or TACT. The association would take the responsibility of forming the group keeping in mind the repayment capabilities of the group and the past performance of the members in doing business. The formal registration with association ensures that the formed group possesses the ability to repay the loan. Here it should be noted that the group will be held responsible for any credit borrowed from the bank, if any of the borrowers from the group defaults the bank loan, the group would be liable to repay the loan.

The role of association in this model is that it acts as an intermediary between the banks and the groups. The association is eligible to act as a guarantor to the group provided it maintains a savings account with the bank. The account should represent the corpus of the association and all the members' contribution. The loans provided to the groups would be worked based on a ratio of the micro unit association savings. The association would act as a guarantor provided it can pool the savings; the extent to which the association could take the role of guarantor would be decided based

on the amount of savings. The ratio of savings to total loan amount should be at the discretion of the issuing bank. The savings pool would act as a Delinquency Risk Fund to the banker and in this way the association would take the responsibility of tracking the performance of the various groups in terms of loan repayment.

In this model the credit risk of the borrowers is distributed among the group members and any default by one of the group members continuously for three months would lead to ineligibility of other group members to obtain a loan from the bank in the future. Here it should be noted that this model works on concept of peer pressure which acts as a source of social collateral to the bank. It is understood that the bankers are wary of the repayment capabilities of the borrowers and this model would minimize the credit risk borne by the banker and in terms of collateral the joint liability would act as social collateral in addition to the association guarantee if at all considered by the banker.

The performance of the group is tracked by the bank and the loan limit can be extended or reduced based on the past credit history of the group with the bank. The loan taken can be utilized for the following purposes: Working capital requirement, Expansion/ Modernization of the unit. The success of the model is dependent on the model implementation by the associations in terms of formation of right groups and also the sensitization of bankers about the model.

The JLG scheme has been tried and run effectively run by cooperatives such as the Coimbatore District Central Cooperative for women traders. The strong family, kinship and community ties that still exist in Coimbatore is conducive for the JLG model, which requires peer pressure to act a social collateral.

Annexure I – Estimation Method for Credit Supply

ESTIMATION OF CREDIT SUPPLY TO THE COIMBATORE ENGINEERING CLUSTER			
	Item	Mar, 2011 Estimate	Remarks/Assumptions
1	Estimated Tamil Nadu Engineering Industry Advances Outstanding - March, 2011 (Rs crores, March, 2010 projected at an expected annual growth rate of 22%)	15,837	Expected growth rate is estimated from State Level Advances (SLA) growth Rate using SLA figures ending Mar, 2010 & Mar, 2011) Source - Table 4.9- Annual-Basic Statistical Returns of SCB, Mar '2010 Source - Statement 9: RBI Quarterly-Basic Statistical Returns of SCB, Mar '2011
2	Estimated Tamil Nadu Engineering Industry Turnover - Mar, 2011 (Rs crores, Projected at an expected annual growth rate of 16% and 0.4% for Year 2009-10 and 2010-11)	106,642	Expected growth rate is estimated from National IIP growth rates Source - Table 3 - ASI, Government of India, MOSPI, 2009 Source - Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug 2011
3	Cluster Sample Turnover (MSEs), Sample Size - 34 units in MSEs Sector (Rs crores)	54	D&B Survey
4	Total Number of MSE units in the Cluster	26700	From Coimbatore Engineering Cluster Diagnostic Study (DS) Report
5	Estimated the Cluster Total Turnover (MSEs, Rs crores) using (3) & (4) for year ending Mar, 2011	4739	
6	Estimated Proportion (P1) of Cluster Turnover to State Industry Turnover using (2) and (5) [$P1 = (5) / (2)$]	4.4%	
7	Estimated the Cluster Level Credit Supply [(1) * (6)] - Rs crores	704	
8	State Level Advances – Term Loan Advance (Small Enterprise - SE) to Total Advance (SE) Proportion (P2)	23%	Estimation based on RBI's Statistical Returns-SCB Source - Table 6.1, Statistical Tables Relating to Banks in India, 2009-10
9	Using (7) and (8) Working Capital Supply is [(1-P2)*(7)].	542	
10	Using (7) and (8) Term Credit Supply is [(P2)*(7)].	162	

Annexure II – Estimation Method for Credit Demand

ESTIMATION OF CREDIT DEMAND IN THE COIMBATORE ENGINEERING CLUSTER					
	Method		Item	Mar, 2012 Estimate	Remarks/Assumptions
	Nayak Committee Approach - Working Capital	1	Cluster Sample Turnover (MSEs), Sample Size - 34 units in MSEs Sector		D&B Survey
		2	Total Number of MSE units in the cluster	26700	Coimbatore Engineering Cluster Diagnostic Report
		3	Estimated the Cluster Sample Total Turnover (MSEs, Rs crores) for year ending Mar, 2011	54	D&B Survey
		4	Estimated the Cluster Total Turnover (MSEs, Rs crores) - Mar, 2012, Expected growth rate of 9.8%	5204	Expected growth rate is estimated from National IIP growth rates Source- Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug, 2011
		5	Basis Nayak Committee Guidelines, Working Capital Funding Requirement is 20% of Projected Turnover calculated in (3)	1041	
	D&B Approach - Term Capital	6	Cluster Sample "Investments in Plant & Machinery", Sample Size - 34 in MSE Sector (Rs crores)	47	D&B Survey
		7	Total Number of MSE units in the cluster	26700	Coimbatore Engineering Cluster Diagnostic Report
		8	Estimated the Cluster Total "Investments in Plant & Machinery" (MSEs, Rs crores) using (1) & (2) for year ending Mar, 2011	3989	
		9	Value in (8) projected to Mar, 2012 level using moving average growth rate of fixed capital for Industry-state wise (28%)	5106	Source - Annual Survey of Industries (ASI) estimates on Fixed Capital for different industries within a state – MOSPI ASI Report, 2009-10
		10	(9) - (8) gives the growth in fixed capital	1117	
		11	80% of (10) is estimated to be Term Credit Funding Requirement	894	
	Total Credit Demand	12	Total Credit Demand [1041 + 894] calculated above in [(5) and (11)]	1934	



Faridabad Auto Components & Engineering Cluster

Overview

The Automobile Industry, due to its very nature, has grown in clusters. The clusters have OEMs as hubs or centers of growth while the suppliers have formed their bases around the OEMs. There are 3 major automobile and auto component production clusters across the country, namely,

- Western Region (Mumbai – Pune – Nasik – Aurangabad),
- Southern Region (Chennai – Bangalore – Hosur) and
- Northern Region (Delhi – Gurgaon – Faridabad).

In the Eastern region, activity in the automotive sector is seen in Jamshedpur and Kolkata, but the development in this region has been to a lesser extent than in the others.

The Faridabad Auto Component and Light Engineering Cluster is a naturally evolved and one of the oldest auto components cluster in the country. Faridabad Small Industries Association (FSIA) has been instrumental in the overall development of the cluster over the past 32 years.

The Faridabad Auto Components and Light Engineering cluster broadly covers two categories of manufacturers – auto components and light engineering segment. The table below lists the different products manufactured in the cluster.

Different Products Manufactured in Faridabad Cluster	
Auto Components	Light Engineering
Engine and Engine Parts	Forgings
Transmission and Steering Parts	Rubber Extrusion/Moulding
Suspension and Braking Parts	Sheet Metal Pressings
Equipments	Machining (CNC, VMC, Conventional)
Electricals	Fabrication
	Casting
Source: Faridabad - Cluster Diagnostic Study,(Prepared by APEX)	

The majorities of companies is in the micro / small category and are being managed by the first generation owner-entrepreneurs. In most of these companies delegation was ineffective. Here the owner – entrepreneur was the only manager who provides guidance / takes decisions in all aspects of operations and has no effective second line of managers. In a few cases there were one or two managers but they too were not given any authority and responsibilities.

The below table summarizes the cluster information.

Faridabad Cluster Summary – MSEs			
Unit Type	Number of Units	Turnover (In Rs Crores)	Investments In Plant and Machinery (In Rs Crores)
Micro and Small	17,000	10,240	3,432
Source: D&B Survey			

The estimates of “Investment (in Plant & Machinery)” and Turnover have been prepared on the basis of D&B Sample Survey, while number of units in the cluster has been borrowed from Diagnostic Study (DS) Report, prepared, by APEX Quality Management Systems, for GTZ.

Sources of Demand for Credit – Opportunity and Risks

Material Linkages

Bulk of the requirements for material related credit was due to the nature in which material itself is handled. Due to entrepreneurial control over the entire facility, most of the times it was observed that lot sizes for ordering varied considerably, **economic order quantities were not called for and most of the procurements are conducted on the “gut feel” of the owner.** This has led to primarily two major issues – one the fact that raw material lying on the floor is increasing and second to control this (and minimize wastages of material through rusting, oxidation etc.), the materials and processes and converted to WIP stocks. Therefore, in most of the enterprises, either large inventories or WIP stocks are observed. This largely has to deal with the problem of inadequate skills of the entrepreneur. In medium enterprises, where production planning procedures were observed, this problem was rarely seen. **Slow moving of items on the shop floor is leading to increased working capital needs.**

Sales Linkages

Large scale industries like Hero Motor Company, New Holland, JCB, Escorts etc. rely on MSMEs for contract manufacturing. **Each industry has a fixed credit cycle and is typically disciplined in meeting payment deadlines. The overall credit cycle in the cluster on an aggregate basis is around 60-90 days but can go up to 120 days. However, well established and strong players (like JCB) pay within 30 days as well.** Therefore, the sales and credit linkages are relatively well established in the cluster. The small units however, at times, face issues in obtaining payments from the micro or medium enterprises.

With respect to marketing as well, a well-established marketing organization is not required in the cluster since most of the work is fixed through contracting and once the contracts are established, these stay for longer durations.

Technology

The light engineering segment of the cluster is fairly under-developed with respect to the knowledge and usage of modern technology. In specific cases like sheet metal processing industries, most of the companies were using traditional power presses, and, only a few were running on hydraulic presses. Typically, the hydraulic presses require larger capital investments and also regular maintenance. It was observed that the units had to resort on external AMCs for this purposes. Therefore, there is a regular requirement for working capital for maintenance and a sporadic requirement for term credit directed towards technology up-gradation.

Quality Management Systems

The most common certifications for quality management are ISO: 9001:2000 and ISO TS: 16949. While a significantly lower number of enterprises are ISO certified and those which have the certification have not invested significantly in the QMS as a process. Data collected and captured is only related to production and dispatches; however data related to material defects, process issues etc. are not captured. Investments in precision instruments and data capturing techniques are necessary and certain units have implemented this.

Supply of Credit to MSEs

Estimate of Outstanding Credit to MSEs in the Engineering Cluster

The credit supply to the Faridabad Auto and Light Engineering cluster is estimated to be Rs. 779 crores out of which Rs. 118 crores (15%) is term credit and Rs. 661 crores (85%) is working capital supply.

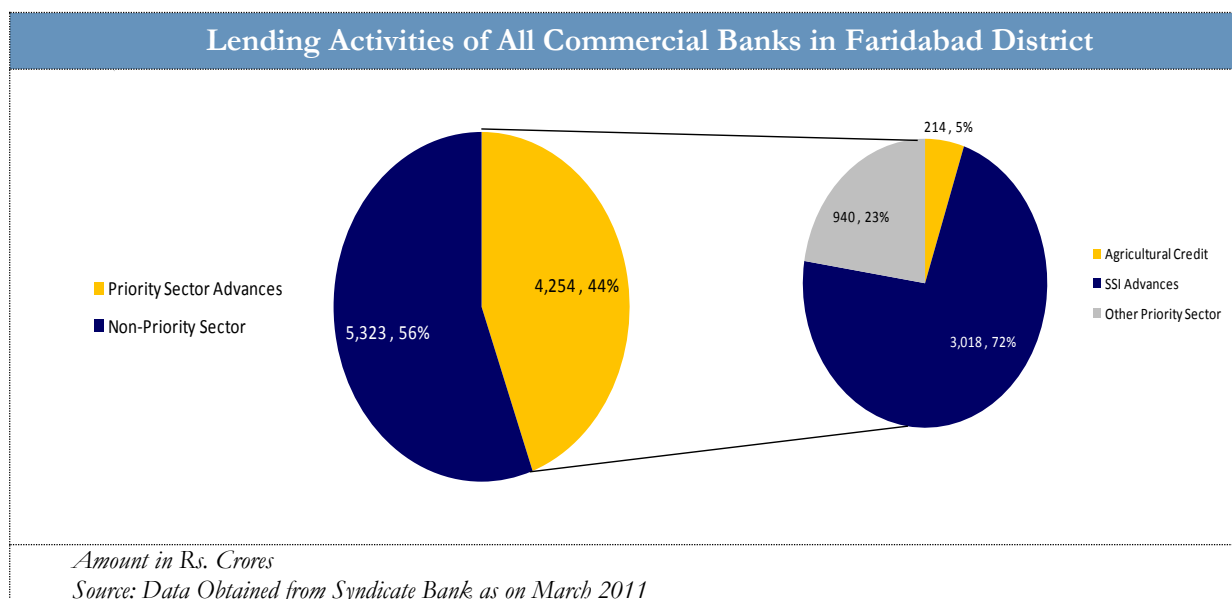
After taking into consideration of lending by SIDBI to MSEs (Rs. 47 crores) and HFC (Rs 1.6 crores) finance in the cluster, the revised credit supply stands at Rs. 828 crores.

Enterprise turnover is one of the important criteria for loan appraisal process and it can be safely assumed that credit supply to the cluster is correlated to the turnover generated. Thus, D&B proposes to use the “Cluster Turnover proportion to Industry State Turnover” method to arrive at cluster level credit supply.

The steps for computation under the identified Methodology (except for the addition of SFC and SIDBI supply data) are detailed in Annexure I. The data obtained through the above methodology was further validated against the data on outstanding advances collected from the lead bank in Faridabad district.

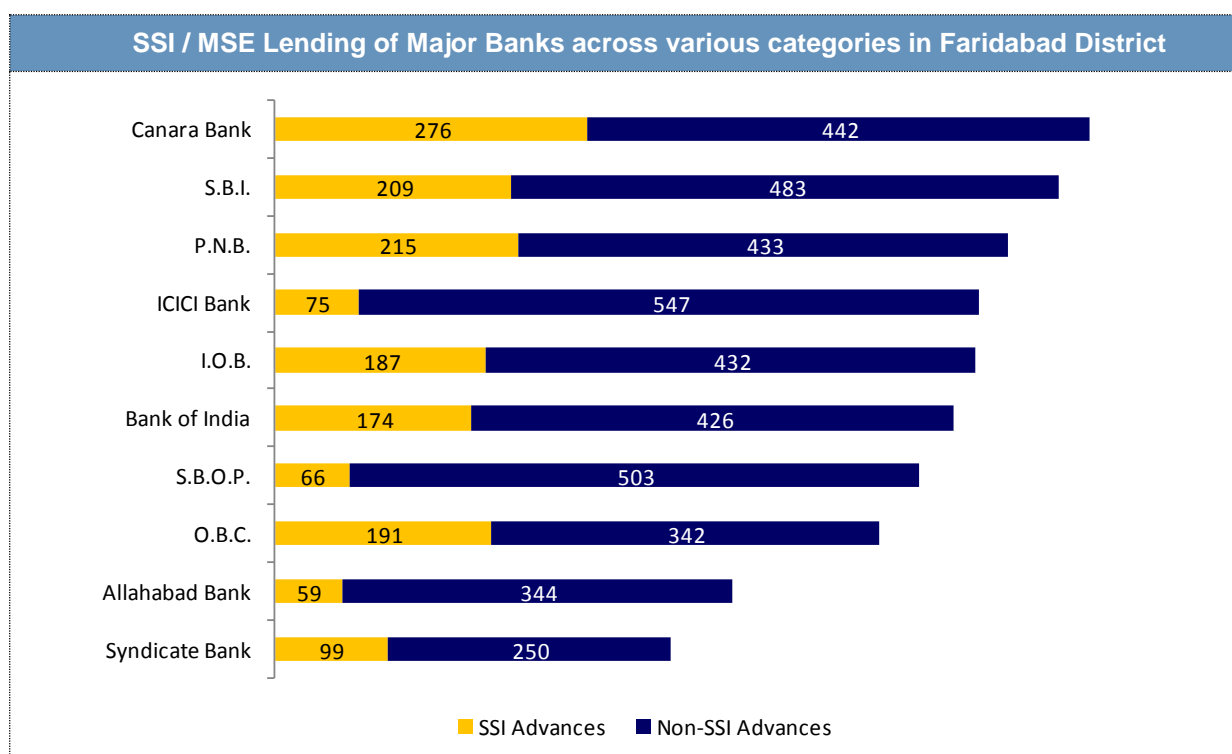
The RBI Lead Bank Scheme management is implemented by Syndicate Bank as the lead bank in the cluster. According to information obtained from the lead bank, an aggregate of about Rs. 9,500 Crores was disbursed under various forms of advances to multiple beneficiary groups like Priority Sector, Weaker Section Loans, Advances to Small Farmers, Advances under DRI Scheme, Other

Schemes etc. The following exhibit depicts the banking flow of credit in the Faridabad District. It can be clearly seen that the Priority Sector Advances in the Faridabad District are around the prescribed lending norms of 44%.



MSE/SSI Advances

The proportion of SSI advances in the total priority sector lending indicates the development focus of the particular district. The SSI sector receives around 32% of the total credit disbursements in the cluster. This is also around 71% of the total priority sector advances. Thus, larger proportion of the credit is provided to the industries and the SSI Sector. The following is the composition of SSI and non-SSI Advances in Faridabad as of March 2011 of the top ten banks



Notes:

1. Amount in Rs. Crores

2. SSI does not include Medium Enterprises. It only constitutes Micro and Small Enterprises (MSEs)

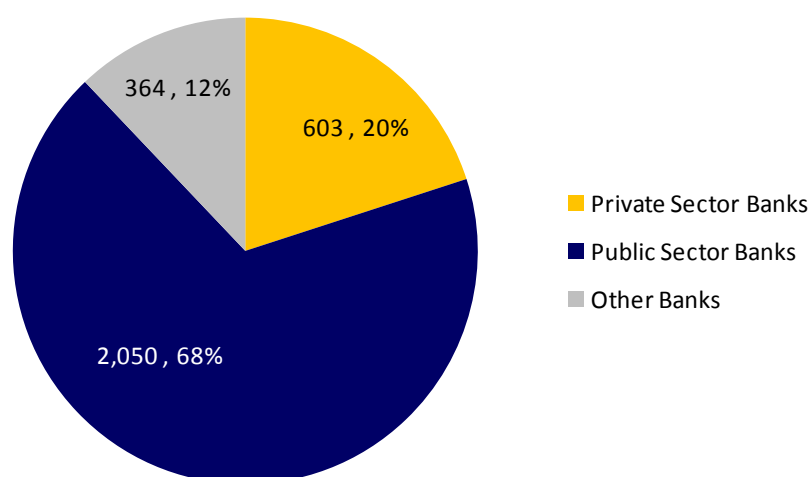
Source: Data Obtained from Syndicate Bank as on March 31st 2011

On interactions with the various banking bodies, it is estimated that around 28% of the total credit in the Faridabad district is available for the Faridabad Auto Components and Light Engineering Cluster, while major lending is directed towards other clusters.

Performance of Banks

In terms of performance of various bank groups, it is seen that of the approximate Rs. 3000 crores of credit to the MSE sector, around 68% of it is provided by the public sector banks. Around 20% of the credit is provided by private sector banks like ICICI since they seem to offer better services and faster turnaround time.

SSI / MSE Lending of Major Banks across various categories in Faridabad District



Notes:

1. Amount in Rs. Crores

2. SSI does not include Medium Enterprises. It only constitutes Micro and Small Enterprises (MSEs)

Source: Data Obtained from Syndicate Bank as on March 2011

The Syndicate Bank is the lead bank in the district however, in terms of aggregate credit disbursements to the SSI sector; Canara Bank leads the overall activity. The aggregate disbursements of Canara Bank account for around 7% of the total SSI credit disbursements in the district.

In terms of aggregate credit disbursements, the above indicated 10 banks contribute to around 60% of the aggregate credit disbursements in the Faridabad district. The private sector banks account for 20% of the credit disbursements to the SSI sector in Faridabad district.

State Bank of India, Canara Bank, Punjab National Bank and SIDBI are the major banks operating in the Faridabad cluster. In terms of advances among SSI /MSE units in Faridabad district, SIDBI has the highest outstanding, with an SSI (micro and small enterprises) loan book of Rs. 296 crores, and Canara Bank, with an SSI / MSE loan book of Rs. 276 crores, is the largest commercial bank, followed by Punjab National Bank and State Bank of India.

Institutional finance is also very popular in the Faridabad cluster. NBFCs such as Electronica Finance Limited (EFL) and Bajaj Capital are very active with large loan books despite the high interest rates charged by them. Many are unsecured loans of large ticket sizes. Major plus points for the NBFCs are their large marketing teams, simpler application forms, and easier loan processing. Haryana Finance Corporation (HFC), tapped by SSIs for land and machinery purchase (CNC, etc.) has a large loan book of Rs. 258 crores.

SIDBI MoU with FSIA – A unique arrangement:

MSMEs are often faced with situations when certain equipments need to be acquired urgently, either because the supplier is offering a discount or because the acquisition is required to comply with a norm. Moreover, these enterprises need to acquire a number of small-value equipment that aggregate to significant value through the year. Applying for loans to make these purchases is considered tedious and time-consuming with no certainty of sanction and disbursement. Hence, either unsecured loans are sourced at high interest or working capital credit is employed for the purpose of acquisition of such equipment.

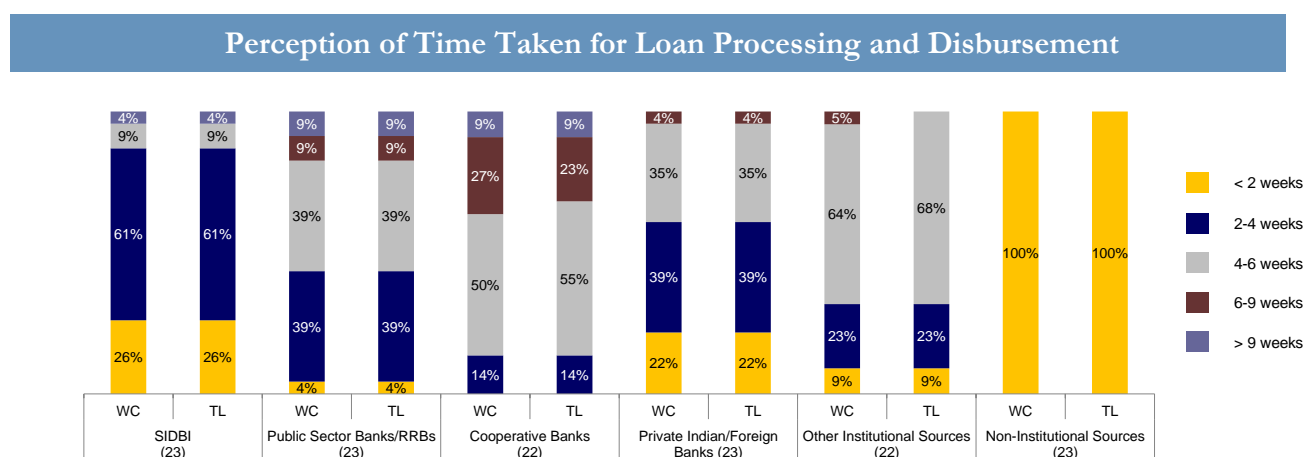
In order to overcome this challenge, SIDBI along with FSIA (a dominant industry association in the Faridabad Auto Components and Engineering cluster) designed a scheme under which a collateral-free line of credit upto Rs. 50 lakh is sanctioned to enterprises, which can avail this facility any time during the year, either in full or in parts, for purchasing equipment.

- The association is responsible for processing of application for the Rs. 50 Lakh limit, doing appraisals, recommending limits as per prescribed norms and provide it to SIDBI, verify the pro-forma invoice, ensuring margin payment, asset value, etc.
- SIDBI does due diligence for the loan. Before disbursement of loan, the assets' existence, working condition, insurance, is verified
- SIDBI disbursements to the SSI / MSE sector in Faridabad stand at around Rs.295 crores, representing around 10% of the aggregate disbursements to SSI / MSE sector
- The SIDBI-FSIA MoU was signed and became operational at the height of the recession in 2008.
- Under the MoU with FSIA, 52 projects have been sanctioned in 30 months. 39 of these have availed the loan. The last outstanding amount was Rs 18 crores.

- There are minor issues that inhibit its use. A number of enterprises have got their limit sanctioned, but are not using it. When an enterprise seeks a part disbursement out of its Rs. 50 Lakh limit, he has to begin paying the EMI on the entire limit, because the SIDBI software system does not allow payment of EMI to the extent of the disbursement. While the software has not been corrected, SIDBI has allowed borrowers to defer EMI payment by a few months.

50 MSMEs were interviewed on the overall perception of their association with various institutional (including SIDBI) and non-institutional sources w.r.t to time taken for loan disbursement and collateral requirement. Most of the respondents had favorable views on suitability of SIDBI products, helpfulness of SIDBI officials and processing time of loan applications. One-thirds of SIDBI's customers and half of non-SIDBI customers suggested that SIDBI needs to further strengthen its marketing of different schemes.

The following chart depicts perception among respondents of time taken for loan processing and disbursement by various financial sources.

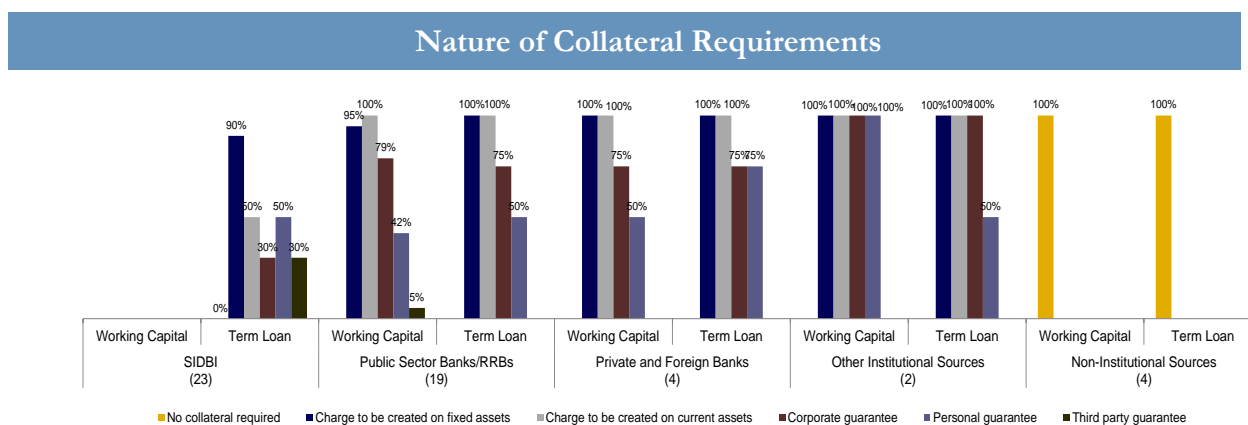


Source: D&B India

Note: Figures in brackets show total number of respondents for each financial source

SIDBI is predominantly perceived to process loans within 4 weeks, while Public Sector Banks have the reputation of taking longer in Faridabad. Cooperative banks are perceived to have the worst track record, with around one-third respondents perceiving that these institutions take more than 6 weeks. Private Indian and Foreign banks, such as HDFC Bank, ICICI Bank and HSBC have a relatively good reputation when it comes to speed of loan processing. Almost all respondents perceive Non-Institutional source to be the fastest.

The following chart shows the nature of collateral requirements across various financial sources.



Source: D&B India

Note: Figures in brackets show total number of respondents for each financial source

A majority of the respondents in the cluster are asked for a charge to be created on fixed assets as well as current assets. A relatively large proportion was also asked for corporate and even personal guarantees. The proportion of such respondents is only marginally lower for SIDBI customers.

Demand for Credit by MSEs

Estimate of Credit Demand by MSEs in the Cluster

There are two methods that D&B India has followed to arrive at Total Credit Demand at cluster level, as mentioned in the methodology section. The methods involved are:

Nayak Committee-D&B Approach

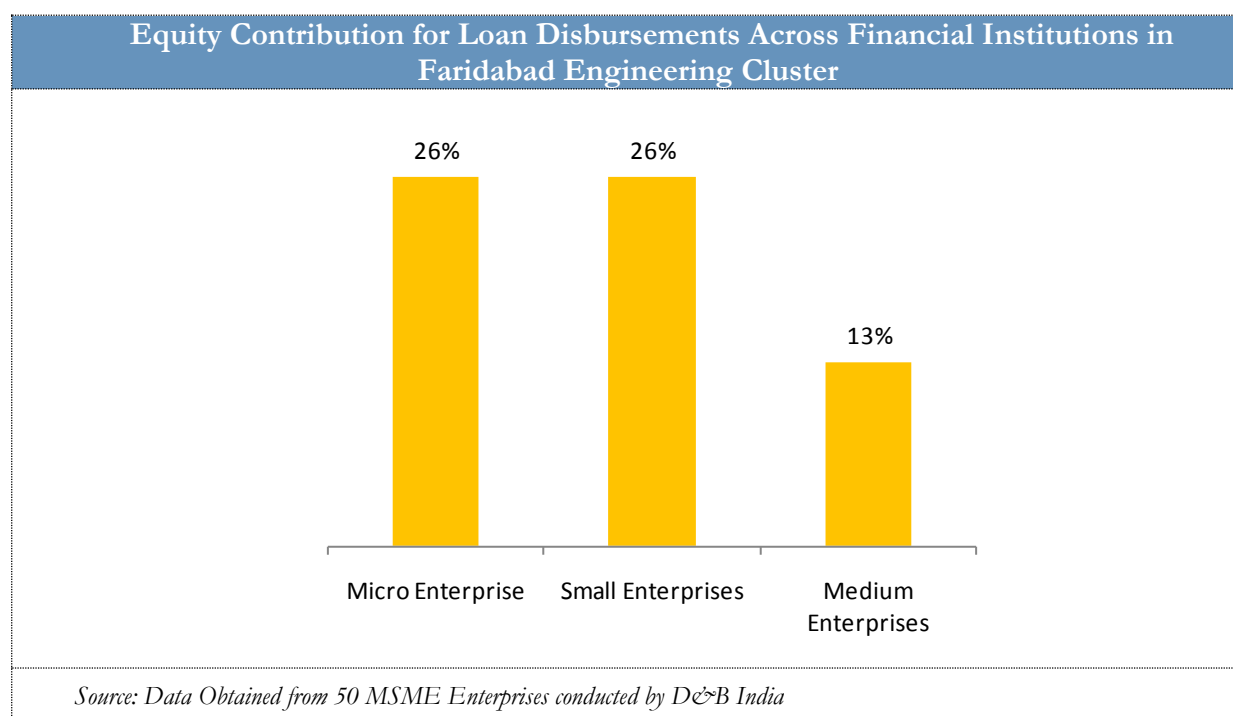
- Working Capital Demand - Turnover Based Approach (Basis – Nayak Committee Guidelines)
- Term Capital Demand - D&B Approach (Basis – Growth in Fixed Capital)

Below are the highlights of the credit demand estimates in the cluster:-

- ❖ Total number of Micro and Small units in the cluster is 17000
- ❖ The turnover for the Faridabad Auto and Engineering MSE cluster is pegged at Rs. 10240 crores during 2010-11 from the D&B survey at cluster level.
- ❖ The turnover is estimated to rise by an annual average growth rate of 9.8% (IIP estimate) to Rs 11245 crores in the year 2011-12.
- ❖ Working Capital Requirement (Basis-Nayak Committee Guidelines) is estimated to be Rs 2249 crores

- ❖ Term Credit Requirement (Basis-Growth in Fixed Capital) is estimated to be Rs 568 crores
- ❖ Total Credit Demand is thus obtained from above [(2249) + (568)] and is Rs 2817 crores

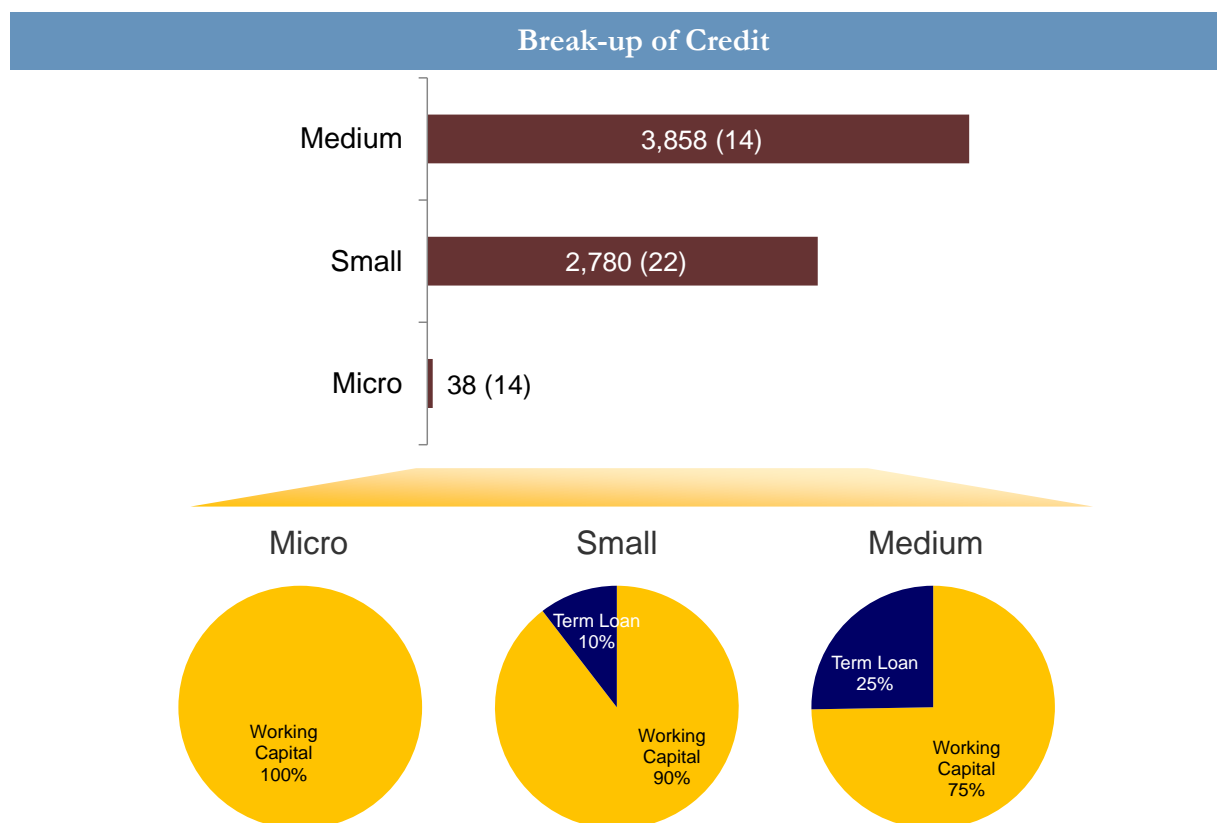
Credit Appraisal Processes followed by various banks differ in terms of time taken for appraisals. However, most of the banks including the lead bank have indicated that for appraisals of working capital loan requirements, the Nayak Committee Recommendations are being followed. It was also observed from the survey that across categories of Micro, Small and Medium Enterprises, this ratio though has varied; the average margin requirement is as per the prescribed Nayak Committee Norm of 20% of the working capital gap. The following chart presents the equity contribution indicated by a sample of 50 enterprises.



It can be seen that for micro and small enterprises, the demand for higher margin contribution is from the bankers' side. The primary reasons for this is micro enterprises are not able to provide adequate collaterals to support their financing needs and hence are required to provide a higher equity margin. Also, since major products produced by the micro units are of the nature of inputs to medium enterprises, variations in order book exists around the year for micro units. There are no long term contracts between micro and medium enterprises. However, the medium enterprises have longer term contracts with the automobile OEMs. Hence, it is easier for medium enterprises to obtain loans at lower margins.

The following charts show the composition of credit among the 50 respondents interviewed in the survey. While 44% of the total respondents were small enterprises, an equal 28% were micro as well

as medium enterprises. The amount of credit per firm in a medium enterprise is 10 times higher than that in a small enterprise. Also, major demand in the cluster is for working capital loans.



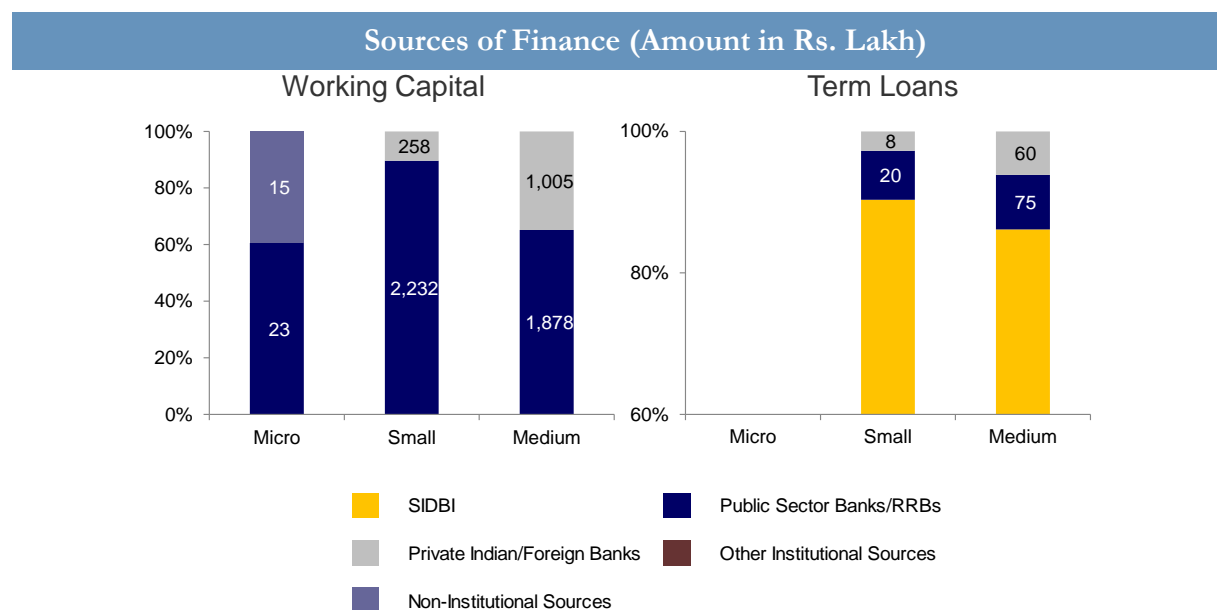
Source: D&B India (Amount in Rs. Lakh; number of respondents in parentheses)

Micro Enterprises: Due to limited availability of affordable land and space, most Micro units are content with their current scale of operations and do not plan to take term loans for expansion. However, such units, particularly job workers, may have term loan needs in case they plan to purchase new cleaner technology. Of the few units that did indicate interest in availing terms loans, it was primarily for purchase of land and building in another area in Faridabad. The quantum of investments that these units would typically look at is Rs. 50 lakh, while they would be able to bring in around Rs. 15 lakh as own funds. Also, many Micro units do not avail any working capital loans as they are able to fund their working capital requirements through proceeds from sales. The typical operating cycle allows them to adjust receivables and payables in such a way that working capital needs are met.

Medium enterprises: These firms avail term loans on a regular basis for the purpose of purchasing new machines, land and building for new factories, and other loans such as car loans. SIDBI is a preferred source for such loans mainly because of lower interest rate and faster disbursement. The CGTMSE scheme has also been utilized by enterprises for such loans.

The following chart shows composition of working capital and terms loans for the 50 respondents by sources of finance, separately for Micro, Small and Medium enterprises. Public Sector Banks and

Regional Rural Banks are the major sources of Working Capital loans across all sizes of enterprises, whereas SIDBI is the major funding source in Term Loans for Small and Medium enterprises. Also, non-institutional sources are a significant source of Working Capital funds for Micro units.



There is significant scope for development of new financial products in the cluster. Industry associations also feel that banks currently offer very standardized products and new avenues for credit delivery can be explored for enterprises in the cluster. For example, MSME units face difficulty in procuring credit for expensive software, as there is no tangible collateral. Financial products that enable funding for such purposes could be introduced.

Credit Gap in the MSE Segment

For the current study, D&B considered the credit supply data of only scheduled commercial banks that form the major source of credit supply. The table below contains the estimated Credit Gap in the cluster on the basis of the two methods.

Method	Total Gap	Credit Supply	Credit Demand	Working Capital Demand	Term Capital Demand
Nayak Committee-D&B (In Rs. Crores)	1989	828	2817	2249	568

Summary of Credit Gap Assessment

Faridabad is a hub for auto component players, including manufacturers, export houses, job workers, etc. and caters largely to large automobile players such as Maruti, Hero Honda, JCB, Suzuki Motorcycles, etc. Faridabad though is well served cluster including credit facility, but credit facility is

limited largely to small and medium size units. Micro firms do suffer from lack of access to institutional finance and new technology know-how.

There is significant credit gap in MSEs in the Faridabad Auto and Engineering cluster. Additionally, there is credit demand both for working capital and term capital. However, working capital demand is significantly more than term credit demand. Therefore there is more credit requirement for working capital needs compared to term capital needs. The following can be summarized as major reasons for the same:

- Material inventories of raw materials and WIP inventories due to lack of proper production planning requires larger working capital needs.
- Most businesses in the cluster are at the commoditized end of the product spectrum with little or no pricing power –the business risk is high. To mitigate such risks, lending to such units is restricted.
- In the move to expand and grow, most of the medium enterprises borrow for research and development purposes and technology improvement in small steps.

The cluster growth is highly dependent on growth of the auto sector, which has been one of the fastest growing sectors in India. In countries like Germany and USA, the automobile sector contributes more than 10% of the GDP while in India, the contribution stands much less than that (<5%). India is witnessing increased consumer spending and this impacts auto sector positively. Keeping this in mind, there is an urgent need to address to support the growth of Faridabad Auto and Engineering cluster, one of the most important clusters across India. MSEs needs to be catered for their credit needs in a timely and adequate fashion to make sure the opportunity at the door step is not lost.

Recommended Products and Delivery Channels

Requirement of Capital

Though the cluster is well served of its credit needs, the micro units do suffer from significant credit gap. There is a large presence of micro units and they have working capital demand to fulfill wage payment, warehouse management etc. to run their daily operations. The typical capital requirements are as follows:

- Purchase of raw materials
- Wage payments
- Quality management systems
- Technology up-gradation

The cluster is one of the most important clusters in terms of output and importance. It caters largely to auto sector and is well served cluster in terms of credit. There are well established auto players in the cluster such as Maruti, Hero Honda, JCB, and Suzuki Motorcycles. The MSME units have well established linkages with the bigger players and there is discipline amongst the entrepreneurs and bigger players in terms of their delivery and credit payments. There is enough awareness of financial services available to them except for CGMTSE as pointed by people of the units, association, and banks.

Working of Current Government Schemes

The current schemes that units can be availed by units are

SIDBI MoU with FSIA – A unique arrangement.

- SIDBI disbursements to the SSI / MSE sector in Faridabad stand at around Rs.295 crores, representing around 10% of the aggregate disbursements to SSI / MSE sector
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- SIDBI does due diligence for the loan. Before disbursement of loan, the assets' existence, working condition, insurance, is verified
- There are minor issues that inhibit its use. A number of enterprises have got their limit sanctioned, but are not using it. When an enterprise seeks a part disbursement out of its Rs. 50

Lakh limit, he has to begin paying the EMI on the entire limit, because the SIDBI software system does not allow payment of EMI to the extent of the disbursement.

- While the software has not been corrected, SIDBI has allowed borrowers to defer EMI payment by a few months.

Credit Linked Capital Subsidy Scheme (CLCSS)

Aimed at technology up gradation of the small scale enterprises, the Government (Ministry of SSI, now Ministry of MSME) has been operating a Credit Linked Capital Subsidy Scheme since the year 2000. The scheme aims at facilitating technology up gradation for improvement in productivity of the SSI / MSE units, by providing them 15 per cent (initially it was 12 per cent) upfront subsidy.

Awareness of this scheme is low and benefits of this scheme have not reached the units. The light engineering segment of the cluster is fairly under-developed and proper awareness and utilization of the above scheme can spur the growth of the units in the light engineering sub-sector.

Credit Guarantee Trust Scheme for Micro & Small Enterprises (CGTMSE)

The Credit Guarantee Fund Trust Scheme for small industries was introduced by the Government in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.25 lakh without collateral/ third party guarantees.

Awareness of this scheme is low and benefits of this scheme have not reached the units. The presence of many micro units has led to huge credit gap in the cluster and if micro firms know and avail the above scheme, then major credit gap can be taken care in the future. FSIA along with SIDBI need to promote this scheme at a much wider scale.

The other products that are available in the cluster include bills discounting, and general working/term capital loan.

Bills discounting credit cycle is currently 90 days but is being looked to extend it for 180 days, as there are payments that go up to even 150-180 days. It is also recommended that Post-Dated Cheques be used to make bills discounting product more effective.

Descriptions of Products and Delivery Mechanisms

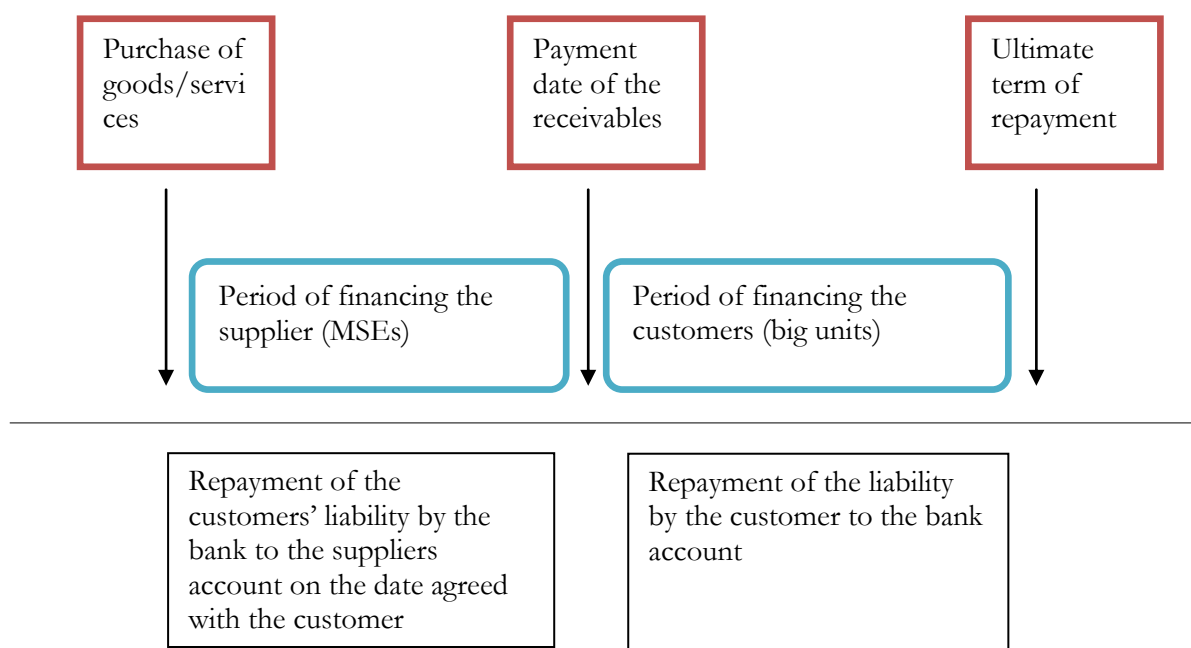
Reverse Factoring

It is financing solution that starts by the ordering party, in order to help his suppliers to finance more easily their receivables, with a best interest rate than the one they would have got otherwise. The solution involves three parties namely ordering party, supplier and, the factor (FIs). Contrary to basic factoring the initiative is not from the supplier that would have presented his invoices to the factor to be paid earlier. This time, it is the ordering party that starts the process – usually a large company –

choosing invoices that he will allow to be paid earlier by the factor. And then, the supplier will himself choose which of these invoices he will need to be paid by the factor. It is therefore a really collaborative project between the ordering party, the supplier and the factor

Since there is well established linkage and discipline with regards to payment across MSME and bigger units in the cluster, the above product shall work well in favor of the micro and small units.

Below is the transaction scheme:



Purchase Order Financing

It is a short term funding provided by FIs and can be used as working capital to manufacture goods for some credit-worthy buyer. Every order is evaluated on its merit and terms are identified with the seller. The fund is then used by the unit to procure raw materials and support other working capital expense required to fulfill the order. Since the cluster has players of very high credit worthiness, POF seems a viable way of providing financial support. One of the primary requirements for this to work from the bank's perspective is that buyer has to furnish a comfort letter to the bank detailing the seller information and credibility.

The POF mechanism shall work in the following way for MSEs in the cluster:

- The buyer/customer (high credit worthiness players) submits a purchase order to the seller (MSEs) with all documents.
- The seller submits the purchase order to the bank for POF.
- The bank makes a partial advance to the seller on the value of the purchase order. The advance is made to the seller to cover the costs of materials, trade goods and/or services.

(This allows the seller to receive funds far sooner than if it had to wait for the buyer to pay on the invoice and even sooner than if the invoice is discounted. POF allows the seller to receive funds even before the goods are shipped and the invoice is issued.)

- The seller procures the raw materials and fabricates the goods and ships the products to the buyer.
- The seller prepares and submits an invoice for the sale. Depending on the agreement, the invoice will go to the buyer or directly to the bank (or factoring company).
- The buyer pays the invoice according to the payment terms, usually directly to the bank.
- When the bank receives payment on the invoice from the buyer, the bank withholds the amount it advanced to the seller as repayment on the POF loan, and also deducts the agreed amount of interest and fees. The balance is then remitted to the seller.

Annexure I – Estimation Method for Credit Supply

ESTIMATION OF CREDIT SUPPLY TO THE Faridabad Auto and ENGINEERING CLUSTER			
	Item	Mar, 2011 Estimate	Remarks/Assumptions
1	Estimated Haryana Auto and Engineering Industry Advances Outstanding - March, 2011 (Rs crores, March, 2010 projected at an expected annual growth rate of 12%)	5,064	Expected growth rate is estimated from State Level Advances (SLA) growth Rate using SLA figures ending Mar, 2010 & Mar, 2011) Source - Table 4.9- Annual-Basic Statistical Returns of SCB, Mar '2010 Source - Statement 9: RBI Quarterly-Basic Statistical Returns of SCB, Mar '2011
2	Estimated Haryana Auto and Engineering Industry Turnover - Mar, 2011 (Rs crores, Projected at an expected annual growth rate of 16 % and 0.4% for Year 2009-10 and 2010-11)	66,600	Expected growth rate is estimated from National IIP growth rates Source - Table 3 - ASI, Government of India, MOSPI, 2009 Source - Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug 2011
3	Cluster Sample Turnover (MSEs), Sample Size - 32 units in MSEs Sector (Rs crores)	39	D&B Survey
4	Total Number of MSE units in the Cluster	17000	From Faridabad Engineering Cluster Diagnostic Study (DS) Report
5	Estimated the Cluster Total Turnover (MSEs, Rs crores) using (3) & (4) for year ending Mar, 2011	10240	
6	Estimated Proportion (P1) of Cluster Turnover to State Industry Turnover using (2) and (5) [$P1 = (5) / (2)$]	15.4%	
7	Estimated the Cluster Level Credit Supply	779	
8	State Level Advances – Term Loan Advance (Small Enterprise - SE) to Total Advance (SE) Proportion (P2)	10%	Estimation based on RBI's Statistical Returns-SCB Source - Table 6.1, Statistical Tables Relating to Banks in India, 2009-10
9	Using (7) and (8) Working Capital Supply is $[(1-P2)*(7)]$.	700	
10	Using (7) and (8) Term Credit Supply is $[(P2)*(7)]$.	79	

Annexure II – Estimation Method for Credit Demand

ESTIMATION OF CREDIT DEMAND IN THE Faridabad Auto and ENGINEERING CLUSTER					
	Method		Item	Mar, 2012 Estimate	Remarks/Assumptions
	Nayak Committee Approach - Working Capital	1	Cluster Sample Turnover (MSEs), Sample Size - 32 units in MSEs Sector		D&B Survey
		2	Total Number of MSE units in the cluster	17000	Faridabad Engineering Cluster Diagnostic Report
		3	Estimated the Cluster Sample Total Turnover (MSEs, Rs crores) for year ending Mar, 2011	39	D&B Survey
		4	Estimated the Cluster Total Turnover (MSEs, Rs crores) - Mar, 2012, Expected growth rate of 9.8%	11245	Expected growth rate is estimated from National IIP growth rates Source- Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug, 2011
		5	Basis Nayak Committee Guidelines, Working Capital Funding Requirement is 20% of Projected Turnover calculated in (3)	2249	
	D&B Approach - Term Capital	6	Cluster Sample "Investments in Plant & Machinery", Sample Size - 36 in MSE Sector (Rs crores)	33	D&B Survey
		7	Total Number of MSE units in the cluster	17000	Faridabad Engineering Cluster Diagnostic Report
		8	Estimated the Cluster Total "Investments in Plant & Machinery" (MSEs, Rs crores) using (1) & (2) for year ending Mar, 2011	3432	
		9	Value in (8) projected to Mar, 2012 level using moving average growth rate of fixed capital for Industry-state wise (21%)	4142	Source - Annual Survey of Industries (ASI) estimates on Fixed Capital for different industries within a state – MOSPI ASI Report, 2009-10
		10	(9) - (8) gives the growth in fixed capital	710	
		11	80% of (10) is estimated to be Term Credit Funding Requirement	568	
	Total Credit Demand	12	Total Credit Demand [2249+568] calculated above in [(5) and (11)]	2817	



Rajkot Engineering Cluster

Overview

Rajkot is centrally located in Saurashtra region in the state of Gujarat in India. The geographical spread of the cluster includes Aji Vasahat, Bhaktinagar Industrial Area, Mavdi Plot, Samrat Industrial Area and Atika Industrial Area areas in Rajkot. In addition, a large number of engineering units are located in fast expanding industrial neighborhoods such as Metoda GIDC and Sapar-Veraval.

Gujarat has a large and vibrant engineering industry and accounts for nearly 9% of the total production from engineering sector in the country. Location of large industrial projects, good infrastructure, availability of natural resources, proactive government policies besides entrepreneurship excellence, have contributed to development of the engineering sector in the state. Rajkot, in the state of Gujarat, is one of the largest engineering clusters in the country. The cluster manufactures a range of engineering items across the value chain and they are represented in the below table.

Different Engineering Segments in Rajkot Cluster					
Foundry	Engine	Machine Tools	Automobile Parts	Pump Sets	Bearings
Pump and Motor bodies	Lister Engine	Conventional Machine and Spares	Connecting Rods	Submersible Pump Sets	Ball, Taper Roller bearings etc.
Diesel Engine Components	Peter Engine	Metal Cutting - Lathe	Pistons	Centrifugal Pump Sets	
Auto Components	Comet Engine	Metal Forming - Power Press etc.	Crankshafts and Camshafts	Mud Pump Sets	
Other Casting Products	Diesel Engine	CNC Machines	Blocks, Liners, and Spares		

Source: Rajkot - Cluster Diagnostic Study, Aug 2009 (Prepared by TERI)

In addition to the above, a number of miscellaneous engineering items such as agricultural implements, hydraulic jacks, air compressors, fasteners and so on are also manufactured in the cluster.

Historically, Rajkot was famous for diesel engines manufacturing catering to agricultural sector and exports. The engines were mainly exported to countries in Africa and Gulf. Due to the falling water table in the Rajkot region, the farmers had to switch to submersible pumps and thus foundries catering primarily to diesel engine sector, diversified to pump castings, automobile castings, and electrical motor bodies etc. Though the cluster is known for its entrepreneurship excellence, there are only few firms that are progressive in nature. The rest of the firms, mainly micro firms, are unaware of new technology, credit facilities, and lack skills to grow their business. The membership fee for

Industry Associations is a hindrance factor for many micro firms and does not use any external BDS facilities. Out of all engineering segments, foundry and pump-sets are two segments that hold good potential to modernize and grow¹³.

The cluster development program for Rajkot engineering cluster was initiated by EDI back in 2003 and was supported by Development Commissioner, SSI Association, Government of India, and ICICI Bank. There have been interventions in the cluster to promote growth and prominent amongst them include UNIDO-Technology Up-gradation for machine tools units and TERI promoted Energy Efficient Technology in the cluster. The MSMEFDP programme has been a key differentiator, through which BDS market development was fostered.

The local support institutions in the cluster include Rajkot Industry Association, Training Institutions (ITI, and Engineering Colleges), National Small Industries Corporation Ltd. (NSIC), Financial Institutions (SIDBI, Commercial and Cooperative Banks), and many unorganized BDS providers in different fields such as Environment, Financial Services, R&D etc.

The following table summarizes the information on Rajkot Engineering cluster.

Rajkot Cluster Summary – MSEs				
Category	Number of Units (MSME)	Employment Numbers	MSEs - Turnover (In Rs Crores)	MSEs - Investments In Plant and Machinery (In Rs Crores)
Foundry	505	20000		
Diesel and Generation Sets	374	7500		
Machine Tools	326	10000		
Automobile Parts	303	9500		
Pump Sets	161	4700		
Bearings	88	3100		
Forgings	433	8000		
Total	2190	62800	9157	1072
Source: Rajkot – Cluster Diagnostic Study, Aug 2009 (Prepared by TERI), and D&B Survey				

Out of total 2190 MSMEs units, 1769 (80%) are micro units, 294 (13%) are small units, and rest 127 (6%) are medium units. The estimates of “Investment (in Plant & Machinery)” and Turnover have been prepared on the basis of D&B Sample Survey, while number of units and cluster employment figure has been borrowed from Diagnostic Study (DS) Report, prepared for SIDBI in 2009.

¹³Diagnostic Study Report on Rajkot Engineering Cluster prepared by TERI under MSMEFDP, Aug 2009

Sources of Demand for Credit – Opportunity and Risks

Presence of Sub-contracting and significant Non-progressive Tiny Units

It is observed that only a small number of firms are progressive in the cluster. A vast segment of units in each of the market segments in the cluster can be categorized as ‘micro’ in size and lack the vision to modernize and grow their business. These units have traditional manufacturing systems and little awareness about the new technologies and product developments. **These units are producing sub-assemblies for more organized manufacturers of automobile parts, diesel engine, pump-sets and machine tools in the cluster.** Usually, the manufacturers or middlemen purchase their goods directly from their doorsteps. Most of these small assembly shops employ less than 10 workers. The owners of these micro units lack spare time to think about business growth since the owner himself and his family members are working in the same unit. Some of the common factors which can be attributed to their backwardness are **lack of knowledge of latest technology and know-how, lack of access to finance/capital for expansion/modernization and lack of marketing skills.** In order to promote the micro units, there is a significant need to create awareness on new technology and skill development. Subsequently, there would be capital need to implement the new technology and skill-development initiatives.

Manpower Intensive Manufacturing

Traditionally, the manufacturing process is manpower intensive. As per industry estimates, the cluster provides direct employment to about more than half a million people. **Therefore, the requirements of the working capital to make continuous labor payments increase.** It also increases the risk in the sector due to labor issues, varying productivity levels etc.

Quality and Norms Compliance

BIS has issued separate standard specifications for each type of pump. Similarly, testing facilities for agricultural, jet and submersible pumps are also specified by BIS to be followed by the industries. All pump set manufacturers must follow the Bureau of Indian Standards (BIS) for pumps. **BIS is mandatory to ensure that the industry produces standard quality pump-sets only.** Regular calibration and testing of all gauges and instruments used in testing the final pump is essential. Hence the units need to maintain proper records of calibration of such testing equipment and meters.

For BIS certification, it is mandatory to employ qualified technicians for conducting the inspection and testing. Most progressive industries have their own quality control system which is used during the manufacturing stages of each component. A small percentage of pump manufacturers have ISO 9000 certification. **This is also a critical component of the bankers’ project and viability assessment while appraising loans to these units.**

Technology

Majority of the enterprises are presently using conventional manufacturing processes such as manual lathe and turning machines. Knowledge about up gradation of manufacturing processes by use of advanced machining centers such as CNC (computer numerically controlled) machines and VMC (Vertical Milling Centre) is non-existent among majority of the enterprises. Similarly, **most of the machine tool manufacturers in the cluster manufacture conventional machine tools only and do not have knowledge of upgrading to advance machine tool manufacture.**

Vendor Development

Most of the machine tool manufacturers are buying castings from foundries located in other clusters such as Kolhapur, Belgaum, Ahmedabad etc. due to lack of availability of good quality castings for machine tools within Rajkot. Most of the foundries in Rajkot are primarily catering to diesel engine, pumps and motors and automobile segments. **There is a scope and need for SIDBI schemes like the Vendor Development Scheme to take off.**

Skill Development and Common Facility Center Usage

A technical services center of NSIC (The National Small Industries Corporation Ltd.) was established in Rajkot in the 1960s. The Centre has a large campus of about 70 acres. The Centre used to offer courses for foundry, pattern shop, fabrication shop, electroplating and heat treatment shop, but these courses have been discontinued some time back and the facilities are not being used at present. Presently, only courses related to welding and pump calibration and testing are being offered, albeit only once in a while. Other ongoing activities of the center include material testing (both mechanical and chemical), testing and calibration of pump-sets for BIS certification, energy audit services, cleaner production audit, and vendor registration services for SMEs. Vendor certification is mandatory for submitting quotation for DGS&D (Directorate General of Suppliers & Disposal) government rate contracts. A testing laboratory of CMTI (Central Manufacturing Technology Institute), Bangalore, has been established with assistance under the UNIDO machine tool intervention a few years back. The laboratory is housed within the NSIC campus. **For usage of above mentioned facilities for skill-development or testing/certification, the enterprises incur cost that has to be allocated out from credit available for working capital fulfillment, putting extra pressure on very small units.**

Supply of Credit to MSEs

Estimate of Outstanding Credit to MSEs in the Engineering Cluster

The credit supply to the Rajkot Engineering cluster is estimated to be Rs. 1161 crores out of which Rs. 204 crores (18%) is term credit and Rs. 956 crores (82%) is working capital supply.

Enterprise turnover is one of the important criteria for loan appraisal process and it can be safely assumed that credit supply to the cluster is correlated to the turnover generated. Thus, D&B proposes to use the “Cluster Turnover proportion to Industry State Turnover” method to arrive at cluster level credit supply.

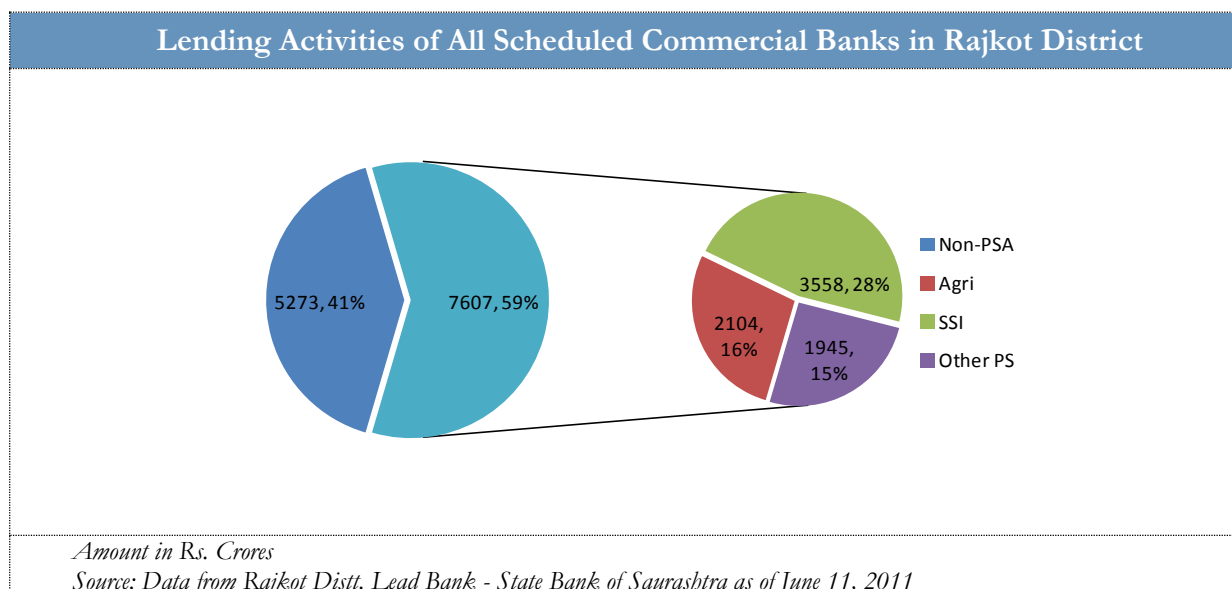
The steps for computation under the identified Methodology are detailed in [Annexure I](#).

The data obtained through the above methodology was further validated against the data on outstanding advances collected from the lead bank in Rajkot district.

In terms of financial institutions support, it is estimated that Rajkot district has a bank branch network of more than 298 branches of around 35 scheduled commercial banks with a strong presence of major public sector banks. Along with nationalized banks there are private sector banks, co-operative banks, regional rural banks and other financial institutions such as SIDBI, Gujarat State Finance Corporation.

The RBI Lead Bank Scheme is implemented by State Bank of Saurashtra as the lead bank in the district. According to the RBI Banking Statistical Returns, the outstanding credit (by all SCBs) for Rajkot district stood at an aggregate of about Rs. 9325 Crores (as of March 31, 2010)¹⁴. Information obtained from the lead bank suggests that the total outstanding credit (by all SCBs, June 11, 2011) is 12880 crores out of which priority sector advance(PSA) stand at Rs. 7607 Crores (60% of the total credit). Out of total PSA, the contribution to SSI / MSE stands at Rs. 3558 crores (47% of PSA).

The following exhibit depicts the banking flow of credit in the Rajkot District.

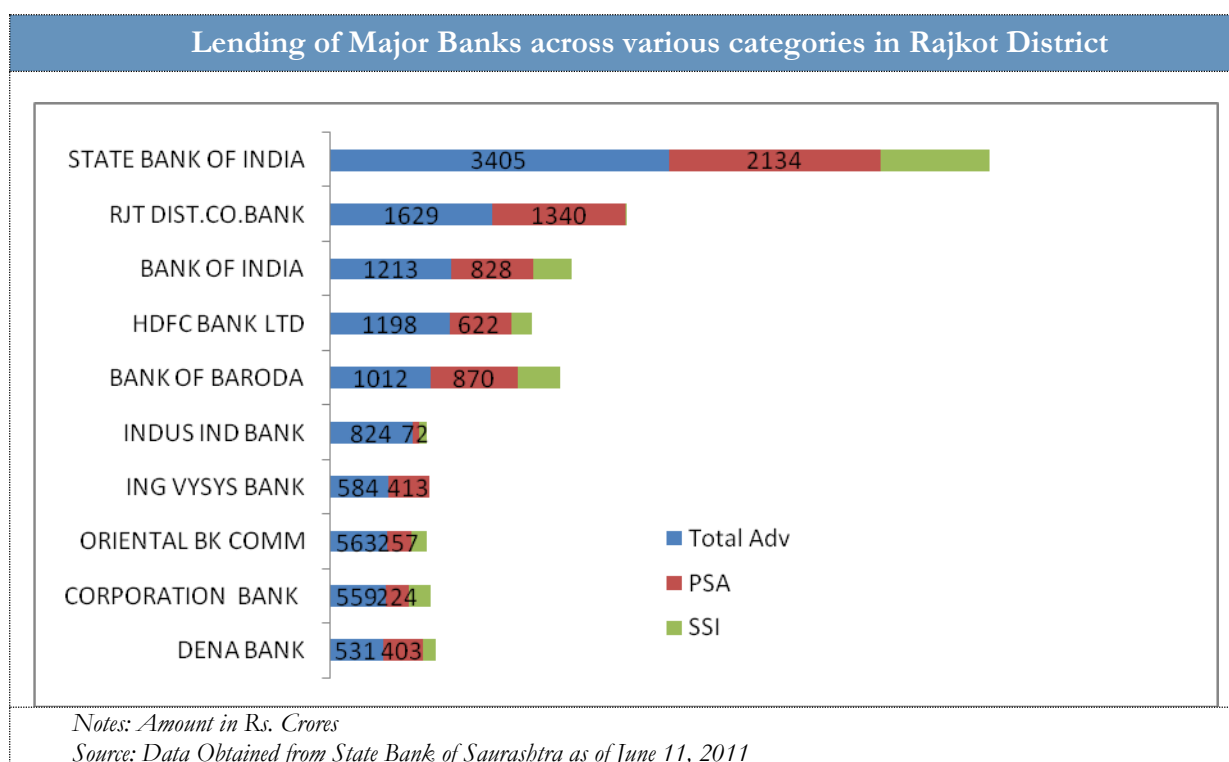


¹⁴ Table 5.9, District Wise Classification of Outstanding Credit of SCBs, Basic Statistical Returns of SCBs in India, Vol 39 – Mar, 2010

Performance of Banks

Public sector banks contribute to 59% of the total credit and 62% of the priority sector credit. In contrast, private sector banks contribute to 29% of the total credit, and 22% of the priority sector credit. The MSE sector is primarily served by Public sector banks, contributing 80% of total outstanding credit to the sector.

The following is the composition of total advance, priority sector and SSI / MSE sector credit in Rajkot as of June 11, 2011, for the top ten banks. The top 10 banks contribute to 80% of the outstanding credit in the Rajkot district. State Bank of India has the largest outstanding credit portfolio as well as priority sector lending. HDFC bank leads among the Private Sector Banks and has the largest priority sector lending portfolio.



SIDBI is providing direct finance only through its Rajkot branch and refinancing facility is provided through Ahmedabad branch. Under direct financing, SIDBI Rajkot is offering financial services which are term loans, working capital term loans, working capital accounts and bills discounting.

Working capital account service is extended by SIDBI with the support of IDBI. All the back-end support like technology, service platform etc. is extended by IDBI and SIDBI is utilizing these services to provide working capital account to its existing customers.

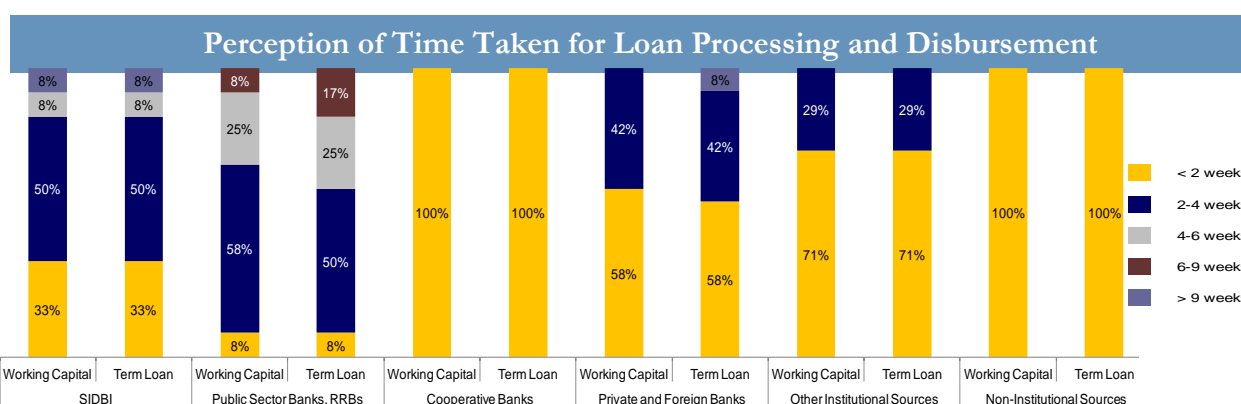
Bill discounting facility is not directly made available through SIDBI-Rajkot branch but it is provided through Ahmedabad branch and there is only one customer from Rajkot branch who is availing this facility.

SIDBI is actively lending under different government schemes like Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) and Credit Linked Capital Subsidy Scheme (CLCSS), but the disbursement of loans under CGTMSE is comparatively low as most of the small and medium size units prefer to provide collateral security to bank. Customers do not avail benefit of CGTMSE because, customers have to pay a charge of 1.5% of disbursed loan amount as a one- time fees in first year and from 2nd year onwards, unit has to pay 0.75% of loan amount to continue with the scheme. 50 MSMEs were interviewed on the overall perception of their association with various institutional (including SIDBI) and non-institutional sources w.r.t to time taken for loan disbursement and collateral requirement.

The following chart depicts perception among respondents of time taken for loan processing and disbursement by various financial sources.

The quality of credit received by various enterprises can be compared on two parameters:

- The loan documentation process for MSME’s needs to be simplified in order to deliver credit in a timely manner. It is observed that there is a common perception among MSME’s that PSB’s and the cooperative banks take long time to process and disburse loans and it is clearly reflected in the survey. Also, it is understood that entrepreneurs in Rajkot are sensitive to interest rates and most of them prefer to avail loan from public sector bank as the interest rates are comparatively lower. So, there is a need for PSU’s to simplify their loan documentation process especially for disbursing working capital loans.
- The time taken for loan processing across bank groups indicates the timeliness of credit received. The following chart indicates the duration of loan processing for working capital and term loans across major bank groups. The processing is faster only in case of non-institutional sources of credit followed by private Indian banks.

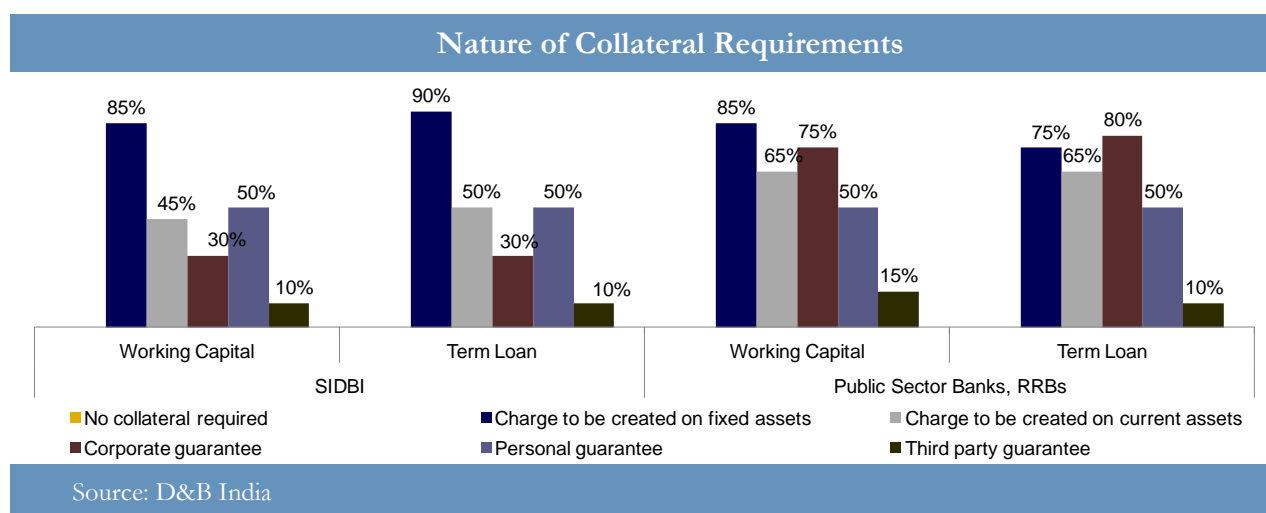


Source: D&B India

Note: Figures in brackets show total number of respondents for each financial source

SIDBI/Cooperative Banks are predominantly perceived to process and disburse loans in less than 4 weeks. Public Sector Banks have a slightly less better reputation and while a few believe they take less than 2 weeks, few others also believe it to take more than 9 weeks. Other sources such as Private Banks, and other institutional and non-institutional sources of finance also have mixed perception of time taken for loan processing and disbursement.

The following chart shows the nature of collateral requirements across various financial sources.



A majority of the respondents in the cluster are asked for a charge to be created on fixed assets as well as current assets, with a relatively large proportion also asked for corporate and even personal guarantees.

Demand for Credit by MSEs

Estimate of Credit Demand by MSEs in the Cluster

There are two methods that D&B India has followed to arrive at Total Credit Demand at cluster level, as mentioned in the methodology section. The methods involved are:

Nayak Committee-D&B Approach

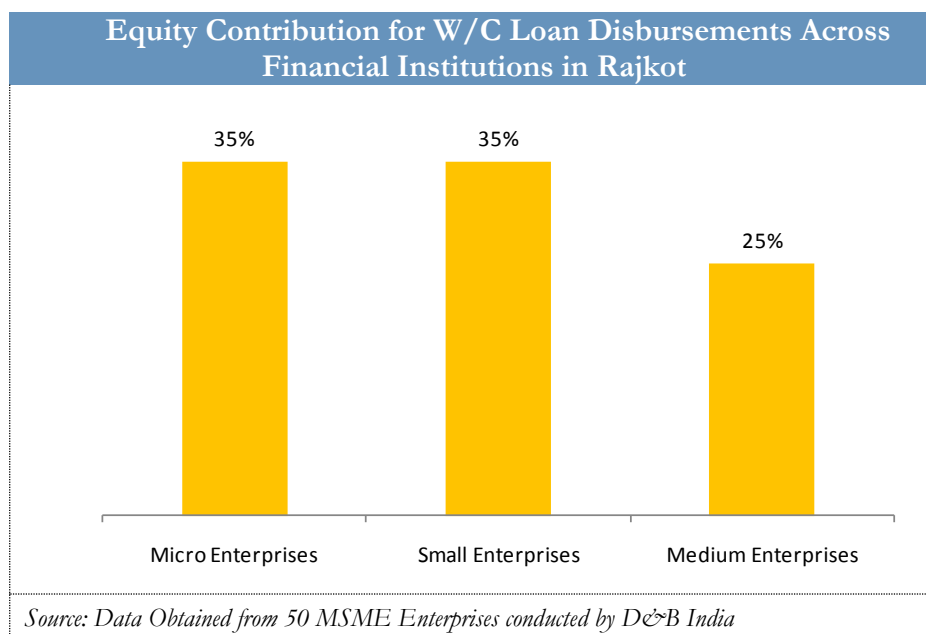
- Working Capital Demand - Turnover Based Approach (Basis – Nayak Committee Guidelines)
- Term Capital Demand - D&B Approach (Basis – Growth in Fixed Capital)

Below are the highlights of the credit demand estimates in the cluster:-

- ❖ Total number of Micro and Small units in the cluster is 2063

- ❖ The turnover for the Rajkot Engineering MSE cluster is pegged at Rs. 9157 crores during 2010-11 from the D&B survey at cluster level.
- ❖ The turnover is estimated to rise by an annual average growth rate of 9.8% (IIP estimate) to Rs 1005 crores in the year 2011-12.
- ❖ Working Capital Requirement (Basis-Nayak Committee Guidelines) is estimated to be Rs 2011 crores
- ❖ Term Credit Requirement (Basis-Growth in Fixed Capital) is estimated to be Rs 398 crores
- ❖ Method 1 - Total Credit Demand is thus obtained from above [(2011) + (398)] and is Rs 2409 crores

Credit Appraisal processes followed by various banks differs in terms of time taken for appraisals. However, most of the banks including the lead bank have indicated that for appraisals of working capital loan requirements, the Nayak Committee Recommendations are being followed. However, during the survey, it was observed that across categories of Small and Medium Enterprises, this ratio has varied considerably. The following exhibit presents the equity contribution of entrepreneurs for working capital loans indicated by a sample of 50 enterprises. It can be concluded that the Nayak Committee Recommendations are currently not being followed at least in the case of micro and small enterprises where the contribution is comparatively high.



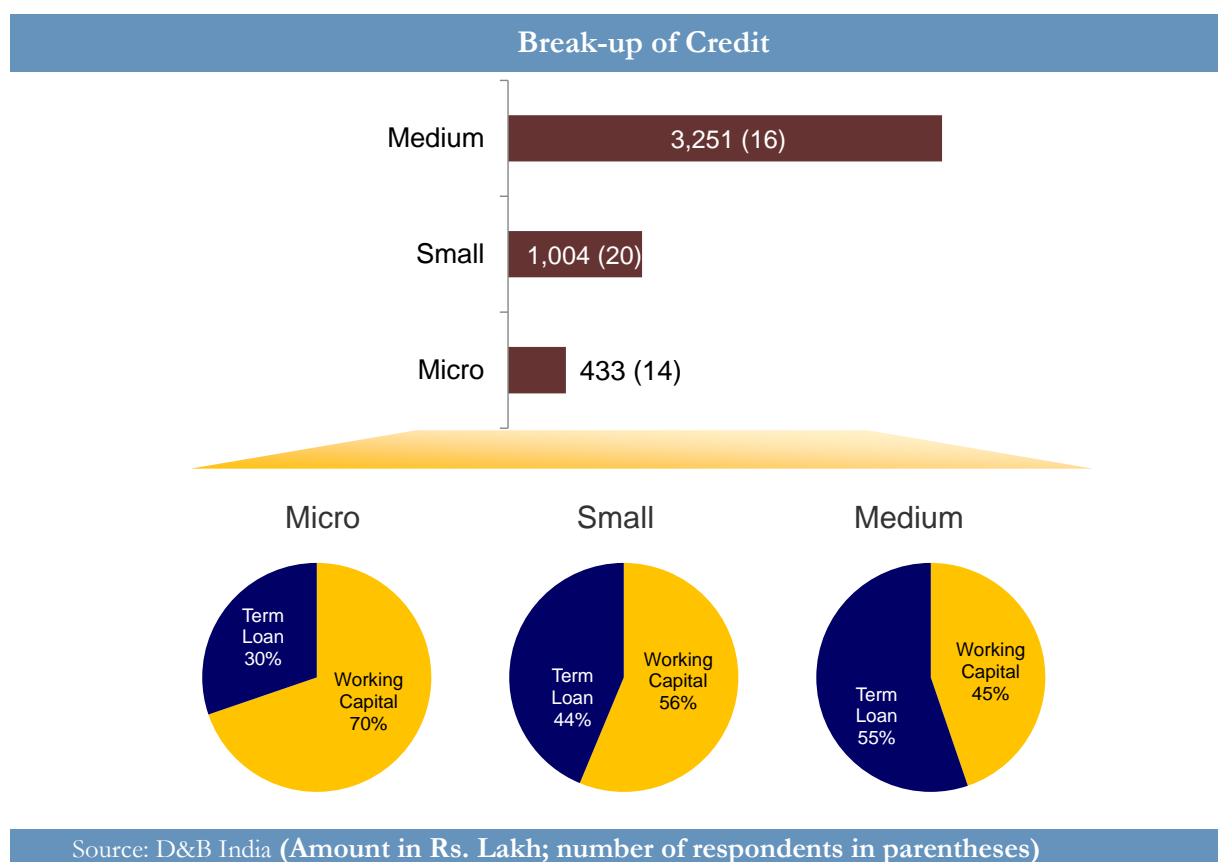
In Rajkot, a significant proportion of the firms are able to fund their capital requirements, and many of those who have additional financing needs prefer non-institutional sources such as family and friends. This is because of the long procedures and detailed documentation requirements in case of

banks. Also, because of high land costs in Rajkot, not many enterprises have expansion plans and are self-content with existing scale of operations. Hence, they don't have significant term loan requirements and the limited requirements are fulfilled by the preferred non-institutional sources.

Also, enterprises prefer cooperative banks as opposed to schedules commercial banks in spite of higher interest rates as they require less number of documents and provide speedy loan disbursement. Cooperative banks in Rajkot are lending aggressively to MSMEs due to lower level of audits that they are subjected to. They require less paperwork and disburse the loan amount in about a week's time.

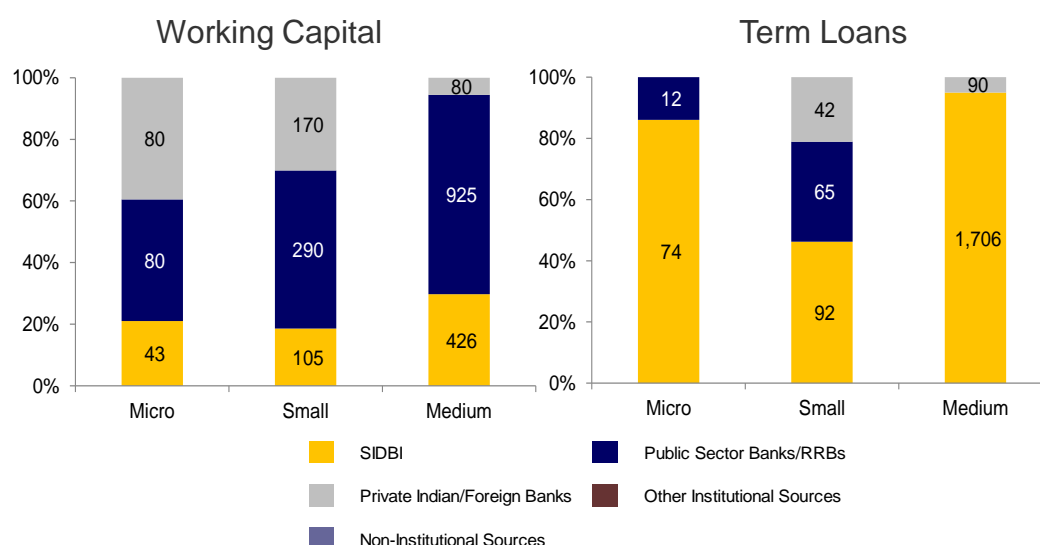
Industry Associations are of the opinion that engineering units in Rajkot are not aware of various financial products such as bills discounting and do not utilize such products. Banks do not actively cater to the SME units in Rajkot. The attitude of banks is very conservative towards MSMEs in this region.

The following charts show the composition of credit among the 50 respondents interviewed in the survey. While 28% of the total respondents were micro enterprises, 40% were small and 32% were medium enterprises. Major demand among micro and small units is for working capital loans, and among medium units is for term loans.



The following chart shows composition of working capital and terms loans for the 50 respondents by sources of finance, separately for Micro, Small and Medium enterprises.

Sources of Finance (Amount in Rs. Lakh)



Source: D&B India

In case of working capital, the major source of capital is mostly PSBs/RRBs. For term loans, SIDBI is the major financial institution across micro, small, and medium units.

It can be seen from the above chart that for the surveyed enterprises, the aggregate term credit and working capital loans are almost equal at Rs. 42 crores (Rs. 11 crores in MSEs). It can be seen that share of SIDBI has been relatively higher in case of medium enterprises for term loans. The medium enterprises are able to meet the appraisal criteria set by SIDBI for its term loans and hence, a higher financing is provided to these firms. Due to high ticket size of loans, SIDBI constitutes a major proportion of credit among the 50 respondents for working capital as well as term loan. Among the remaining respondents, very few have availed any credit at all from banks and other institutional and non-institutional sources. SIDBI is the primary lending institution in the cluster but the working capital lending to micro and small units have been relatively lower. Of the total credit requirement, bulk of the credit requirement is primarily for working capital. Certain micro and medium enterprises also require term credit in the cluster. The following can be summarized for the greater working capital needs:

- Large presence of micro units that have labour intensive manufacturing process, increasing working capital (daily wage) requirement on the enterprise.
- Quality and Norms compliance – The enterprise have to adhere to different standard specifications for their products and this requires credit for using fee based service provided by common facility centres.

From the various methods employed and explained before, the demand and supply side estimations of the cluster have been provided in the next section.

Credit Gap in the MSE Segment

For the current study, D&B considered the credit supply data of only scheduled commercial banks that form the major source of credit supply. The table below contains the estimated Credit Gap in the cluster on the basis of the two methods.

Method	Total Gap	Credit Supply	Credit Demand	Working Capital Demand	Term Capital Demand
Nayak Committee-D&B (In Rs. Crores)	1248	1161	2409	2011	398

Summary of Credit Gap Assessment

The engineering sector is an important industrial segment for economic growth. The sector contributes to nearly 38% the total industrial production and provides 30% of total employment. And Rajkot is one of the largest engineering clusters in India, contributing significantly to State and Country's output. The cluster also exports 20% of its total output.

Despite the cluster importance to country's engineering output, the cluster suffers from significant credit gap. SIDBI is the major financial institutions serving the Rajkot district but Ceramic cluster is the major beneficiary of SIDBI credit facility. There is huge credit demand in the cluster and the primary reasons driving the demand are:

- Labor intensive sector and large presence of micro units driving working capital demand especially for wages requirement.
- Quality and norms compliance expenditures.
- Machinery maintenance and Technology up-gradation.

There is a total credit gap of approximately Rs. 1200 crores. D&B India, through its research, identified possible reasons for this huge gap. A summary of the findings are mentioned below.

- No maintenance of account books, leading to rejection of loan applications.
- Credit appraisal process requires quality certification and absence of these lead to loan application rejection.
- Lack of awareness on enterprise part on their eligibility for loan.
- Lack of quick loan disbursal induces borrowers to take credit from non-institutional sources.

- For the unit owners who are not able to provide collateral security for loans, central government has introduced different schemes like CGTMSE and CLCSS. But banks are very apprehensive to implement these schemes because under CGTMSE the bank gets back at the most only 75% of the amount defaulted by creditor and the rest amount bank has to bear as loss.
- All most 50% of the unit owners fund their credit requirements either through their internal accruals or through their family and friends as they find the procedure of taking finance from banks is cumbersome and when they take loans from the banks they have to justify some of their business decisions in front of the banks.
- The units whose gross turnover exceeds Rs. 40 lakhs per year have to get their accounts audited from a qualified Chartered accountant; this increases the overheads for the unit. To subvert this law units usually do not report their sales above Rs. 40 lakhs and hence their financial worth shown on paper is much less than their real worth and hence banks are able to give credit to units only in accordance with what units have shown on their financial statements
- Some units from the cluster are located in illegal premises and some banks are not ready to fund their businesses despite providing with 100% collateral security.
- Some unit owners in the cluster do not possess CST VAT registration number which is preliminary requirement for loan application as per RBI KYC norms for opening a current account. These unit owners are either ignorant about the importance of this registration or in order to evade taxes they do not register their firm under VAT law. Due to this reason these unit owners are not able to avail finance from the banks

Further analysis revealed that working capital requirements are met by banks for medium-size units as they can provide collaterals. MSEs find it difficult to furnish collaterals leading to the high credit gap. There is a large presence of micro and small units and the need of the hour is to cater to their credit needs both in terms of working capital and term capital requirement, creating an environment where credit support is provided to propel growth of one of the most important engineering clusters of India.

A Note on the BDS Implemented under MSMEFDP in the Rajkot Engineering Cluster

BDS business grew significantly (~30% on an average) during the period of the MSMEFDP project in the Rajkot Engineering cluster. Significant growth was observed in newly introduced BDS such as BEE star labeling, followed by export promotion and energy auditing. The clientele of MSMEs served by BDSPs also grew significantly. In addition a SPV was formed for establishing a CFC for pump testing in the cluster. A Detailed Project Report (DPR) was prepared, which has been submitted to the relevant state/central government agencies. BDS activity in the Coimbatore

Engineering cluster under the MSMEFDP project primarily focused on interventions in four major areas, i.e. quality, skill trainings, Energy saving measures and technology up gradations. 45 new service providers were introduced to the cluster.

Associations and firms could realize the advantages of these interventions. The first milestone was achieved with the facilitation of quality certifications like BIS and BEE for 50 firms. Another major area covered was intervention through skill development training programme. As a result 500 semi-skilled persons upgraded their skills. Some of them were absorbed in larger firms and nearly 50 trained persons availed loans for purchasing CNC Machines.

Similarly, energy saving measures were adopted by 25 firms, out of 10 firms reaped large benefits. Energy audits have demonstrated that savings worth nearly Rs. 25 lakh accrued with a payback period of 3-5 years.

Six technology up-gradation programmes were organized during the project period resulting in installation of Divided Blast Technology. Improvement in terms of quality and saving of fuel was experienced. Standardization of components in Motors and Pumps with the help of BDS Project interventions resulted in a saving of Rs. 40 lakh per year. Standardization would continue in the cluster by leveraging government funds from the local MSME DI.

The project, through strengthening the network of BDSPs in the cluster, has contributed to enhance the turnover of the cluster by about Rs 2600 crore. About 100 units in the cluster received direct voucher cost support under the project. Strengthening of BDSP in financial services resulted in direct loan disbursement, through SIDBI alone, of about Rs 30 crore to 20 small and medium scale units. Other areas where the project scored significantly were productivity and quality improvement, energy savings, skill up-gradation and employment generation.

While exiting from the cluster, the sustainability of various initiatives has been ensured. The SPV has been formed under the umbrella of Rajkot Engineering Association (REA). The good organization set-up and infrastructure existing with REA would ensure the sustenance of the SPV and the proposed CFC in the cluster. All the BDSPs in the cluster have been brought under a consortium which has strong links with REA. The BDS consortium also has its own web-site and organization structure. The linkages between local technical institutes/colleges and industry association have been strengthened to ensure the growth of training and skill-up gradation activities in the cluster. To this affect, an MOU has been signed between the two stake holders with clearly laid out areas of cooperation and sharing of responsibilities. Hence sustenance and growth of the focus sub-sectors within the cluster has been ensured.

The total outreach of the project has been vast. The project has impacted (both directly and indirectly) a large group of stakeholders in the cluster. This includes about 40 BDS providers across a range of business development areas covering technology, energy efficiency, market development etc. Over 150 MSMEs have directly been impacted either in voucher activities and/or workshop participation. Similarly, the project has also impacted over 500 MSMEs through various demonstration and knowledge dissemination activities. Furthermore, REA and other cluster associations operating in different industrial zones of Rajkot along with industrial associations in neighboring clusters have also been strengthened through capacity building and knowledge propagation activities.

Recommended Products and Delivery Channels

Requirement of Capital

The primary requirement is for working capital however term capital requirement can't be ruled out. The presence of micro units, who mainly use traditional technology, drives the requirement of working capital for wage payments. The know-how of units for new technology is low and thus the need for term capital is low. There are also other quality norms (BIS etc.) and registration (VAT) requirements that drive the working capital requirement. Micro units do not maintain their books properly and do not have quality certification and VAT registration leading to rejection of their loan proposal. Unlike other clusters such as Rourkela, units do possess fixed assets and can be presented as collateral for securing loan from institutional sources.

Few salient points regarding the cluster:

- Micro units are producing sub-assemblies for more organized manufacturers of automobile parts, diesel engine pump sets, and machine tools in the cluster. Therefore term loan requirement for these units is very low. However, there is working capital requirement in the form of wage payments.
- There is well established linkage between pump and bearings manufacturing units
- Most of the foundry units are catering to diesel engine, pumps & motors, and automobile segments and there seems to be well established linkage of the units.
- NSIC provide all kind of technical support activities such as testing, calibration, certification, energy audit services, and vendor registration services.
- Mostly the pump manufacturing units in Rajkot are doing the work of assembling the parts which they procure from other units who do job type of work therefore their requirement for term loan as well as WC loan is quite low and therefore the demand for credit from such units is quite low

- The DIC also assists MSME's in taking finance from the bank particularly for the micro sector and it recommends them to banks to give them loan. Prior to getting recommendation from the DIC an individual unit owner is interviewed by a committee which comprises of eminent people like district collector, MP's, MLA's, Principal of ITI/Polytechnic etc. of the area for the project feasibility and knowledge of the unit owner regarding the business

Working of Government Schemes

The current schemes that units can be availed by units are

Credit Linked Capital Subsidy Scheme (CLCSS)

Aimed at technology up gradation of the small scale enterprises, the Government (Ministry of SSI, now Ministry of MSME) has been operating a Credit Linked Capital Subsidy Scheme since the year 2000. The scheme aims at facilitating technology up gradation for improvement in productivity of the SSI / MSE units, by providing them 15 per cent (initially it was 12 per cent) upfront subsidy.

There are majority of micro units and due to their lack of new technology know-how and this makes the above scheme not applicable to the cluster. For this scheme to take off micro units have to be made aware of the different upcoming technology and then units shall be able to reap the benefits of this scheme.

Credit Guarantee Trust Scheme for Micro & Small Enterprises (CGTMSE)

The Credit Guarantee Fund Trust Scheme for small industries was introduced by the Government in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.25 lakh without collateral/ third party guarantees.

It is important to note here that overall, units do not face problems of producing collaterals for availing loan facility from institutional source. This makes the above scheme to be expensive for the units and makes units reluctant to avail this scheme.

Bills Discounting

This product is being offered by the SIDBI Ahmedabad branch and by Rajkot branch, which is more near to Rajkot engineering cluster. Only one unit is availing this facility through Ahmedabad branch. Additionally, awareness of this product is quite low in the cluster, and there exist a need to create more awareness for this scheme.

Descriptions of Products and Delivery Mechanisms

Foundry and Pumps industry forms the backbone of the cluster and there is significant linkage between the units in the cluster. The two significant linkages are:

- Between pump and bearings manufacturing units
- Most of the foundry units are catering to diesel engine, pumps & motors, and automobile segments and there seems to be well established linkage of the units.

Keeping above in mind, the following products seem applicable to the growth of the cluster.

Pre-approved Collateral-free Equipment Finance Scheme

- Through MoU with Rajkot Industry Association (RIA)

There is a unique credit disbursal mechanism in Faridabad Auto and Light Engineering cluster, where SIDBI and FSIA works in tandem to sanction a pre-approved loan facility that can be tapped anytime during the year. The association is responsible for processing of application, doing appraisals, recommending limits as per prescribed norms and providing it to SIDBI, as well as verifying the pro-forma invoice, ensuring margin payment, asset value, etc.

In the Rajkot engineering cluster, a similar initiative can be taken where Banks / SIDBI can form a MoU with RIA to form a special cell taking care of the initial due-diligence of the units by RIA. Subsequently, based on the recommendation of RIA, Banks / SIDBI can approve the loan either for working capital or term capital requirement. The credit limits, margin payment, collateral requirement etc. can be discussed between Banks / SIDBI and RIA, so that a suitable and workable arrangement can be made specific to the cluster.

Factoring

As there are two strong linkages (Pump and Bearing sub-sector, Foundry and units in diesel engines, and pumps sub-sector) in the Rajkot engineering cluster, and open account sales is the preferred arrangement between larger buyers and smaller sellers, banks should embrace products that enable them to extend working capital finance on an ongoing basis against invoices raised by their clients on their buyers. Factoring is one such method, in which the 'factor' (bank / FI offering the service) obtains control over the sales ledger of the client. In effect, the entire receivables management is taken over by the factor and this disclosed to the client's customer (buyer). The offerings of a 'Factor' are far more than just the discounting of individual bills by a bank.

Further, as opposed to Cash Credit, under ‘Factoring’, there is scope for flexibility as to quantum of potential funding, as it is based on the level of debtors. Also, the credit line is based on the financial strength of the borrowing client’s debtors, as well as on the borrower’s own financial strength. The borrower’s bank approves the list of debtors whose invoices, it is prepared to finance and accordingly, the level of funding varies as per the amount due from such approved debtors. In many industries, it is observed that the sales do not occur on a uniform basis, but fluctuate from month to month. Hence the predominant system of receivable financing through ‘Cash Credit’ is found to be inappropriate, leading to intermittent over-financing or under-financing. Factoring is more appropriate for MSMEs with potential for rapidly expanding sales and units with unpredictable cash flows and a high proportion of receivables in their working capital cycle.

Factoring has the potential to emerge as a valuable alternative means of finance, because of the following benefits:

Improved cash flows: Majority of MSMEs in the cluster is not able to grow due to insufficient capital and long receivables credit cycle, factoring could be a viable solution for propelling the growth of MSMEs. Factoring solution provides instant cash on receivables, the funding problem of MSMEs can be easily solved.

Elimination of default risk: Factoring without recourse eliminates credit risk for the clients, which is transferred to the factor company. This is a valuable service for MSMEs, as their sensitivity to default risk is usually very high.

Fixed assets freed up for collateralization for other credit requirements: Since factoring generally does not use fixed assets for collateralizations against advances, these assets of the clients are freed up, which can be used as collateral against other loans, for other business needs.

Benefit of sales ledger management: With collections and sales ledger management being outsourced to the factoring companies, MSMEs would be able to utilize the freed up resources for marketing or other business development purposes. Besides, due to specialization, factor companies are better placed to conduct these functions effectively.

Increased ability to extend open account terms to clients: Since extending open account terms of credit involves higher risk, MSMEs are able to offer these terms only to long standing reliable clients, in the absence of open-account receivables finance and adequate credit protection. However with factoring, MSMEs can enjoy better cash flows and reduced default risks, which would enable them to offer open account terms of credit to their clients, which would in turn help their businesses to grow.

Improved financials: Factoring without recourse removes credit sales receivables from the balance sheets of clients, resulting in improved accounts receivable days and a better current ratio. Since

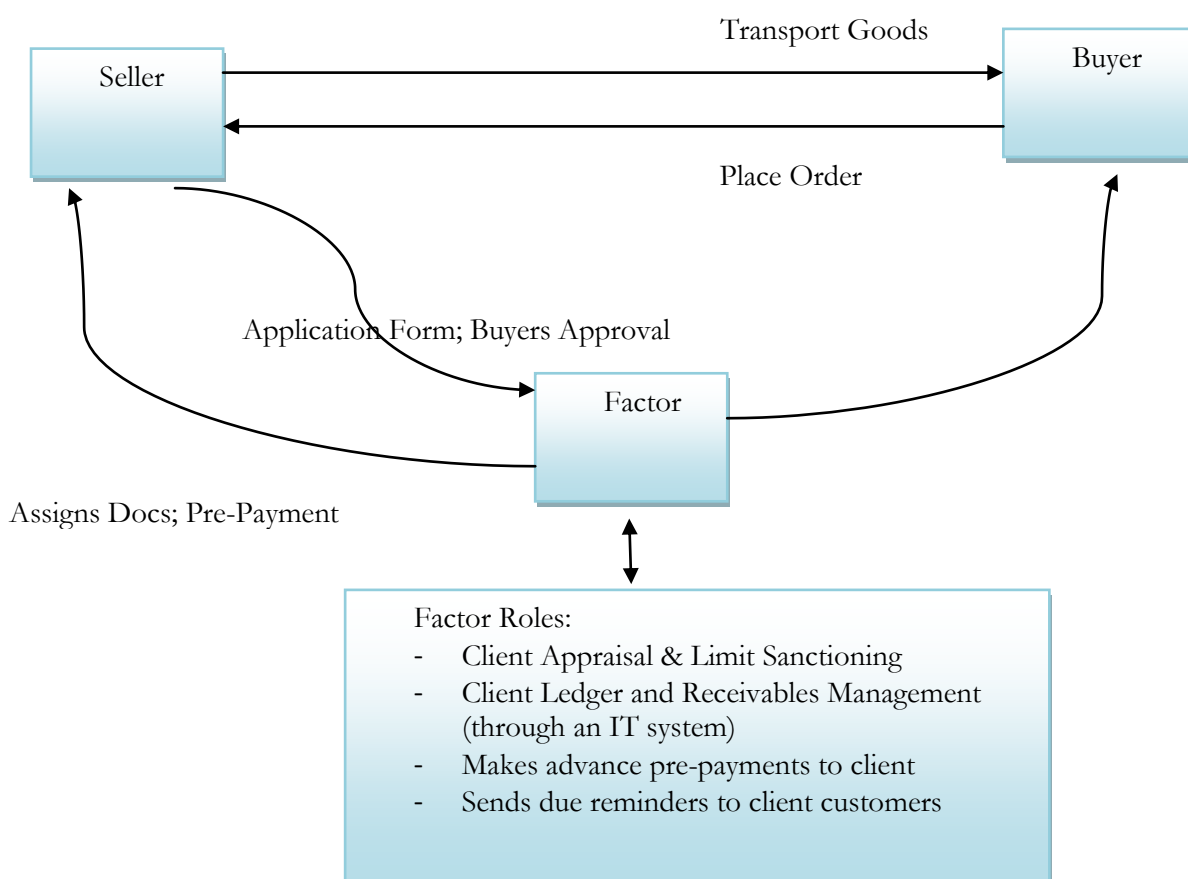
factoring would also reduce the additional debt requirements for working capital, it helps in improving the debt-equity ratio and the debt service coverage ratio of the entities.

Factoring Mechanism

The parties involved in a factoring arrangement are:

- The Client, or the seller
- The Debtor, or the buyer
- The Factor (International factoring may have a correspondent factor in addition to the domestic factor)

Factoring mechanism



Steps Involved:

- Client approaches factor company with last three year financial statements and fills the application form
- Factor conducts the client's appraisal (quantitative assessment of financial ratios etc. and qualitative assessment such as integrity and management capability etc.) and approves/disapproves accordingly
- Client submits the sales ledger of his customers to the factor and sanction limit is assigned based on the quality of customers.

- Factor sends the notification letter to client buyers and upon acceptance of notification a factoring agreement is signed between the client and factor
- Based on the invoices, factor makes advance prepayments (up to 80% of invoice value) and subsequently manage the client's ledger and sends due reminder to client customers. The whole process is taken care through a proper software system.

Lease Financing

Most of the units in this cluster are micro and currently using conventional machines. In such cases, the formal financial institutions can help these units by financing their equipment purchase under lease financing. Based on promoter's record, the business's future potential in addition to unit's proven track record, banks can do lease financing for the acquisition of plant, machinery and the equipments for these units.

The typical term for the lease would be 5-10 years. The units would pay rentals to the bank for the period till when they have successfully repaid the cost of the equipment. The banks could also charge a processing fee and a lease management fee for the same. Till the time the entire amount has been paid back, the equipment/machinery would stand as the primary security. The possession of the equipment will remain with the borrower, while the bank would enjoy the full legal title. The equipment would become the property of the unit as soon as the debt is paid.

The major advantage of lease financing is that it enables the lessee (manufacturing unit) to plan its cash flows properly. The rentals can be paid out of the cash coming into the business from the use of the same assets.

Purchase Order Financing

It is a short term funding provided by FIs and can be used as working capital to manufacture goods for some credit-worthy buyer. Every order is evaluated on its merit and terms are identified with the seller. The fund is then used by the unit to procure raw materials and support other working capital expense required to fulfill the order. Since the cluster has players of very high credit worthiness, POF seems a viable way of providing financial support. One of the primary requirements for this to work from the bank's perspective is that buyer has to furnish a comfort letter to the bank detailing the seller information and credibility.

The POF mechanism shall work in the following way for MSEs in the cluster:

- The buyer/customer (high credit worthiness players) submits a purchase order to the seller (MSEs in Foundry and Bearings industry) with all documents.

- The seller submits the purchase order to the bank for POF.
- The bank makes a partial advance to the seller on the value of the purchase order. The advance is made to the seller to cover the costs of materials, trade goods and/or services. (This allows the seller to receive funds far sooner than if it had to wait for the buyer to pay on the invoice and even sooner than if the invoice is discounted. POF allows the seller to receive funds even before the goods are shipped and the invoice is issued.)
- The seller procures the raw materials and fabricates the goods and ships the products to the buyer.
- The seller prepares and submits an invoice for the sale. Depending on the agreement, the invoice will go to the buyer or directly to the bank (or factoring company).
- The buyer pays the invoice according to the payment terms, usually directly to the bank.
- When the bank receives payment on the invoice from the buyer, the bank withholds the amount it advanced to the seller as repayment on the POF loan, and also deducts the agreed amount of interest and fees. The balance is then remitted to the seller.

Quality Testing and Registration linked Working Capital Finance

The units in the cluster have to adhere to many quality standards and registration procedures to procure orders and avail institutional finance. In the cluster, NSIC provides comprehensive testing and compliance services to the units in the cluster and DIC recommends the units to banks for loan after due diligence. This existing condition can be taken advantage by creating a working capital finance product solely for quality testing and registration activities. This will make units more competitive. Here is how this product shall work:

- NSIC collaborate with DIC to prepare a list of units that have had healthy financial state.
- Based on the above list, units avail the NSIC facility and FIs finance the facility center usage for the units.
- Units pay to the FIs after some time decided earlier by discussion amongst NSIC, DIC, and FIs.

Annexure I – Estimation Method for Credit Supply

ESTIMATION OF CREDIT SUPPLY TO THE RAJKOT ENGINEERING CLUSTER			
	Item	Mar, 2011 Estimate	Remarks/Assumptions
1	Estimated Gujarat Engineering Industry Advances Outstanding - March, 2011 (Rs crores, March, 2010 projected at an expected annual growth rate of 7%)	8,458	Expected growth rate is estimated from State Level Advances (SLA) growth Rate using SLA figures ending Mar, 2010 & Mar, 2011 Source - Table 4.9- Annual-Basic Statistical Returns of SCB, Mar '2010 Source - Statement 9: RBI Quarterly-Basic Statistical Returns of SCB, Mar '2011
2	Estimated Gujarat Engineering Industry Turnover - Mar, 2011 (Rs crores, Projected at an expected annual growth rate of 6% and 7% for Year 2009-10 and 2010-11)	62,268	Expected growth rate is estimated from National IIP growth rates Source - Table 3 - ASI, Government of India, MOSPI, 2009 Source - Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug 2011
3	Cluster Sample Turnover (MSEs), Sample Size - 34 units in MSEs Sector (Rs crores)	170	D&B Survey
4	Total Number of MSE units in the Cluster	2063	From Rajkot Engineering Cluster Diagnostic Study (DS) Report
5	Estimated the Cluster Total Turnover (MSEs, Rs crores) using (3) & (4) for year ending Mar, 2011	9157	
6	Estimated Proportion (P1) of Cluster Turnover to State Industry Turnover using (2) and (5) [$P1 = (5) / (2)$]	14.7%	
7	Estimated the Cluster Level Credit Supply [(1) * (6)] - Rs crores	1161	
8	State Level Advances – Term Loan Advance (Small Enterprise - SE) to Total Advance (SE) Proportion (P2)	18%	Estimation based on RBI's Statistical Returns-SCB Source - Table 6.1, Statistical Tables Relating to Banks in India, 2009-10
9	Using (7) and (8) Working Capital Supply is [(1-P2)*(7)].	956	
10	Using (7) and (8) Term Credit Supply is [(P2)*(7)].	204	

Annexure II – Estimation Method for Credit Demand

ESTIMATION OF CREDIT DEMAND IN THE RAJKOT ENGINEERING CLUSTER					
	Method		Item	Mar, 2012 Estimate	Remarks/Assumptions
	Nayak Committee Approach - Working Capital	1	Cluster Sample Turnover (MSEs), Sample Size - 34 units in MSEs Sector		D&B Survey
		2	Total Number of MSE units in the cluster	2063	Rajkot Engineering Cluster Diagnostic Report
		3	Estimated the Cluster Sample Total Turnover (MSEs, Rs crores) for year ending Mar, 2011	170	D&B Survey
		4	Estimated the Cluster Total Turnover (MSEs, Rs crores) - Mar, 2012, Expected growth rate of 9.8%	10,055	Expected growth rate is estimated from National IIP growth rates Source- Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug, 2011
		5	Basis Nayak Committee Guidelines, Working Capital Funding Requirement is 20% of Projected Turnover calculated in (3)	2011	
	D&B Approach - Term Capital	6	Cluster Sample "Investments in Plant & Machinery", Sample Size - 45 in MSE Sector (Rs crores)	67	D&B Survey
		7	Total Number of MSE units in the cluster	2063	Rajkot Engineering Cluster Diagnostic Report
		8	Estimated the Cluster Total "Investments in Plant & Machinery" (MSEs, Rs crores) using (1) & (2) for year ending Mar, 2011	1113	
		9	Value in (8) projected to Mar, 2012 level using moving average growth rate of fixed capital for Industry-state wise (45%)	1610	Source - Annual Survey of Industries (ASI) estimates on Fixed Capital for different industries within a state – MOSPI ASI Report, 2009-10
		10	(9) - (8) gives the growth in fixed capital	497	
		11	80% of (10) is estimated to be Term Credit Funding Requirement	398	
	Total Credit Demand	12	Total Credit Demand [2011+398] calculated above in [(5) and (11)]	2409	



Rourkela Engineering Cluster

Overview

Rourkela is located in the mineral rich district of Sundargarh, also the industrial capital of the state of Orissa. The engineering cluster of Rourkela mainly consists of machining and fabrication units and the core activity of the units is structural and equipment machining, and fabrication. The cluster mainly caters to metallurgical, cement and power sector. There are more than 220 MSMEs¹⁵ in the cluster, out of which 190 fall in MSEs segment.

The growth of the cluster can be traced back to the establishment of factories in the adjoining area such as Orissa Cement Limited (OCL) plant at Rajgangpur in 1951, Hindustan Steel Limited (now Rourkela Steel Plant) in 1955 and Utkal Machinery plant (Now Larsen and Toubro's Heavy Engineering). These factories provided impetus to rapid industrialization of region in and around Rourkela. A large number of sponge iron, steel melting (Induction Furnace), and Re-Rolling units came up in and around Rourkela, catering to the need of both large & medium scale and also small individual customers. Currently, there are 35 sponge iron units, 40 induction furnace units, and 10 rerolling mills. Sponge iron produced is used mainly as an alternate to scrap for melting. There is a lack of effort on entrepreneurs to produce value added products from sponge iron and explore additional markets for their products. There has been a significant increase in competition from other clusters coming up in Jharkhand and Karnataka and this requires initiatives in different business functions (such as operational efficiency, marketing, new products introduction etc.) from units in the cluster to remain competitive.

The fabrication and machining units present in the cluster are supplying equipment and structures for above units, in addition to serving SAIL, RSP, and other plants directly.

NSIC implemented cluster development programme for the foundry sector of Rourkela in the year 2002. Later, UNIDO implemented a cluster development programme during 2005-08, where the project's objective was to promote the economic growth of the cluster. SIDBI implemented BDS market development programmes under MSMEFDP aimed at instilling sustainability and functionality among BDS providers. It has brought in systemic change in 19 clusters on pan India basis, including the Rourkela Engineering Cluster.

The local support service in the cluster is unorganized and there is lack of awareness of availability of support services in the area. Majority of micro units have not used the fee based service and do not have access to institutional finance. The support institutions present in the cluster include:

¹⁵APITCO Cluster Diagnostic Report, July 2009 under MSMEFDP

- Government support institutions include DIC, Development Institute-MSME, NSIC, Testing Lab, Employment Exchange, OSIC, Orissa State Finance Corporation (OSFC), and Orissa Industrial Infrastructure Development Corporation (IDCO).
- Industry Associations include Rourkela Chambers of Commerce and Industry (RCCI), Orissa Young Entrepreneurs Association (OYEA), District Small Scale Industries Association (DSSIA), and Orissa Assembly of Small and Medium Enterprise (OASME).
- Private BDS providers in different fields such as audit, design, testing, and skill development.

The following table summarizes the information on Rourkela Engineering cluster.

Rourkela Cluster Summary – MSEs				
Type of Units	No. of Units	Employment	Turnover (Rs. Crores)	Investments (Rs. Crores)
Micro Units	150	4620	316	94
Small Units	40			
Source: Diagnostic Study Report, July 2009, prepared by APITCO limited and D&B India Survey				

The estimates of “Investment (in Plant & Machinery)” and Turnover have been prepared on the basis of D&B Sample Survey, while number of units and cluster employment figure has been borrowed from Diagnostic Study (DS) Report, prepared for SIDBI in 2009.

Sources of Demand for Credit – Opportunity and Risks

Material Linkages

Machining and fabrication units buy their material i.e. steel rods, sheets, channels, beams and plates locally and through dealers. Retails branch of Rourkela Steel Plant (RSP) also supplies in bulk quantity. Special steels and stainless steel is procured from Kolkata and Mumbai. Sometimes inventories have to be maintained for such items. Orissa Small Industries Corporation is also supplying to the small units as it gets its discounted supply from RSP the benefit of which is passed on to the units. Its services are not fully utilized by the units due to procedural problems. Other than the steels available from Rourkela steel plant, steel products of private steel plants like Jindal, Bhushan steel are also consumed through dealers. **There is no credit system in purchase of steel, however due to long standing business relationship between the units and traders, short term credit of 3 to 7 days are generally negotiated.** There are local traders who stock and supply welding consumables, inert gas and miscellaneous items.

Sales Linkages

The units in and around Rourkela presently do the marketing of their own without engaging any outside agencies. The enquiries are obtained from organizations and the quotation is prepared with

detailed study of drawings. **Most of the clients go for lowest bid, which are further negotiated based on technical requirements, quality adherence and once accepted the order is placed by the client.** Rourkela steel plant outsources 25 % of their machining and fabrication work from the cluster. The units have to be registered with RSP for getting enquiries and participate in tender. Number of power plants is being established in the eastern region, the equipments and components required for power plant are procured from the fabrication cluster located in southern and western region of our country.

Technology

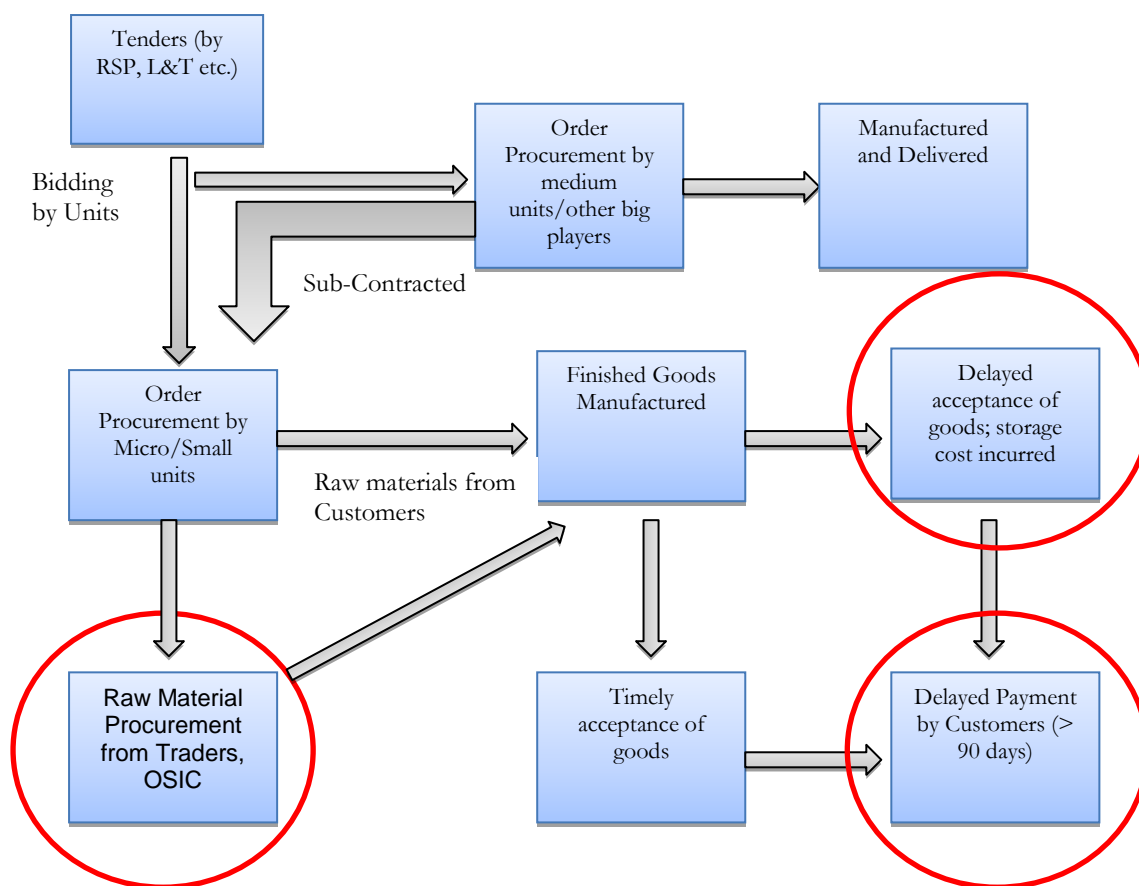
The cluster manufactures products related to cement, paper and metallurgical plants and **employs conventional welding and cutting equipment and machinery resulting in increase in man-day for completing a job.** If the cluster goes for modern machineries like CNC multi nozzle cutting machine, automated welding machine etc., there is scope for at least 25-30% increase in production resulting in execution of more tonnage of work per month. Relatively larger firms have capability to manufacture power plant equipments which are of high value with the existing facilities but lack technical inputs on design capabilities.

Registrations and Rating

Most of the firms operate from illegal premises or rented land. Since most of the micro units sub-contract to larger units, these tend to operate out of the premises of the larger units. As a result, there is no formal lease or rental agreement which can be produced as evidence of operations. Further, Dun and Bradstreet and SMERA are constantly covering registrations and banks have now started accepting these. Hence, this also increases the need for working capital finance.

Registrations like Export Marketing (EM and EM1) require mandatory stocks of inventories to be carried all the time; failing to which these registrations are canceled. Hence, for those units which engage in exports, the working capital requirements are higher.

Below is the schematic of the value chain of the cluster:



In the diagram above, the term “customers” is synonymous with the players such as RSP, L&T etc. that float tenders for outsourcing of fabrication/machining jobs. The red circle zone represents major huddle for MSE units operating in the cluster.

Supply of Credit to MSEs

Estimate of Outstanding Credit to MSEs in the Engineering Cluster

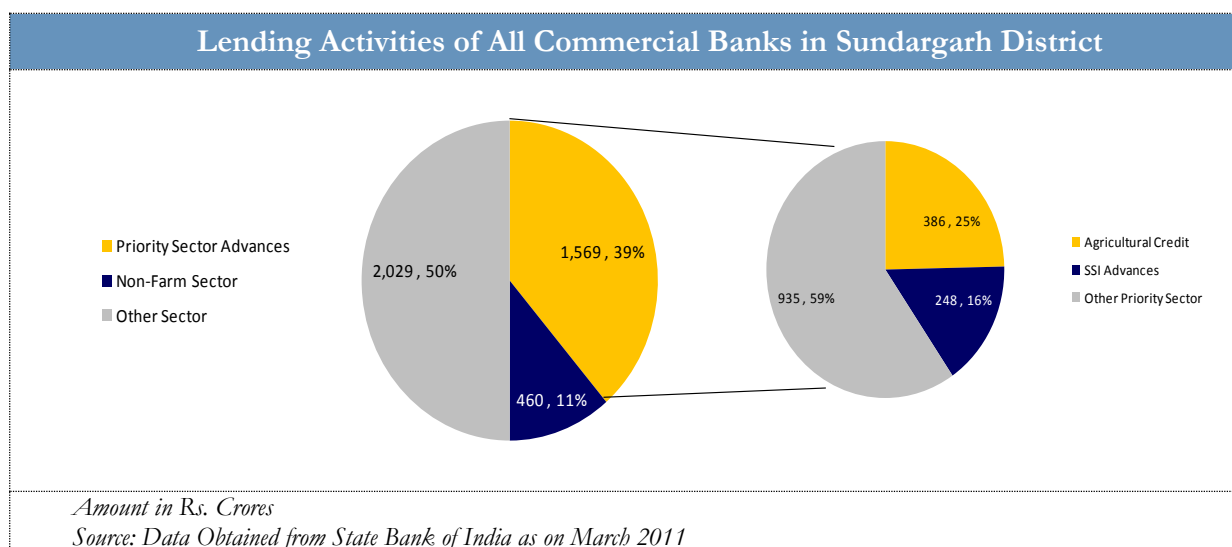
The credit supply to the Rourkela Engineering cluster is estimated to be Rs. 42 crores out of which Rs. 5 crores (11%) is term credit and Rs. 37 crores (89%) is working capital supply.

Enterprise turnover is one of the important criteria for loan appraisal process and it can be safely assumed that credit supply to the cluster is correlated to the turnover generated. Thus, D&B proposes to use the “Cluster Turnover proportion to Industry State Turnover” method to arrive at cluster level credit supply.

The steps for computation under the identified Methodology are detailed in Annexure I.

The data obtained through the above methodology was further validated against the data on outstanding advances collected from the lead bank in Sundargarh district.

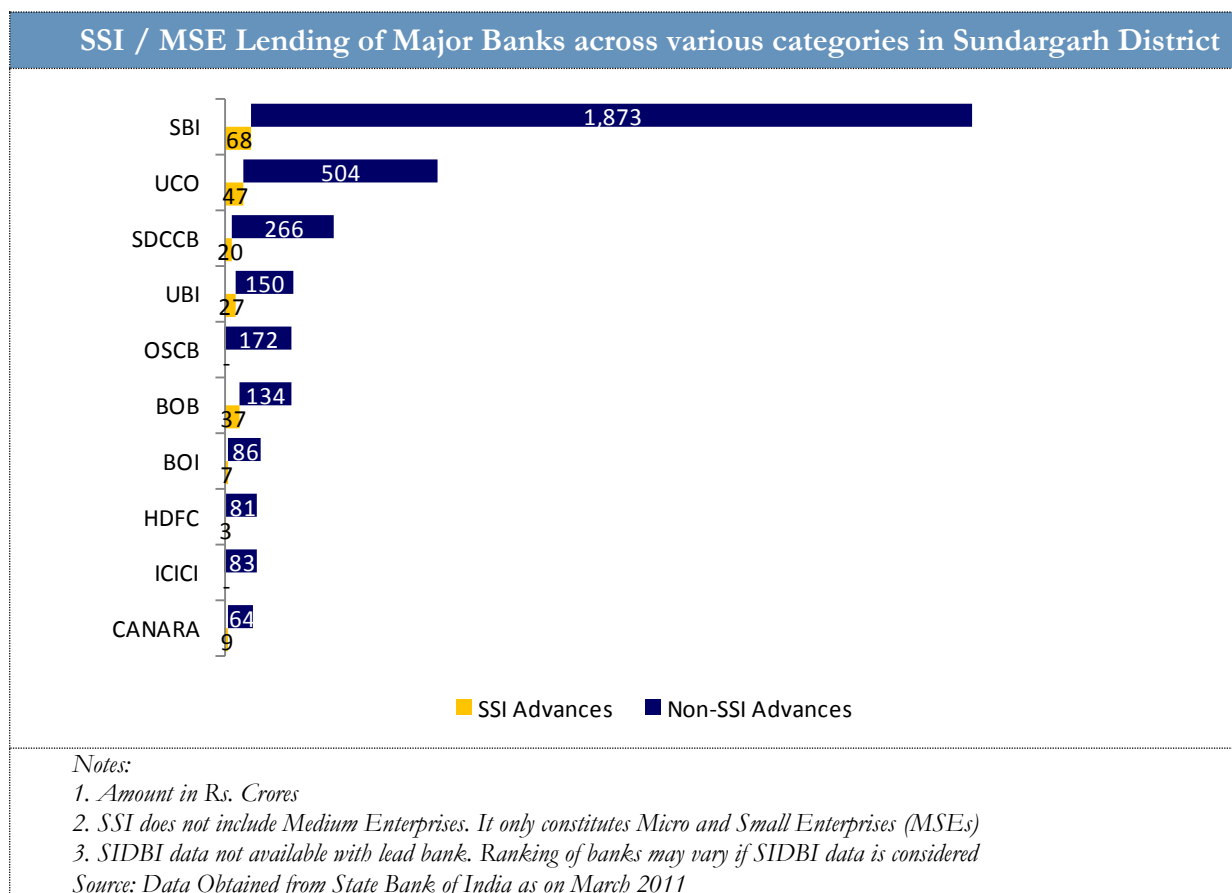
The RBI Lead Bank Scheme management is implemented by State Bank of India as the lead bank in the cluster. According to information obtained from the lead bank, an aggregate of about Rs. 4,000 Crores was disbursed under various forms of advances to multiple beneficiary groups like Priority Sector, Weaker Section Loans, Advances to Small Farmers, Advances under DRI Scheme, Other Schemes etc. The following exhibit depicts the banking flow of credit in the Sundargarh District. It can be clearly seen that the Priority Sector Advances in the Ludhiana District are around the prescribed lending norms of 39 – 40%.



SSI / MSE Advances

The proportion of SSI (MSEs) advances in the total priority sector lending indicates the development focus of the particular district. The SSI / MSE Sector receives around 6% of the total credit disbursements in the cluster. This is also around 16% of the total priority sector advances. A larger proportion of the credit is provided to the other Priority sector and agricultural credit.

The following is the composition of SSI and non-SSI Advances in Sundargarh as of March 2011

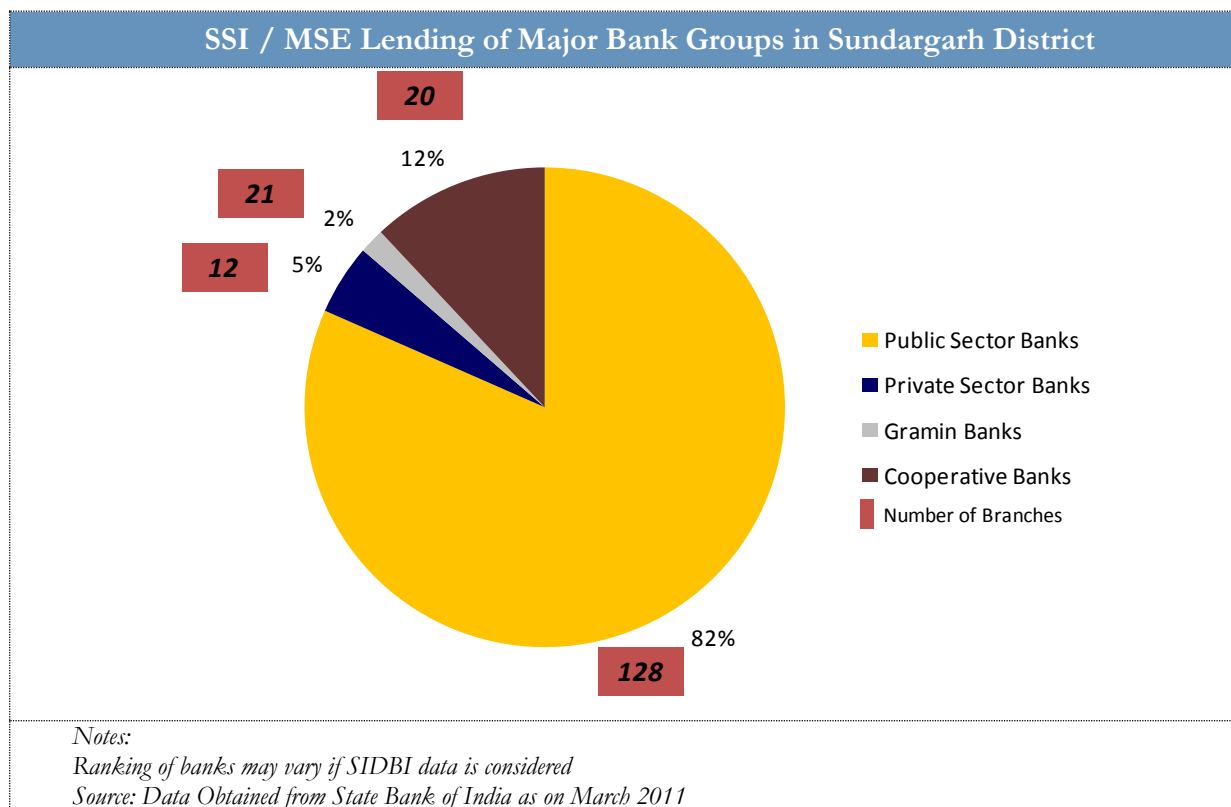


On interactions with the various banking bodies, it is estimated that only 1% of the total credit in the Sundargarh district is available for the Rourkela Engineering Cluster, while major lending is directed towards other clusters.

Performance of Banks

The State Bank of India is the lead bank in the district and is also leading the share of credit of banks to total disbursements. The aggregate disbursements of SBI in Sundargarh account for around 48% of the total credit disbursements in the district.

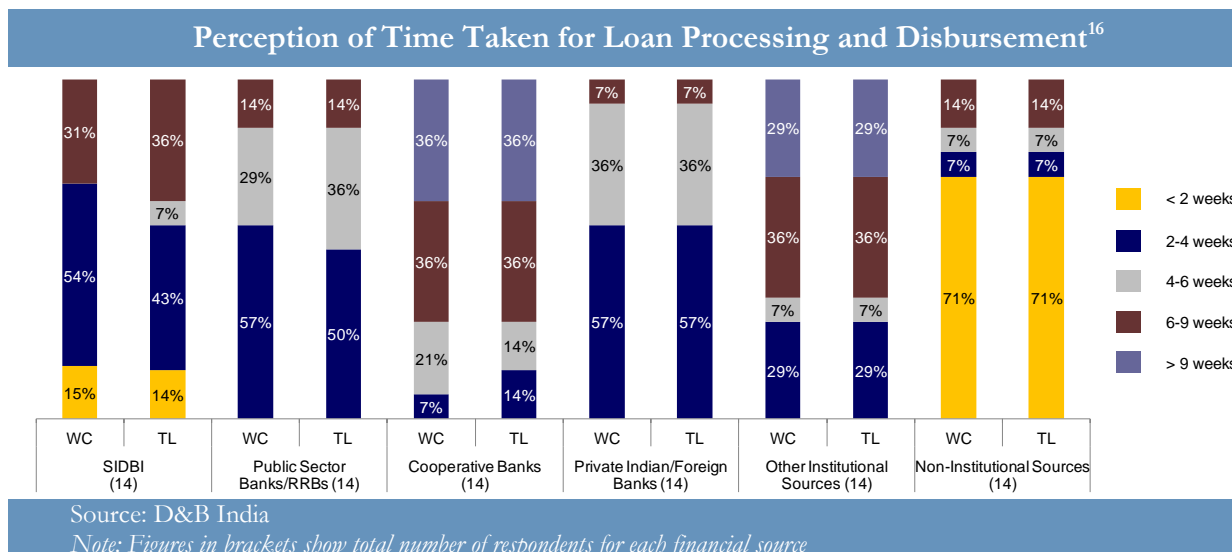
In terms of aggregate credit disbursements, the above indicated 10 banks contribute to around 90% of the aggregate credit disbursements in the Sundargarh district. It can be seen that around 17 Public Sector Banks share 82% of the total credit disbursements in the district indicating strong influence of public sector banks in the financing activities in the district.



Of these disbursements, the private sector banks like HDFC, ICICI and Axis contribute to 5% of the disbursements.

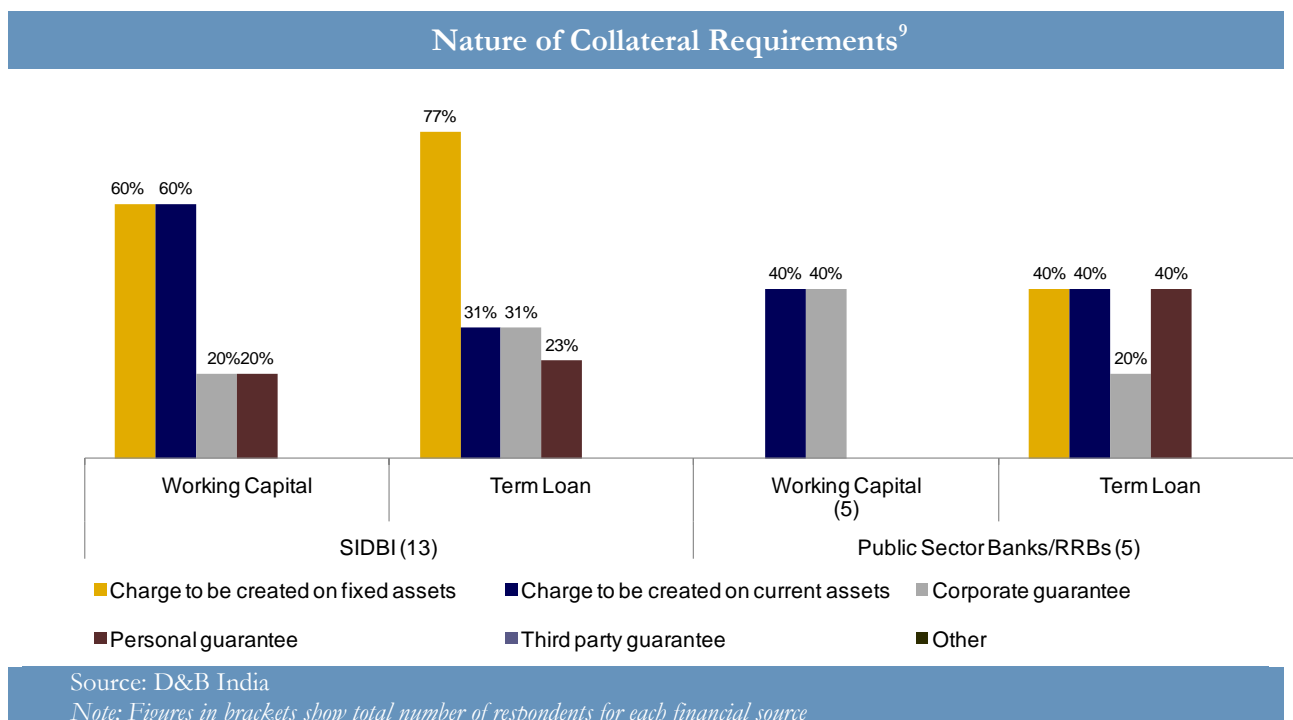
14 SIDBI customers were surveyed on the overall perception of SIDBI, as well as on attributes such as time taken for loan disbursement and collateral requirement. While respondents believed that SIDBI would largely take 2-4 weeks to process and disburse loans, a couple of them reported that it would take less than 2 weeks. 2-4 weeks was also the norm in the case of Public and Private sector banks. The only source that is believed by a greater number of respondents to take less than 2 weeks for loan processing and disbursement is the non-institutional source.

The following chart depicts perception among respondents of time taken for loan processing and disbursement by various financial sources.



Many MSMEs are of the opinion that high loan processing time is a major obstacle with respect to availing of loans in the cluster.

The following chart shows the nature of collateral requirements across various financial sources.



SIDBI customers as well as Public Sector Banks and Regional Rural Banks customers are asked for charge on fixed assets, charge on current assets, and corporate guarantee.

¹⁶ Relates to 50 respondents from the Rourkela Engineering Cluster only

Demand for Credit by MSEs

Estimate of Credit Demand by MSEs in the Cluster

There are two methods that D&B India has followed to arrive at Total Credit Demand at cluster level, as mentioned in the methodology section. The methods involved are:

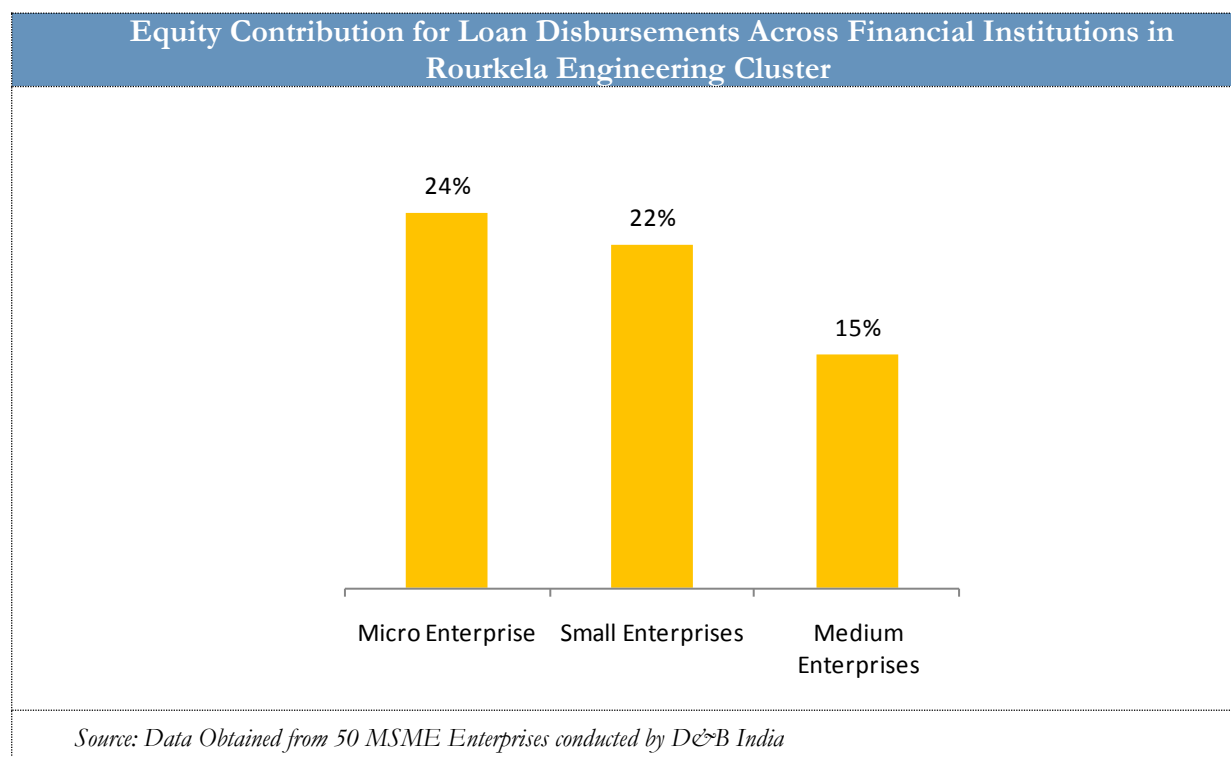
Nayak Committee-D&B Approach

- a. Working Capital Demand - Turnover Based Approach (Basis – Nayak Committee Guidelines)
- b. Term Capital Demand - D&B Approach (Basis – Growth in Fixed Capital)

Below are the highlights of the credit demand estimates in the cluster:-

- ❖ Total number of Micro and Small units in the cluster is 190
- ❖ The turnover for the Rourkela Engineering MSE cluster is pegged at Rs. 316 crores during 2010-11 from the D&B survey at cluster level.
- ❖ The turnover is estimated to rise by an annual average growth rate of 4.4% (IIP estimate) to Rs 330 crores in the year 2011-12.
- ❖ Working Capital Requirement (Basis-Nayak Committee Guidelines) is estimated to be Rs 66 crores
- ❖ Term Credit Requirement (Basis-Growth in Fixed Capital) is estimated to be Rs 18 crores
- ❖ Method 1 - Total Credit Demand is thus obtained from above $[(66) + (18)]$ and is Rs 84 crores

Credit Appraisal Processes followed by various banks differ in terms of time taken for appraisals. However, most of the banks including the lead bank have indicated that for appraisals of working capital loan requirements, the Nayak Committee Recommendations are being followed. It was also observed from the survey that across categories of Micro, Small and Medium Enterprises, this ratio though has varied; the average margin requirement is as per the prescribed Nayak Committee Norm of 20% of the working capital gap. The following chart presents the equity contribution indicated by a sample of 50 enterprises. Nayak Committee recommended a maximum of 80% of the working capital gap as maximum permissible bank finance; it implies a margin contribution of minimum 20%.



It can be seen that for micro enterprises, the demand for higher margin contribution is from the bankers' side. The primary reasons for this is micro enterprises are not able to provide adequate collaterals to support their financing needs and hence are required to provide a higher equity margin. An important reason for lower collaterals being provided by micro enterprises is that these enterprises most of the time do not operate from their own premises and hence, cannot provide land or machinery (which is also rented) as collateral.

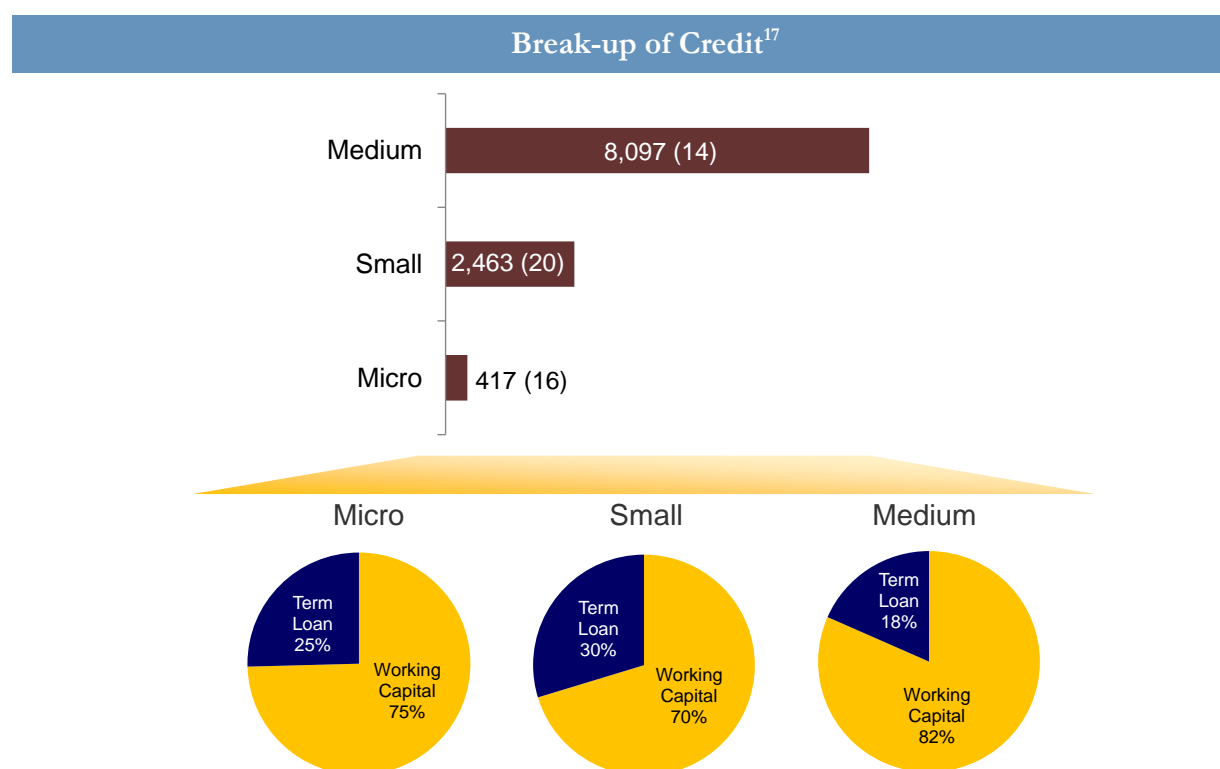
Rourkela is majorly served by the Public Sector Banks such as State Bank of India and Central Bank of India.

While the medium enterprises in Rourkela cluster get contracts directly from big companies, the small and micro firms receive outsourced work from external companies such as Shapoorji Pallonji, which in turn, get contracts from big companies. Such small and micro units have urgent finance needs which are not being met from the financial sources in the region currently. Problems faced by the smaller units include delayed payments from big companies, immense price competition, increase in power tariff, frequent power outages and affordability of DG sets shortage of workers and low wages, use of conventional machines, etc.

The primary reasons due to which the small and micro units are not able to obtain credit are that they do not have bank records or financial statements, as most transactions are cash transactions, and because they are unable to provide any address proof as they operate on land unofficially rented out to them by bigger units.

Industry associations are of the opinion that banks could be encouraged to accept the residence proof of owners for extending credit, and could consider extending bills discounting facility with relaxed guidelines, so that such micro and small units are able to overcome the credit crunch and other problems faced due to limited financial sources. SIDBI officials suggest that instead of extending general working capital facility, banks could consider extending the facility against specific orders which would remain valid for the duration of the order. This would enable small units to execute bigger orders, which they might otherwise not be able to execute due to high working capital requirements.

The following charts show the composition of credit among the 50 respondents from the Engineering Cluster interviewed in the survey. While 40% of the total respondents were small enterprises, 32% were micro and 28% were medium enterprises. Also, major requirement in the cluster is for working capital loans, in all categories.

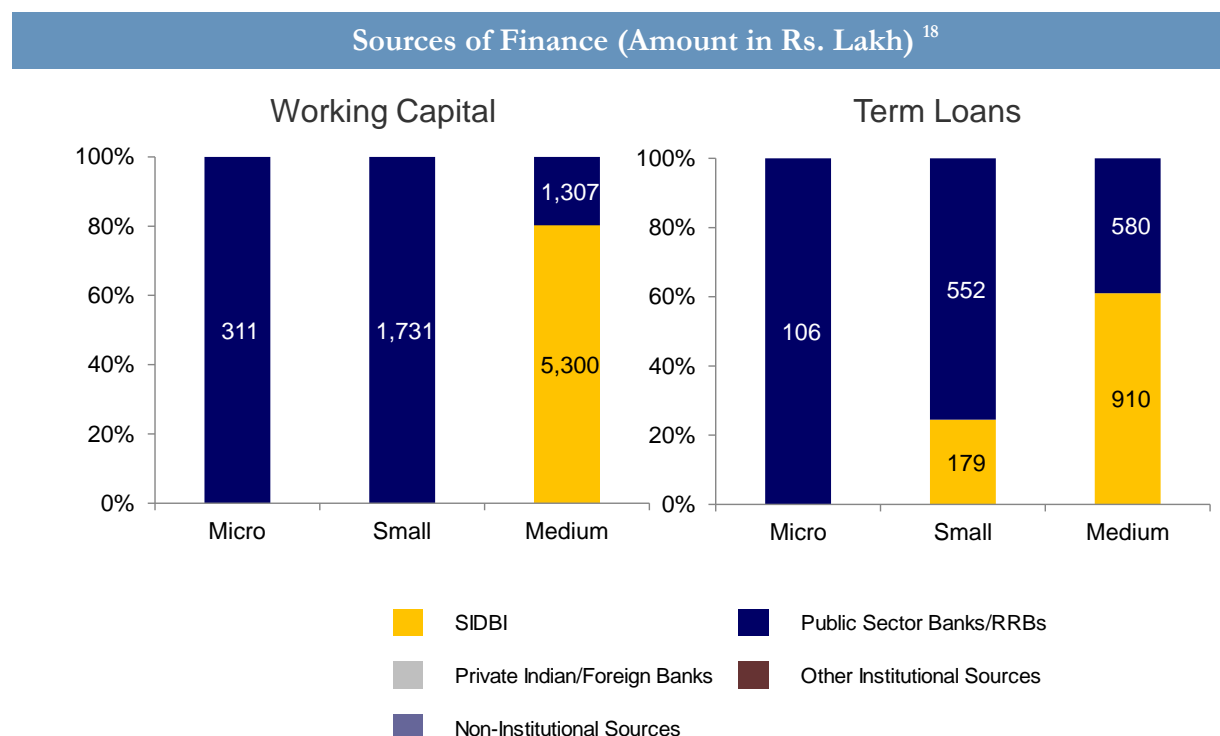


Source: D&B India (Amount in Rs. Lakh; number of respondents in parentheses)

While the credit available to a micro firm is 1/10th of that to a medium in almost all clusters studied, the same in Rourkela engineering cluster is 1/100th of that of a medium firm. This reiterates the feedback given by the industry associations in the area that credit crunch is faced mostly by the smallest firms in the cluster due to various problems stated.

¹⁷ Relates to 50 respondents from the Rourkela Engineering Cluster only

The following chart shows composition of working capital and terms loans for the 50 respondents by sources of finance, separately for Micro, Small and Medium enterprises. As noted earlier, Public Sector Banks and Regional Rural Banks are the major sources of Working Capital as well as Term Loans across all sizes of enterprises. SIDBI is a significant contributor in medium enterprises for Working Capital and in small and medium enterprises for Term Loans.



Credit Gap in the MSE Segment

For the current study, D&B considered the credit supply data of only scheduled commercial banks that form the major source of credit supply. The table below contains the estimated Credit Gap in the cluster on the basis of the two methods.

Method	Total Gap	Credit Supply	Credit Demand	Working Capital Demand	Term Capital Demand
Nayak Committee-D&B (In Rs. Crores)	42	42	84	66	18

Summary of Credit Gap Assessment

Though, Rourkela is relatively small engineering cluster compared to its benchmark Rajkot cluster, it has significant importance due to its useful to nearby steel and cement industries. Total credit gap in

¹⁸ Relates to 50 respondents from the Rourkela Engineering Cluster only

the cluster is approximately 41 crores, much less than Rajkot cluster and it is primarily due to lesser number of units present in the cluster and lesser average turnover for micro and small units compared to that of Rajkot cluster.

The primary component of total credit requirement emanated from working capital needs compared to term capital needs and following are the reasons for the same:

- Raw material linkages for coal and iron are not well established hence either raw materials or finished goods inventories need to be carried
- Registrations cause higher inventories to be carried by firms increasing the demand for working capital
- The benchmark cluster for Rourkela is Rajkot Engineering Cluster and compared to this cluster, the productivity is much lower, and hence output is also lower
- Production outages cause inventory holdings for coal and diesel for generators
- Sales channels are primarily routed through traders and hence, payments are at the discretion of the large traders, which take a longer period for processing

Further, micro and small enterprises compared to medium firms are in greater need of working capital loans because of the following factors

- The enterprises in the cluster primarily do contractual machining and fabrication work. The major customers of the units in the cluster are the big plants such as Bhushan Steel, NALCO, RSP, etc.
- The micro and small units tend to operate out rented premises located in the industrial area. The prevalent practice is that bigger units with extra space tend to unofficially rent out the space to the micro and small units. As the land originally belongs to Orissa Industrial Infrastructure Development Corporation, and cannot be legally sub leased, there are no legitimate lease documents which serve as proof of address. Due to this, the basic documentation for proof of address that is required by banks is not available with micro units
- Another key problem is that majority of the micro and a substantial portion of the small units mainly enter into cash transactions and hence do not have any bank records. In addition they do not maintain regular financial statements, thereby making it difficult for them to avail bank finance.
- Even those units which do prepare financial accounts tend to show lower profits in order to reduce tax liability. The lower profits results in lower net worth thereby further harming their chances of getting bank finance.

- The small and micro units generally experience delays in obtaining payments from their big customers. The raw material suppliers however have to be paid on time and at times, immediately. This causes a gap between cash receipts and cash payments thereby increasing the need for cash and thereby working capital.
- For outsourced jobs to micro/small units, bigger units do not always provide raw materials and have to be procured on their own.
- Raw materials supplies at OSIC are not sometime sufficient and rates offered are same as market ones, so no advantage can be tapped using OSIC service for procuring raw materials.

The small and medium enterprises intend to avail working capital and term loans mainly for technology up gradation and maintenance. Other than these, the following issues are observed in the cluster:-

- Most of the units are currently using traditional or non-automated technology. There is a general opinion that if the cluster goes for modern machineries like CNC multi nozzle cutting machine, automated welding machine etc., there is scope for at least 25-30% increase in production resulting in execution of more tonnage of work per month.
- Developing and contracting necessary linkages and centers within the organization for testing, calibration of equipments, maintenance, etc. are required for medium enterprises. Hence, term loan requirements increase
- SIDBI is unable to provide credit to micro and smaller enterprises, primarily due to absence of documentary proofs and inability to provide adequate collaterals.
- In term credit as well, various problems are experienced with respect to specific loan schemes and loans under CGTMSE are only utilized by medium enterprises.
- Due to operation on illegal premise, many micro/small units cannot furnish the fixed asset collateral to obtain institutional finance.
- Due to non-availability of working capital credit from institutional sources, the units are unable to procure large orders preventing the growth of the units.
- Order procurement trend by micro units has been on decline due to adverse market forces, self-capability of larger firms to complete the task, and reluctance of big firms to sub-contract the task to micro/small units.

The cluster, though having lower productivity compared to other engineering clusters, has enough potential to become one of the fastest growing clusters in India, given its proximity to core industries and unexplored markets for its products. Many units in the cluster are unaware of different support services existing in the cluster and this is a major bottleneck in promoting growth of the cluster. Very few enterprises in the cluster have access to institutional finance. This presents a significant

opportunity to the financial institutions to participate in the growth of the cluster through its credit awareness and lending programs.

A Note on Impact of BDS Implemented under MSMEFDP in Rourkela Engineering Cluster

BDS activity in the Rourkela Engineering cluster under the MSMEFDP project primarily focused on interventions in four major areas – Marketing, skill training, Energy studies and technology up-gradation. Around 40 new service providers were introduced to the cluster.

Associations and firms could realize the advantages of these interventions. The first milestone was achieved with interventions in the area of Marketing, by the way of formation of consortium (by 10 firms) with the coordination of the Associations. The consortia have been able to bid for projects worth Rs. 158 Crore till date. They have received orders worth Rs 11.25 Crore. Linkages have been established with major industries like Nalco, Vedanta, HEC, PPT and NCL.

Another major area covered was intervention through skill development training programmes such as TOT and NDT programmes. As a result 74 persons were upgraded in technical areas and 165 candidates were trained in welding, fitting, Auto CAD, etc.

Similarly, training in Energy Conservation was imparted to 15 firms. Energy audits demonstrate that nearly Rs. 16 lakh of savings accrued with a pay-back period of 3-5 years. Interventions also resulted in the installation of automated CNC machines and Portable Cutting tools in 6 firms. An improvement in terms of quality as well as productivity increase of 25% to 40% was experienced.

Overall the Project Impact include (a) Turnover of the cluster has gone up from Rs 257 Crores per annum to Rs 512 Crores per annum (b) Capacity of the cluster to meet the orders has gone up from 4000 TPA to 6720 TPA and (c) Employment has gone up from 2075 to 3310.

Recommended Products and Delivery Channels

Requirement of Capital

The primary credit need of the MSEs is for working capital and there is minimal requirement for term loan. This is due to the fact that most of micro and small firms do not have continuity in their operation due to intermittent order (and that too small ones) procurement, thereby leading to their reluctance of expansion.

The specific capital needs and associated issues that arise are:

- Raw material procurement

- Raw materials supplies at OSIC are not sometime sufficient and rates offered are same as market ones, so no advantage can be tapped using OSIC service for procuring raw materials.
- Under the scenario where micro/small units have to procure raw materials, the cost of raw material acts as a deterrent for them to execute order in a profitable manner since the cost of making the end products exceeds the agreed price of end products in the order agreement.
- Due to non-availability of working capital credit from institutional sources, the units are unable to procure large orders preventing the growth of the units.
- Finished goods storage cost
Big players, who sub-contract to MSEs, tend to delay accepting the supplies and thus MSEs incur extra storage cost, for which they need working capital. The delay, sometimes, extend to months making difficult for units to manage the cost.
- Power Tariffs
Increase in power tariffs has further hampered the business operations of the units in the cluster. Last year tariffs were raised by 40%. This year, tariff hike of 30% was proposed however it has been stayed by the court.
- Delayed payments from customers leading to inability to procure and execute further orders.
Delayed payment from big players to micro/small is also significant in the cluster and this makes Bills Discounting facility under current repayment tenure of 90 days becomes non-profitable scheme for smaller units. Further, smaller units can't introduce a delayed payment penalty clause in the order agreement as this puts them at a disadvantage in procuring order.

It is important to note here that the primary/critical requirement of working capital emanates from “Raw material procurement”, and “Delayed payment from customers”. The section below highlights the existing financial support to cater to these needs and how new products/mechanism can be devised to better address the above problems.

Working of Government Schemes

Credit Linked Capital Subsidy Scheme (CLCSS)

Aimed at technology up gradation of the small scale enterprises, the Government (Ministry of SSI, now Ministry of MSME) has been operating a Credit Linked Capital Subsidy Scheme since the year 2000. The scheme aims at facilitating technology up gradation for improvement in productivity of the SSI / MSE units, by providing them 15 per cent (initially it was 12 per cent) upfront subsidy.

Most of MSEs are not looking to upgrade their machinery/set-up facilities as they are not sure of procuring order all the time. There is insufficient linkage in the cluster leading to unpredictability of continuous operation of the units. This makes the micro/small units reluctant to go for machinery up-gradation due to increased financial burden with unpredictable and untimely cash inflows.

Credit Guarantee Trust Scheme for Micro & Small Enterprises (CGTMSE)

The Credit Guarantee Fund Trust Scheme (term loan and working capital loan both) for Small Industries was introduced by the Government (Ministry of Small Scale Industries) in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.25 lakh without collateral/third party guarantees. The scheme is being operated through the Credit Guarantee Fund Trust for Small Industries (CGTFSI) set up jointly by the Government of India and the Small Industries Development Bank of India (SIDBI).

Units face adverse market forces in the form of very competitive pricing and high raw material cost and as a result, the MSEs are reluctant to avail this scheme as it makes them more uncompetitive because of higher borrowing cost (one time charge of 1.5% of the borrowed amount and yearly charge of 0.75%). Further, banks are reluctant to lend under this scheme as MSEs are operating in intermittent manner and repayment risk becomes high.

Bills Discounting

The current bills discounting facility is mainly availed by medium/bigger units. SIDBI and other financial institutions do offer this product in the cluster. The current credit offered by SIDBI under bills discounting stands at Rs. 40 crores. The buyer/debtor has to pay within 90 days under the current covenant associated with this credit product.

On discussion with various stakeholders in the cluster namely SIDBI, MSEs, and BDS providers, D&B India found that there is frequent delay in payment (> 90 days) by customers of MSEs and this makes bills discounting an uneconomical means of financing.

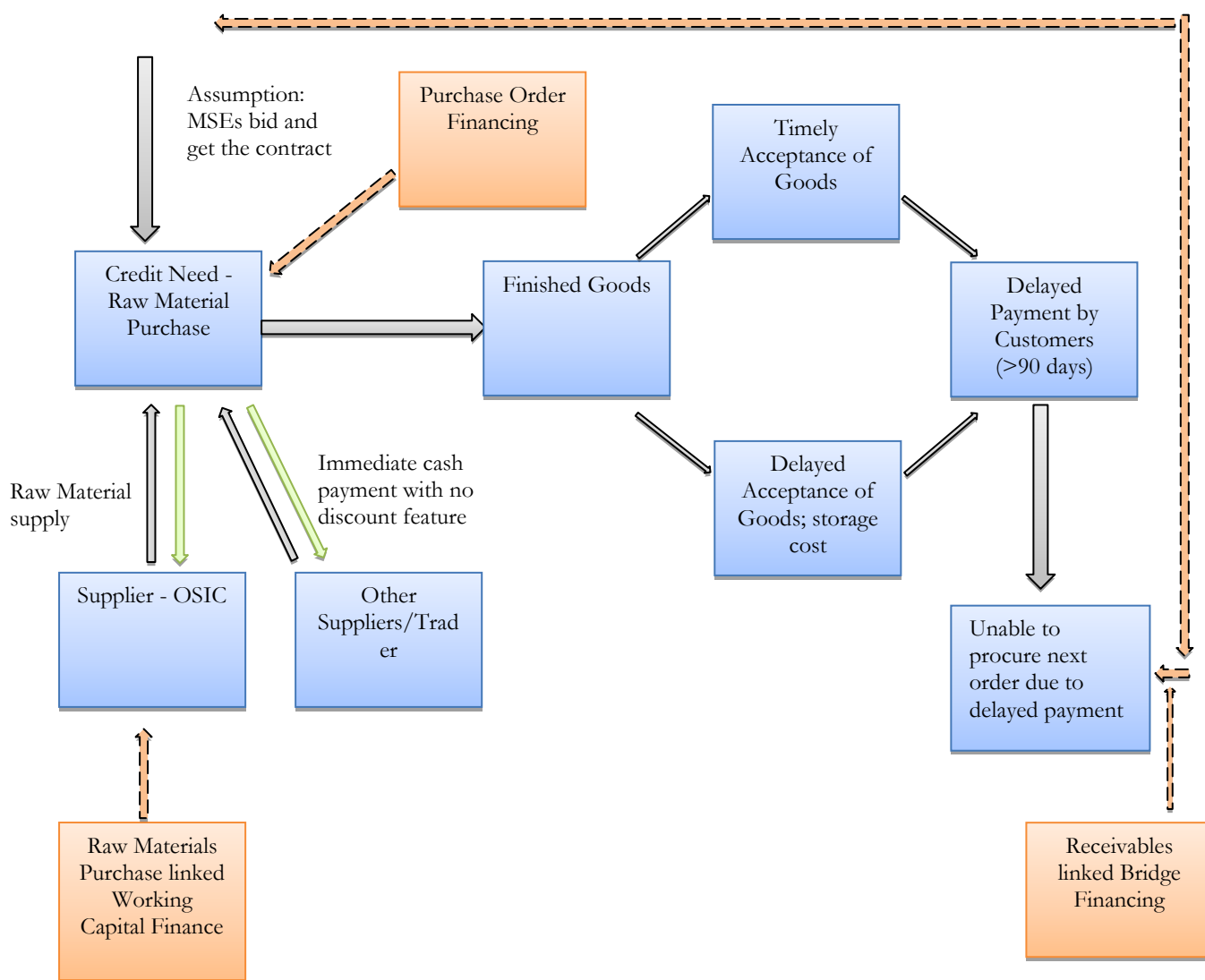
There are also general term/working capital loans available from different financial institutions but they are not of much use given the fact that most of MSEs operate out of illegal land premise and can't furnish fixed asset collaterals.

Descriptions of Products and Delivery Mechanisms

In light of the above discussion, one of the major problems associated with MSEs in the cluster is the lack of fixed asset collateral. This becomes a major hurdle for units to procure working capital

loan, which is the major requirement in the cluster. Other than that, there has been little support to MSEs from financial institutions and major focus has been on medium and bigger units. The above coupled with lack of discipline from bigger players to make timely payments to their suppliers (MSEs) has hampered the growth of the units in the cluster. Affordable and economically viable working capital financing is the need of the hour in the cluster. Loan products need to be structured to match the payments to the borrower's cash flow cycle and address specific credit needs that exist in the cluster. Further, financial institutions need to have a greater focus on providing credit based on cash flow rather than based on collaterals, which is mostly absent with the MSEs, and also create a mechanism to evaluate the economic viability of the project. Further, to propel the growth of the cluster, MSEs need to be promoted to take up bigger orders, which they are unable to do currently due to lack of working capital financing.

Below is the representation of MSEs critical credit needs and suitable financial products to address the same



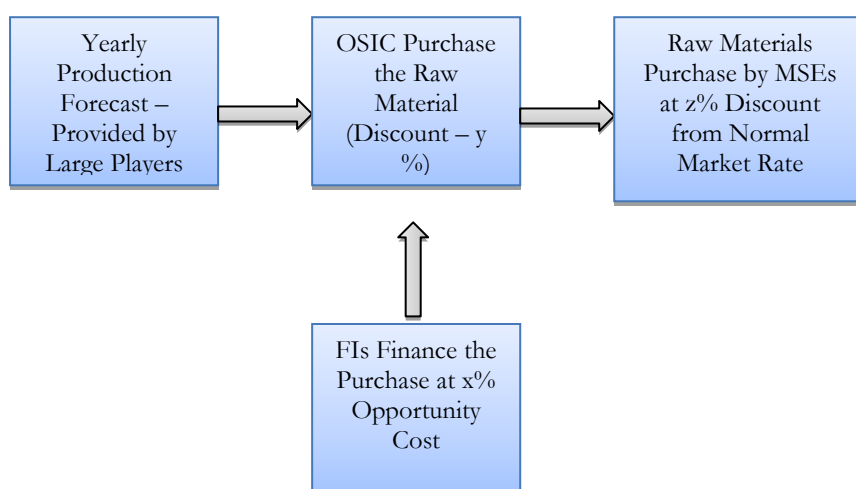
The dotted line indicates potential future linkages (basis the use of recommended financial products) and orange box indicates the type of products that may be introduced to cater to specific needs of the cluster

The detail on each product is elaborated below.

Raw Materials Purchase Linked Working Capital Finance

Under this scheme, the financial institutions (FIs) shall finance the raw material purchase and Orissa Small Industries Corporation (OSIC) shall be the implementing institute as it is already supplying raw material (though limited) to different units. Below are the salient points of the scheme:

- Since MSEs cater largely to the industries within the cluster, a forecast of the yearly production (output) of large units can be obtained directly through large players itself.
- Based on the above forecast, OSIC shall purchase the raw materials in bulk, get heavy discount, and get financed by FIs, with raw materials serving as collateral and OSIC serving as guarantor.
- OSIC becomes the major supplier of raw materials to the MSEs present in the cluster at a discount.
- For the loan facility to be economically feasible, the basic condition that may have to be checked at the cluster would be $(y\%-z\% > x\%)$



The mentioned scheme would facilitate a better growth of MSEs as it would promote them to procure bigger orders.

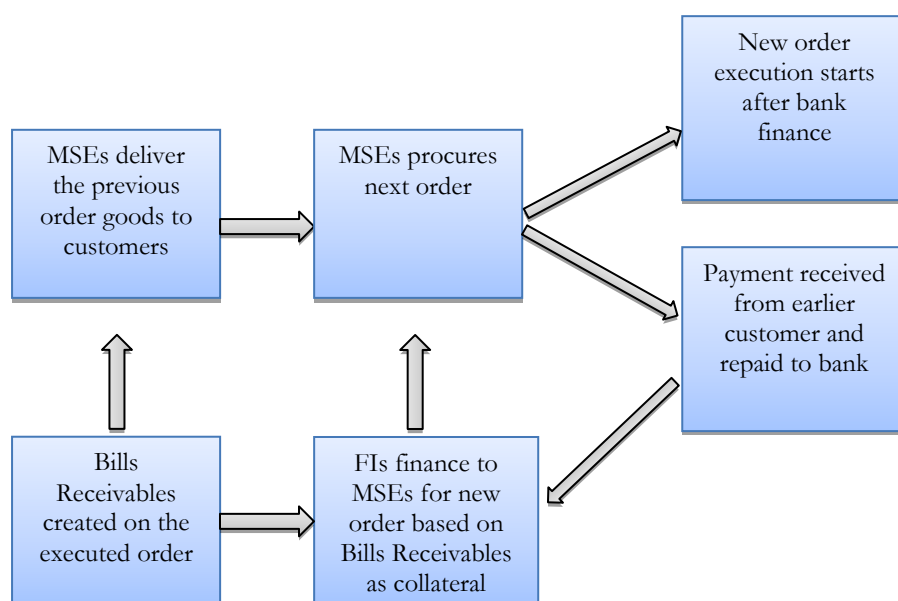
Receivables linked Bridge Financing for Working Capital Finance

One of the major factors inhibiting Bills Discounting in the cluster is the lack of payment discipline amongst buyers. The major beneficiary of bills discounting facility is the larger units. The restricted use by MSEs is because of delayed payment (often payment duration exceeds 150 days) by their customers. This creates a serious and endemic problem in the cluster for MSEs of inability to procure future orders. Using post-dated Cheques (by debtors) has been in practice for implementing bills discounting facility in western world but it does not seem to be feasible in the current scenario where bigger players largely govern the working of the cluster in terms of conditions/agreement with contractors (MSEs)

The possible solutions that can be addressed using existing Bills Discounting facility are:

- Flexibility from the current 90 days period for repayment by debtor shall be the key to effective growth of this facility in the cluster. 90 days period could be extended to 150 days to suit the requirements of the cluster. Further, the covenants and returns on modified bills discounting should be worked out to get a viable funding model for MSEs
- Another way for receivables bills to work in favor with MSEs shall be to club with bridge financing concept, where funding can be extended with bills as collateral to enable the units to take further order and not suffer from the delayed payment from debtors (customers).

Bridge financing is used to maintain liquidity in the scenario of anticipated cash inflows. This can be seen as temporary loan that shall map the sales receivables cycle to future order procurement to facilitate continuous operation of MSEs. Below is the schematic how bridge financing shall work addressing the specific need of the cluster.



Up-scaling of Microfinance to Meet Credit Requirements of Micro enterprises

Orissa is one among the top 5 states in terms of the number of microfinance clients. Microfinance has made significant inroads into Orissa, creating a conducive culture for the financing mechanism. The total number of microfinance clients in Orissa (Credit Self Help Group (SHG) members and MFI Client put together) stood at roughly 62 lakh in 2010. The SHG model is predominant in Orissa. There are roughly 46 lakh credit SHG members and 16 lakh MFI clients in the state. Microfinance loans in Orissa aggregated to Rs. 2,680 crores in 2010, with average loans outstanding per household standing at Rs. 7,582.

There are roughly 150 micro units in the Rourkela Engineering cluster. Micro enterprises in the cluster primarily do contractual machining and fabrication work and tend to operate out of rented premises located in the industrial area. The prevalent practice is that bigger units with extra space tend to unofficially rent out the space to the micro and small units. As the land originally belongs to Orissa Industrial Infrastructure Development Corporation, and cannot be legally sub leased, there are no legitimate lease documents which serve as proof of address. Due to this, the basic documentation for proof of address that is required by banks is not available with micro units. Further, these enterprises mainly enter into cash transactions and hence do not have any bank records.

Up-scaling MFIs would prove to a potent method to handle this issue. MFIs that upscale typically target the lower end of the SME spectrum that have more features in common with their existing microfinance clients, as reflected by the average loan size of micro firms. For micro firms operating on the verge of informality, up-scaling of micro-finance seems to have great potential. In such cases, up-scaling would comprise offering financial services/products that cater to the special needs of a micro enterprise. The benefits of up-scaling may encourage a transition from an informal to a formal enterprise.

MFI active in the Sundargarh district modify their microfinance business models to incorporate SME operations by taking advantage of their market knowledge and network, and by adapting their microfinance methodologies.

Refinancing (or on-lending) and other support from development finance institutions, such as SIDBI, would be critical for helping MFIs adapt their current lending practices to serve the new clientele, as well as in building the MFIs' capacity in staff training and information management.

Further, a few issues need to be addressed before up-scaling of MFI can become a sustainable model:

- New Product Development

- Collection Cycle
- Recovery Mechanism
- Capacity Building for MFIs and Borrowers

Typically, MFIs have daily/weekly collection cycle, which calls for modification while serving micro and small manufacturing units. MFIs need to understand the borrower's business and particularly "Asset Conversion Cycle" and revise its credit collection cycle to suit the needs of borrowers and simultaneously ensure profitability of the lending business model. Suitable loan products and associated attributes (interest rate, tenure, and credit amount) need to be developed keeping in mind the nature of borrowers business. This shall be particularly important because the product and its attributes shall govern the efficacy of collections affecting top-line growth. Further, training would be needed both for MFIs and borrowing micro units on the business cycle, lending model, and practices adopted to ensure smooth implementation.

Historically, the MFI lending model had been successful despite the high borrowing rate of MFI from Banks. Companies in this space had built a sound base of foot-workers, creating an effective credit delivery and recovery mechanism and with the help of SHG/JLG model, they could cut down on transaction costs. This was a unique differentiator for MFIs compared to banks that did not have such effective mechanisms for credit delivery and reducing transaction costs. However, MFIs charged very high interest rate and allegedly followed coercive credit collection practices to make the lending model economically sustainable and these cast serious doubts on socially driven objective of MFIs. This has led to widespread criticism from different corners and threatened the very existence of MFIs. What followed was Andhra Pradesh MFI Act to regulate MFIs in the state and RBI Committee (Malegam Committee) Report on MFI sector detailing issues, concerns, and recommendations on the prevailing ill-effects of the MFI lending and recovery practices. The committee also reviewed the proposed Micro Finance (Development and Regulation) Bill 2010 and recommended few changes to it along with its own set of recommendations on MFI regulation.

Though, the recent MFI regulation in AP, and the more recent draft bill on MFIDR have put the MFI lending model under a scanner, the potential for such model to work effectively does exist.

Financial Inclusion Initiatives under the MSME-FDP Programme

BDS initiatives under the MSME-FDP have helped establish linkages among SBI, SIDBI and a local Micro-finance Institution (MFI) named Sambandh Financial Services. 37 microenterprises are in the process of obtaining loans under the initiative. Further, access to finance has also been facilitated through Special Purpose Vehicles (SPVs) such as the Rourkela Techno-Park Self Help Cooperative Limited (RTPSHCL).

Up-scaling MFI Lending – A Success Story under MSME-FDP Programme

Under the GIZ portion of MSMEFDP, an innovative financial product and delivery model for the upstream apparel supply chain had been worked out in association with an MFI named Satin Creditcare Network Ltd (SCNL). SIDBI had sanctioned a line of credit to SCNL for onward lending to the MSEs in the apparel supply chain. Capacity building support involved:

- A. Assistance to design and develop a special credit scheme with the following features:
 - 1. Loan ticket size in the range of Rs.50000/- to Rs.200000/-;
 - 2. Loan to be available for investment in machinery or for work capital needs;
 - 3. Repayment period up-to 2 years;
 - 4. Repayment in fortnightly/monthly installments instead of daily installments depending on cash flow of the borrower;
 - 5. No collateral security;
- B. Assistance in HR development for appraising and risk assessment of credit to MEs
- C. Interactive sessions were held with apparel supply chain MEs to understand their needs followed by sensitization workshops to motivate them to borrow from SCNL. They were given an orientation course in accounting, finance, quality improvement and marketing after working hours.

The results of pilot intervention (started in late 2008) are as under:

- 1. SCNL granted loans to 60 MEs. Each ME, on an average, employed 40 workers and therefore this intervention impacted the lives of around 2400 families and around 12000 people at pilot stage;
- 2. The enterprises financed under the scheme have shown much better financial discipline and have been repaying installments in time with no default.

Purchase Order Financing (POF)

It is a short term funding provided by FIs and can be used as working capital to manufacture goods for some credit-worthy buyer. Every order is evaluated on its merit and terms are identified with the seller. The fund is then used by the unit to procure raw materials and support other working capital expense required to fulfill the order. Since the cluster has big players of very high credit worthiness, POF seems a viable way of providing financial support. This was further confirmed on discussion with an official from SIDBI, Rourkela and was of the opinion that a pilot project could be initiated to see its efficacy. One of the primary requirements for this to work from the bank's perspective is that buyer has to furnish a comfort letter to the bank detailing the seller information and credibility.

The POF mechanism shall work in the following way for MSEs in the cluster:

- The buyer/customer (big players) submits a purchase order to the seller (MSEs) with all documents.
- The seller submits the purchase order to the bank for POF.
- The bank makes a partial advance to the seller on the value of the purchase order. The advance is made to the seller to cover the costs of materials, trade goods and/or services. (This allows the seller to receive funds far sooner than if it had to wait for the buyer to pay on the invoice and even sooner than if the invoice is discounted. POF allows the seller to receive funds even before the goods are shipped and the invoice is issued.)
- The seller procures the raw materials and fabricates the goods and ships the products to the buyer.
- The seller prepares and submits an invoice for the sale. Depending on the agreement, the invoice will go to the buyer or directly to the bank (or factoring company).
- The buyer pays the invoice according to the payment terms, usually directly to the bank.
- When the bank receives payment on the invoice from the buyer, the bank withholds the amount it advanced to the seller as repayment on the POF loan, and also deducts the agreed amount of interest and fees. The balance is then remitted to the seller.

Annexure I – Estimation Method for Credit Supply

ESTIMATION OF CREDIT SUPPLY TO THE ROURKELA ENGINEERING CLUSTER			
	Item	Mar, 2011 Estimate	Remarks/Assumptions
1	Estimated Orissa Engineering Industry Advances Outstanding - March, 2011 (Rs crores, March, 2010 projected at an expected annual growth rate of 10%)	508	Expected growth rate is estimated from State Level Advances (SLA) growth Rate using SLA figures ending Mar, 2010 & Mar, 2011 Source - Table 4.9- Annual-Basic Statistical Returns of SCB, Mar '2010 Source - Statement 9: RBI Quarterly-Basic Statistical Returns of SCB, Mar '2011
2	Estimated Orissa Engineering Industry Turnover - Mar, 2011 (Rs crores, Projected at an expected annual growth rate of 2% and 4% for Year 2009-10 and 2010-11)	3755	Expected growth rate is estimated from National IIP growth rates Source - Table 3 - ASI, Government of India, MOSPI, 2009 Source - Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug 2011
3	Cluster Sample Turnover (MSEs), Sample Size - 42 units in MSEs Sector (Rs crores)	146	D&B Survey
4	Total Number of MSE units in the Cluster	190	From Rourkela Engineering Cluster Diagnostic Study (DS) Report
5	Estimated the Cluster Total Turnover (MSEs, Rs crores) using (3) & (4) for year ending Mar, 2011	316	
6	Estimated Proportion (P1) of Cluster Turnover to State Industry Turnover using (2) and (5) [$P1 = (5) / (2)$]	8.4%	
7	Estimated the Cluster Level Credit Supply [(1) * (6)] - Rs crores	42	
8	State Level Advances – Term Loan Advance (Small Enterprise - SE) to Total Advance (SE) Proportion (P2)	11%	Estimation based on RBI's Statistical Returns-SCB Source - Table 6.1, Statistical Tables Relating to Banks in India, 2009-10
9	Using (7) and (8) Working Capital Supply is [(1-P2)*(7)].	37	
10	Using (7) and (8) Term Credit Supply is [(P2)*(7)].	5	

Annexure II – Estimation Method for Credit Demand

ESTIMATION OF CREDIT DEMAND IN THE ROURKELA ENGINEERING CLUSTER					
	Method		Item	Mar, 2012 Estimate	Remarks/Assumptions
	Nayak Committee Approach - Working Capital	1	Cluster Sample Turnover (MSEs), Sample Size - 42 units in MSEs Sector		D&B Survey
		2	Total Number of MSE units in the cluster	190	Rourkela Engineering Cluster Diagnostic Report
		3	Estimated the Cluster Sample Total Turnover (MSEs, Rs crores) for year ending Mar, 2011	146	D&B Survey
		4	Estimated the Cluster Total Turnover (MSEs, Rs crores) - Mar, 2012, Expected growth rate of 9.8%	330	Expected growth rate is estimated from National IIP growth rates Source- Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug, 2011
		5	Basis Nayak Committee Guidelines, Working Capital Funding Requirement is 20% of Projected Turnover calculated in (3)	66	
	D&B Approach - Term Capital	6	Cluster Sample "Investments in Plant & Machinery", Sample Size - 42 in MSE Sector (Rs crores)	40	D&B Survey
		7	Total Number of MSE units in the cluster	190	Rourkela Engineering Cluster Diagnostic Report
		8	Estimated the Cluster Total "Investments in Plant & Machinery" (MSEs, Rs crores) using (1) & (2) for year ending Mar, 2011	94	
		9	Value in (8) projected to Mar, 2012 level using moving average growth rate of fixed capital for Industry-state wise (23%)	116	Source - Annual Survey of Industries (ASI) estimates on Fixed Capital for different industries within a state – MOSPI ASI Report, 2009-10
		10	(9) - (8) gives the growth in fixed capital	22	
		11	80% of (10) is estimated to be Term Credit Funding Requirement	18	
	Total Credit Demand	12	Total Credit Demand [66+18] calculated above in [(5) and (11)]	84	

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Ahmedabad Dyes & Chemicals Cluster

Overview

Ahmedabad is the commercial capital of Gujarat and is the hub of major business/ manufacturing activities in the state. Ahmedabad based Dyes & Chemicals cluster started with servicing the needs of the textile industry but in recent times its products are being utilized in other industries such as leather, foodstuffs etc.

The Ahmedabad Dyes & Chemicals cluster has 1200 units and provides employment to nearly 40,000 people. The key reasons that can be attributed to the growth of this cluster in the state are strong base of petrochemical industry, increasing availability of feed stock, relatively low overhead cost and availability of necessary infrastructure.

The following presents the overview of the Ahmedabad Dyes & Chemicals cluster,

Ahmedabad Cluster Information		
Particular	No. of Units	Employment (nos.)
Micro Units	803	13,000
Small Units	375	20,000
Medium Units	22	5,000

Source: Diagnostic Study Report on Ahmedabad Cluster, June 2009, prepared by Entrepreneurship Development Institute of India (EDI)

The turnover generated by the MSE units in the cluster, based on D&B survey estimates, amounts to Rs. 2,730 crores.

Units from Ahmedabad dyes and chemicals cluster produce organic as well as inorganic chemicals. Organic chemicals produced by these units have application in manufacturing of various products like Dyestuff Intermediates, Solvents, Paints, textile products etc. Inorganic chemicals produced by these units have application in manufacturing of dyestuffs, bullion, paints, and paper etc.

The per capita consumption of dyes in India is comparatively less as compared to global consumption. Hence most of units in cluster are export oriented units. Some of the major markets for chemicals are North America, Western Europe, Japan and emerging economies in Asia and Latin America.

One of the major problems plaguing this cluster is that of pollution control, which has created the issue of survival for the cluster. The units from the cluster are not able to curb the level of pollutants released by them and hence they are facing stringent actions from the pollution control board.

Recently some members of Dyes & Chemicals cluster in Ahmedabad have decided to form a consortium, Ahmedabad DyeChem Manufacturers Cluster Limited to buy raw material and allied

purchases and also to market the final products jointly. Some of the major activities to be focused upon will be as follows,

- Purchase of raw materials and chemicals jointly
- Purchase of shop floor consumables
- Joint efforts to negotiate acquiring new technologies
- Establishing a ware house for goods other than under the SPV
- Undertake study and business tours
- Marketing effort for unexplored areas
- Undertake the product research
- Take up social activities etc.

The cluster faces credit related problems due to environmental problems posed by the cluster. The units in the cluster have restricted access to finance because they come under the restrictive list of industries and many units from the cluster are not compliant with the pollution control norms set down by GPCB. Hence, these units are forcefully closed down by GPCB. As banks are wary of financing such units which are facing closure, they have put entire dyestuff industry under restrictive list.

These units are not able to comply with GPCB because they are overproducing chemicals than the consents given to them. These consents were given to them initially when they were established. Over a period of time the units increased their production capacities but their consents were not revised accordingly. Ahmedabad city falls under the list of most polluted cities in the country and because of which the pollution control norms are becoming more stringent day by day and due to this many units are facing closures. To avoid closure many units are under-producing than their optimum capacity, due to which their production costs are increasing and their profit margins are dwindling. This results in deterioration of their financial health and banks are not easily ready to finance such units.

The Dyes and Chemical cluster in Ahmedabad has installed capacity to produce about 12% of the world's requirement for dyes but it is currently producing only 7% of world's requirement. As the units are not receiving finance from the banks they are not able to invest more in their primary effluent treatment plants and hence they are not able to curb down the level of pollutants released by them. Because of this the unit requires new consent for undertaking more production and it results into a cyclical phenomenon.

The SIDBI-implemented MSMEFDP programmes have met with some success in helping the cluster enterprises survive and grow, by facilitating adoption of effluent treatment and cleaner production methods.

Sources of Demand for Credit

Material Linkages

The cluster requires large quantities of raw material inputs from the petrochemicals industry where material payments have to be made within the defined credit period. This is because the larger petrochemical manufacturers do not have flexibility in repayment processes. Secondly, the extent of rivalry and competition does not leave any room for any inter-linkages between the cluster enterprises. This reduces the financial interdependency amongst the cluster enterprises. Absence of sub-contracting also leads to increased efforts and costs for marketing and selling the end product.

Further, 70% of the output of the dyes industry is consumed by the textiles industry. Since the textiles sector is seasonal, the dye making units have to carry adequate inventories for sudden demand fluctuations in the textiles sector. Thus, absence of sub-contracting and excessive dependence on a seasonal sector for finished goods off take increases the demand for working capital.

Pollution Control Norms

The Gujarat Pollution Control Board (GPCB) has stipulated all enterprises in pollutant producing industries to set up effluent treatment facilities or use the services of the facilities center which increases the necessity of holding cash or increasing operating expenses. Further, the ETP is not covered under the Credit Linked Capital Subsidy Scheme (CLCSS) of Government of India, as well. Even if some components are covered, the maximum limit under the CLCSS is up to Rs. 1 crores which is sometimes not enough.

Obsolescence of Technology

Most of the units are older and traditional firms and hence, technology up-gradation is the primary reason for term loans in the cluster. Further, the micro and small enterprises are facing shortfall in working capital loans for improving and adopting clean manufacturing techniques.

Safety and Hazard Protection

The environment safety and hazard protection norms stipulate adequate hazard control tools and equipments such as safety helmets, jackets, specific areas for storage, special tanks etc. Most of the micro enterprises face problems in stocking these (non-value adding) items and hence, stand the risk of losing licenses at renewals. As a consequence, the banks refrain from providing finance to these units, unless the safety certification is also attached.

Supply of Credit to MSEs

Estimate of Outstanding Credit to MSEs in the Dyes & Chemicals Cluster

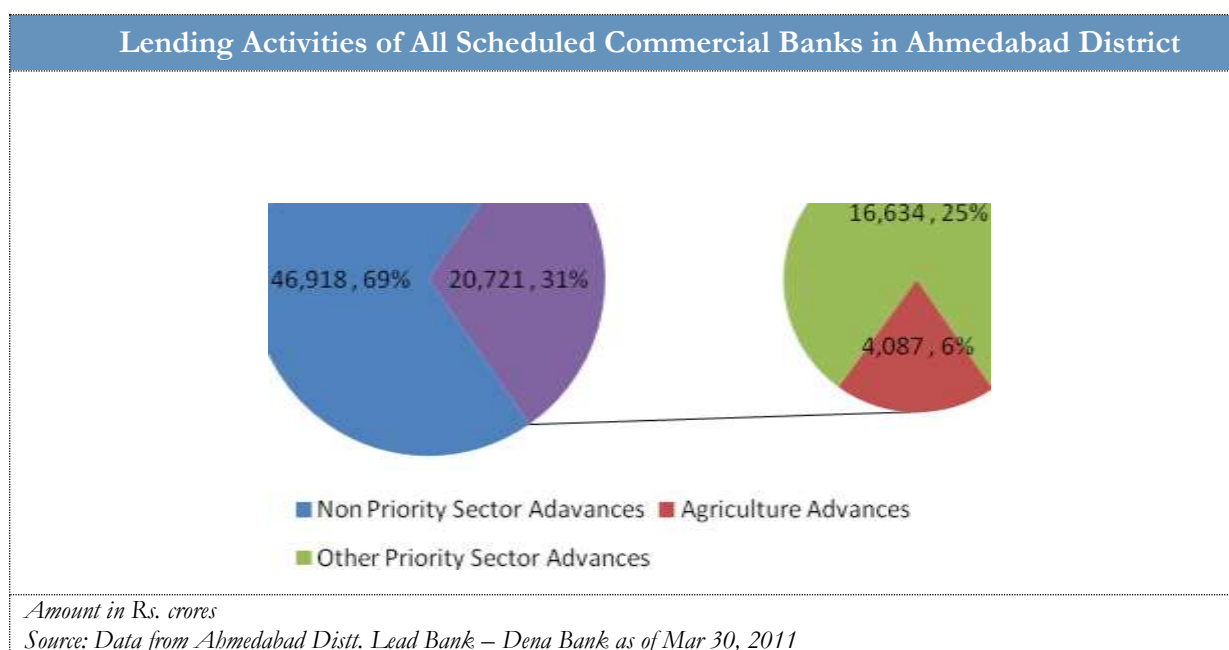
The credit supply to the Ahmedabad D&C cluster is estimated to be Rs. 168 crores out of which Rs. 17 crores (10%) is term credit and Rs. 151 crores (90%) is working capital supply.

Enterprise turnover is one of the important criteria for loan appraisal process and it can be safely assumed that credit supply to the cluster is correlated to the turnover generated. Thus, D&B proposes to use the “Cluster Turnover proportion to Industry State Turnover” method to arrive at cluster level credit supply.

The steps for computation under the identified Methodology are detailed [Annexure I](#).

The data obtained through above methodology was further validated against the data on Outstanding Advances collected from the lead bank in Ahmedabad district.

The RBI Lead Bank Scheme is implemented by Dena Bank as the lead bank in the cluster. According to the RBI Banking Statistical Returns, the outstanding credit for Ahmedabad district stood at an aggregate of about Rs. 62,830 Crores (as of March 31, 2010)¹⁹. Information obtained from the lead bank suggests that the outstanding credit to the priority sector could stand at Rs. 20,720 Crores (31% of the total credit). The following exhibit depicts the banking flow of credit in the Ahmedabad District. Priority Sector Advances in the Ahmedabad District is lower than the prescribed lending norm of 40% (of total advance).

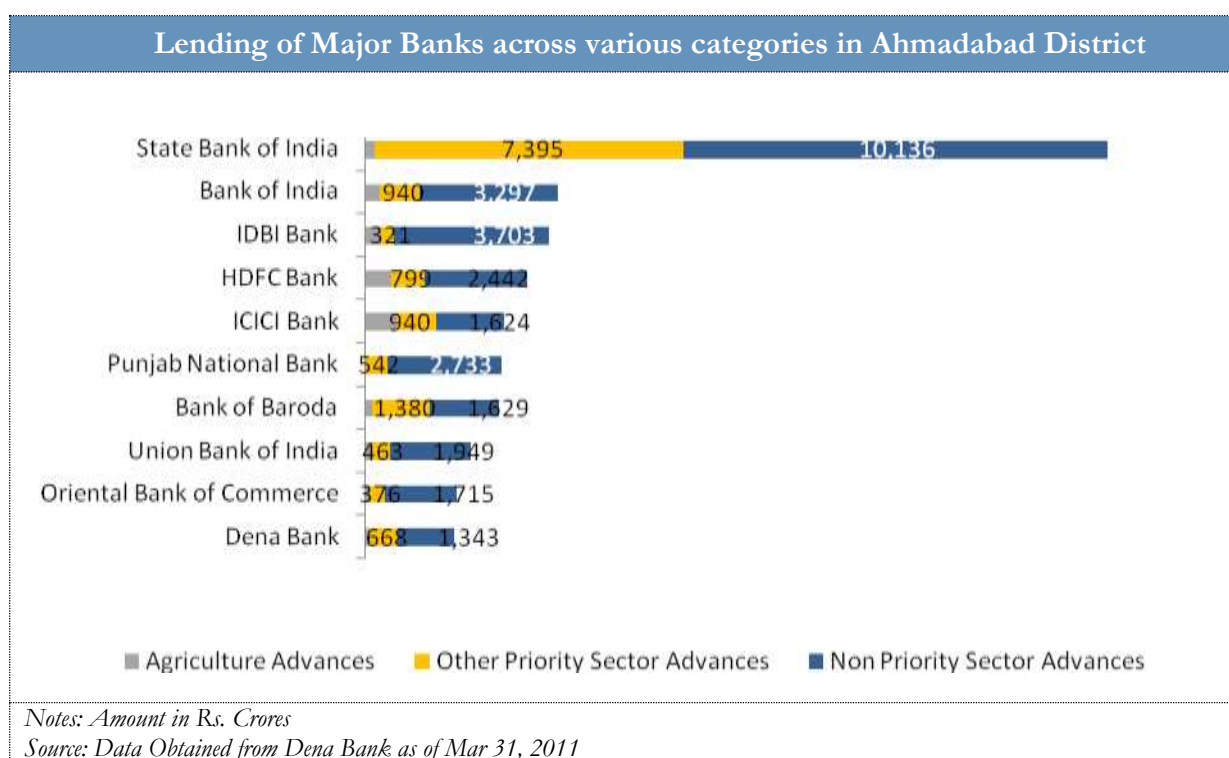


¹⁹ Table 5.9, District Wise Classification of Outstanding Credit of SCBs, Basic Statistical Returns of SCBs in India, Vol 39 – Mar, 2010

Performance of Banks

The public sector banks take the lead here contributing close to 75% of the total credit and 76% of the priority sector credit. In contrast, private sector banks merely contribute to 23% of the total credit, and 22% of the priority sector credit. The rest of the credit is advanced by few cooperative banks that operate in the district.

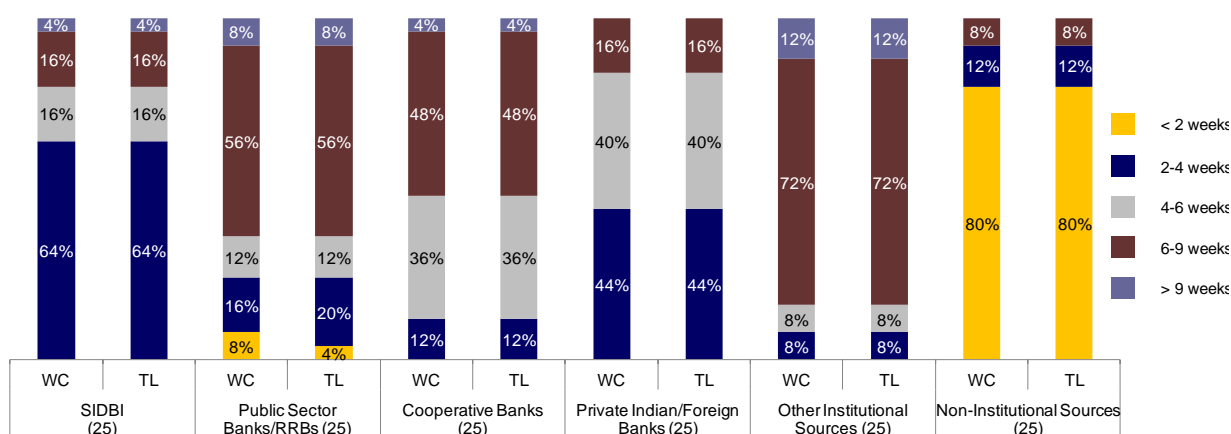
The following is the composition of Agriculture, Other Priority Sector and Non-Priority Sector credit in Ahmedabad as of Mar 31, 2011, for the top ten banks. The top 10 banks contribute to 70% of the outstanding credit in the Ahmedabad district. SBI is the largest lender in the Ahmedabad district contributing nearly a quarter of total advances and 14% of the total priority sector lending in Ahmedabad district. ICICI Bank leads among the Private Sector Banks with the largest priority sector lending portfolio.



Opinion of 25 SIDBI customers were taken on the overall perception of SIDBI, as well as on attributes such as time taken for loan disbursement and collateral requirement. While the respondents believed that SIDBI would largely take 2-4 weeks to process and disburse loans, Public Sector banks, Regional Rural Banks and Cooperative banks would take more than 4 weeks. Non-institutional sources are perceived to take the least time for loan processing and disbursement.

The following chart depicts perception among respondents of time taken for loan processing and disbursement by various financial sources.

Perception of Time Taken for Loan Processing and Disbursement

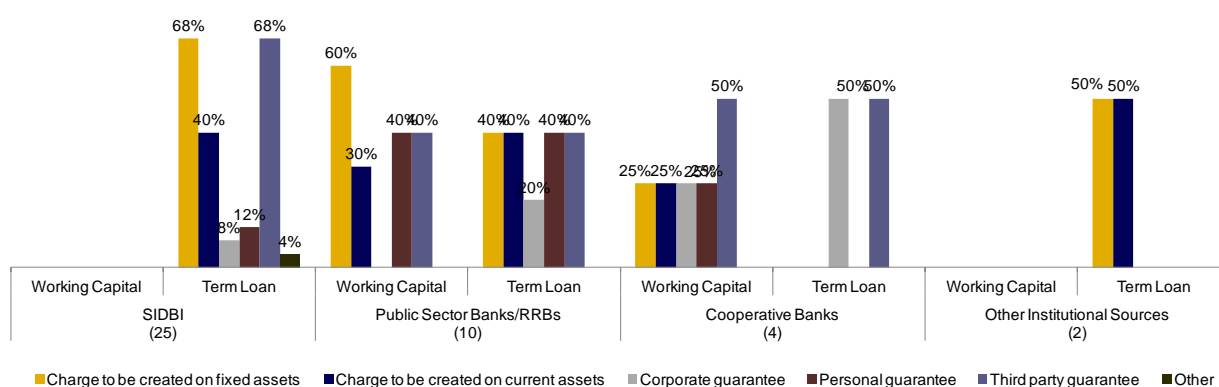


Source: D&B India

Note: Figures in brackets show total number of respondents for each financial source

The following chart shows the nature of collateral requirements across various financial sources,

Nature of Collateral Requirements



Source: D&B India

Note: Figures in brackets show total number of respondents for each financial source

SIDBI and Public Sector Banks ask for charge on current assets in addition to the charge on fixed assets, according to the findings. A high proportion of SIDBI customers reported being asked for Third Party Guarantees, but no personal guarantees, which was required by Public Sector banks.

It has been observed that most of the financial institutions are not lending to units in the Ahmedabad Dyes & Chemicals cluster because the units in the cluster are hazardous. Among the various institutions, other institutional sources demand the highest value of collateral and across all major types such as charge on fixed and current assets, and corporate guarantee, while SIDBI asks for least collateral, usually charge on fixed assets and personal guarantee. According to the findings, the Public Sector Banks ask solely for charge on fixed assets.

Demand for Credit by MSEs

Estimate of Credit Demand by MSEs in the Dyes & Chemicals Cluster

There are two methods that D&B India has followed to arrive at Total Credit Demand at cluster level, as mentioned in the methodology section. The methods involved are:

Nayak Committee-D&B Approach

- a. Working Capital Demand - Turnover Based Approach (Basis – Nayak Committee Guidelines)
- b. Term Capital Demand - D&B Approach (Basis – Growth in Fixed Capital)

Below are the highlights of the credit demand estimates in the cluster:-

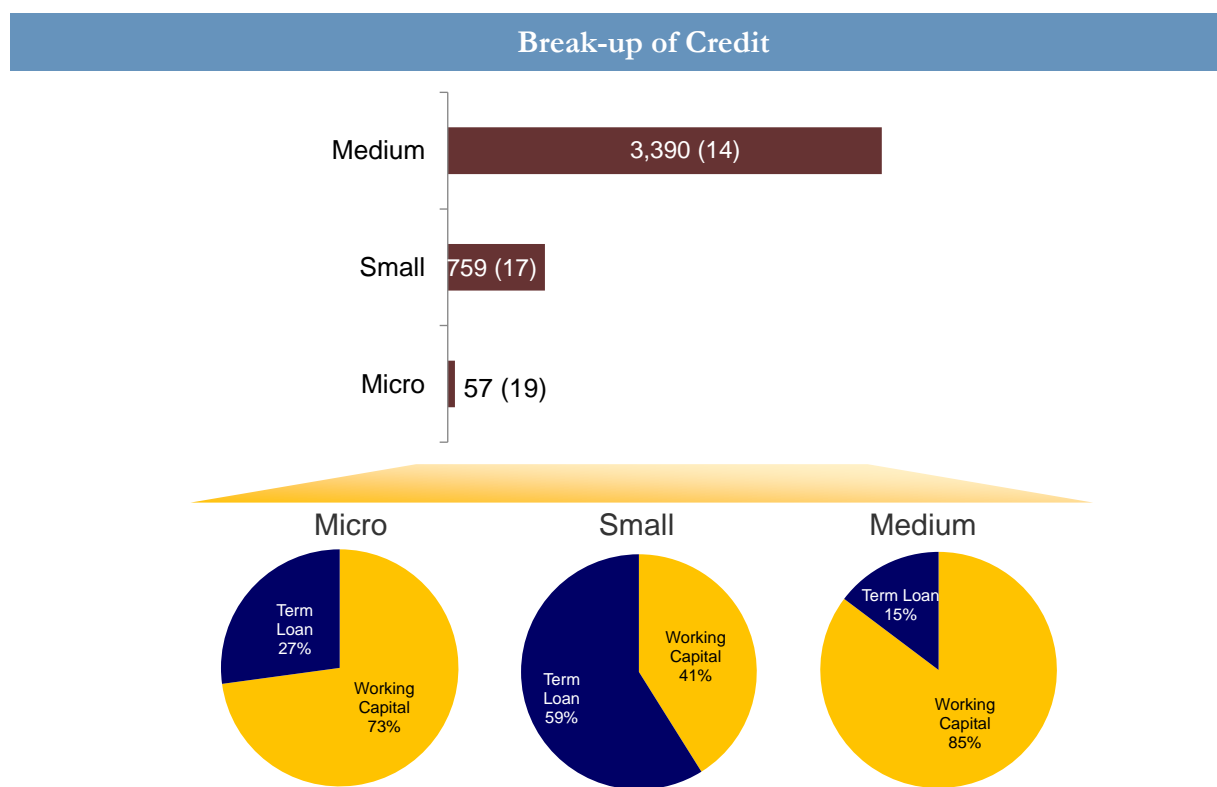
- ❖ Total number of Micro and Small units in the cluster is 1,178
- ❖ The turnover for the Ahmedabad Dyes & Chemicals MSE cluster is pegged at Rs. 2,730 crores during 2010-11 from the D&B survey at cluster level.
- ❖ The turnover is estimated to rise by an annual average growth rate of 2.0% (IIP estimate) to Rs. 2,785 crores in the year 2011-12.
- ❖ Working Capital Requirement (Basis-Nayak Committee Guidelines) is estimated to be Rs. 557 crores
- ❖ Term Credit Requirement (Basis-Growth in Fixed Capital) is estimated to be Rs. 51 crores
- ❖ Total Credit Demand is thus obtained from above [(557) + (51)] and is Rs. 608 crores

Most banks including the lead bank have indicated that for appraisals of working capital loan requirements, Nayak Committee Recommendations are being followed. The equity margin expected from promoters as per the recommendations is 20% of the working capital loan. It was observed from the survey that across categories of Micro, Small and Medium Enterprises, this ratio though has varied, the average margin requirement is much higher than the prescribed Nayak Committee Norm of 20% at around 34% of the working capital gap. The average among the micro, small and medium enterprises is 45%, 28% and 32% respectively.

A major reason for this behavior by banks is the nature of financing itself. Since most of the borrowers can afford to provide higher margin money due to their affluent backgrounds, the margin contributions indicated by most of the respondents are voluntary and not mandated by the banks.

However, for micro enterprises, the demand for higher margin contribution is from the bankers' side. This is because the nature of the industry is risky and since certain sub-sectors are under the restricted industries list, banks prefer asking for higher equity margins. Also, the bank lending is more focused on the relatively risk-free engineering sector where hazards, pollution control regulations, seasonality in demand etc. are relatively lower as compared to the dyes and chemicals industry.

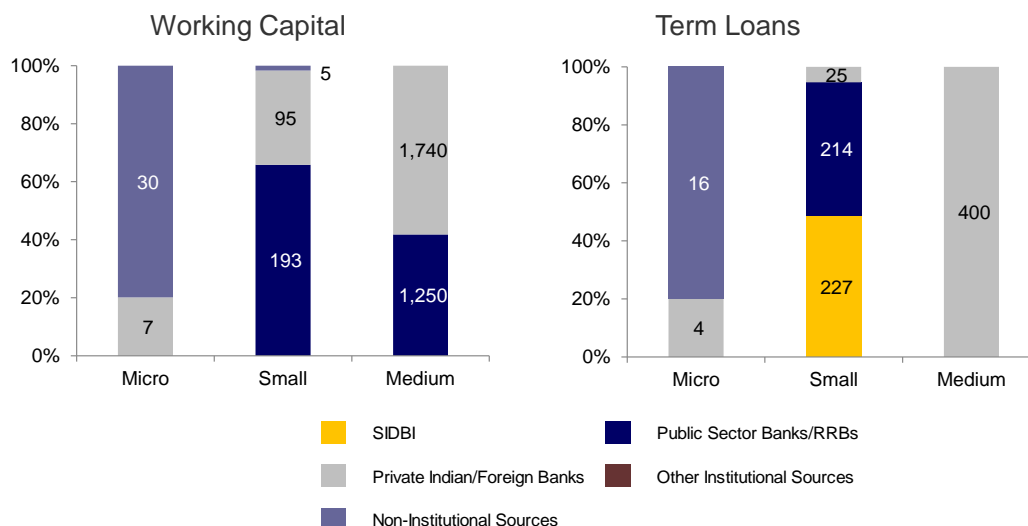
The following charts show the composition of credit among the 50 respondents interviewed in the survey. Looking at the chart below, it can be assumed that the major requirement in the cluster is for working capital loans, in micro and medium categories, and term loans, in small category.



Source: D&B India (Amount in Rs. Lakh; number of respondents in parentheses)

The following chart shows composition of working capital and terms loans for the 50 respondents by sources of finance, separately for Micro, Small and Medium enterprises. Private and Foreign Banks, and non-institutional sources are major sources of working capital as well as Term Loans for Micro enterprises. Public Sector Banks Private and Foreign Banks are the major sources of Working Capital for small and medium enterprises.

Sources of Finance (Amount in Rs. Lakh)



Source: D&B India

In summary, the total working capital credit across the surveyed 50 enterprises is around Rs. 32 crores while the term credit is around Rs. 9 crores. Thus, there is a higher credit requirement for working capital needs. The following can be summarized as major reasons for the same:

- The nature of the end-industry (textiles) is seasonal and hence, enterprises have to lock-in higher volumes of inventories
- There are no instances of sub-contracting. In fact, the competitive rivalry in micro enterprises is even higher since the nature of products is similar and patenting is expensive.
- Though product conversion cycles are lower, inventory holding for raw materials and finished goods are higher, increasing the demand for working capital credit.
- Increasing pollution control norms requiring constant improvements in processes and technology, adoption of better manufacturing practices etc.

From the various methods employed and explained before, the demand and supply side estimations of the cluster have been provided in the next section.

A Note on BDS Programmes under MSMEFDP in Ahmedabad Dyes & Chemicals Cluster

In the first year, the MSMEFDP BDS project addressed the pollution control issue in a practical way by showing the cluster a cost effective design to achieve the norms of PTP (Pre Treatment Plant). It demonstrated the effectiveness of the PTP design by building them in 5 units. The results of this first thrust area were disseminated to the entire cluster through a formal workshop cum interactive

session. The results achieved in the demonstrated units automatically led to 30 more units adopting similar design without project support. The most beneficial qualitative impact has been that units who have gone in for PTP have been ensured of their very SURVIVAL. GPCB has been closing down units which fail to meet with the CETP norms. The beneficiary units (under this intervention) have come out of this risk of closure through proper adherence to the norms.

After giving the above survival kit to the cluster, the project went one step ahead of merely controlling the effluents by offering method. They came up with an initiative for CP (Cleaner Production) to reduce the generation of effluent itself. This was taken up in the second year. The project had introduced the concept of Cleaner production in dyes industry and demonstrated the concept by implementing cleaner production in 15 units. This second thrust area of the project – namely the CP initiative- apart from reducing the generation of effluents also helped the units to optimize their production and operational efficiency. 15 units achieved a cost reduction of 5-7 % on an average. Based on the impact demonstrated in the selected 15 units, 20 more units are in the process of adopting CP, without project support. CP is a firm step towards greener production.

The dyes and chemicals industry depends on a volume based business. The buyers want to buy large volume through single source to get the maximum price advantage and to be free from the hassle of dealing with many small suppliers. The third thrust area of the project was to facilitate the creation of a common front of the units in the form of a SPV (ADMAC). The SPV route would give volume advantage to both the buyer and the units in the cluster. It would result in a win-win situation for the industry. The annual benefit to each member unit is 168 lakhs PA per unit. It is likely to go up to by additional 15% in the coming year. Considering a conservative estimate of 10% increase in volume the overall benefit would be Rs 240 lakhs/per annum /per unit.

The fourth thrust area has been in supporting the formation of Society for Clean Earth - Erection and installation of common evaporating unit for hazardous waste and effluent. The project has been conceived and given a form by GITCO with the financial support given by SIDBI-PMD Project (implemented by EDI). The project envisages setting up facilities for evaporating hazardous effluent by way of using Multi Effective Evaporation followed by spray dryer & other scientific techniques. By using evaporation of effluent the project would achieve Zero Discharge which is eco-friendly.

The project found that while Ahmadabad had all the BDS and BDSPs in this field, they were not accessible to the small unit in this sector. The Project introduced 24 BDSPs to the small units cluster. The project introduced 2 new BDS areas in the cluster. The project supported the cluster with 53 Voucher cost facilities, spread across four thrust areas.

There are an estimated 1200 units in the Ahmadabad cluster. The project could spread its message and goal to 440 units through their various activities (this considers units which attended on one or more events/activities). A conservative outreach of the message of the Project is estimated to be

33%. However there are 120 direct beneficiaries through voucher cost support. This amounts 10% of the total units in the cluster.

The two associations mentioned above are tailored to meet with the requirements of small units in the cluster. They would carry on the agenda taken up by the project in getting higher outreach. It is ensured that these two SPVs are sustainable as they have definite income out of the proposed activities.

Credit Gap in the MSE Segment

For the current study, D&B considered the credit supply data of only scheduled commercial banks that form the major source of credit supply. The table below contains the estimated Credit Gap in the cluster on the basis of the two methods.

Method	Total Gap	Credit Supply	Total Credit Demand	Working Capital Demand	Term Capital Demand
Nayak Committee-D&B Method (In Rs. crores)	440	168	608	557	51

Summary of Credit Gap Assessment

For the Ahmedabad Dyes & Chemicals cluster it is the working capital need which is significantly influencing the total credit need gap, this in spite of Ahmedabad having ample banking coverage. D&B India has, through its primary & secondary research, identified possible reasons for mismatch in the credit demand and supply why the credit demand is not being met. A summary of the findings are mentioned below,

The micro enterprises require larger working capital loans mainly because of the following factors,

- The pollution control board norms are stricter with respect to effluent handling systems. Since micro enterprises cannot afford to have an in-house Effluent Treatment Plant (ETP), they have to outsource this to the common facilities center and hence, there is a higher cost attached in doing so. This is also important from compliance point of view.
- The micro enterprises are relatively older in the cluster and hence, their sanctioned production limits are much lower and have not been revised in recent times. Thus, as per these limits, the micro units are over-capacity units and hence obtaining bank finance for such units becomes difficult.
- Many units in the cluster do not have requisite permission to release pollutants as per their production capacity. These units illegally undertake production but do not report these sales

figures on their financial statements. As a result of this, the sales figures as well as profits shown in the financial statements are much lower than actual figures and due to this banks are not able to provide finance to such units.

- External rating system is an important source for increasing credit worthiness of the enterprises where most of the sector is regulated and restricted. However, micro enterprises cannot afford such services and at times, they are even unaware of such rating agencies.
- Non-flexibility in deployment of labor discourages modernization and investment in technological changes and eventually leads to industrial sickness, thus adversely affecting workers as well. Hence, the cost of labor increases considerably in turn increasing their operating expenses.

The small and medium enterprises intend to avail working capital and term loans mainly for setting up the ETP which is mandated by the Gujarat Pollution Control Board (GPCB). Other than these, the following issues are observed in the cluster

- While land is accepted as collateral for the loan, the book value of land is considered and hence, the valuation turns out to be meager which in turn impacts the capital adequacy of the credit provided adversely.
- Along with ETP, most of the units intend to adopt cleaner and greener technologies, however these loans are not readily available in the cluster.
- Finally, for those units that have availed term credit, their monthly payments are considered as current liabilities and hence, the net working capital limit gets impacted, thereby reducing the working capital advances.

Additionally, quality of credit received by various enterprises can be judged from three factors viz., time taken for loan processing, loan interest rate, and adequacy of credit. Only in case of lending by Public Sector Banks/Regional Rural Banks is faster with processing time less than 4 weeks. Rests of the banks or financial institutions have higher processing time.

Recommended Products and Delivery Channels

Ahmedabad Dyes & Chemicals (D&C) cluster is one of the major production hubs of dyes and chemicals in the country. The emergence of such a large number of MSME units is due to ever growing number of textile manufacturing and processing units. Other key reasons could be attributed to strong base of petrochemical industry, increasing availability of feed stock, relatively low overhead costs and availability of necessary infrastructure.

Requirement of Capital

Based on our discussions with multiple enterprises and with officials from Banks / SIDBI, D&B has identified that the specific reasons for requirement of capital,

- Raw Material Procurement
- Technological Up-gradation
- Installation of Effluent Treatment Plants

The units typically buy their raw materials from large petrochemical players who provide **limited flexibility in payment**. Also a large proportion of units in this cluster serve the textile industry and since the **textile sector is seasonal**, the dye making units have to carry adequate inventories for sudden demand fluctuations in the textiles sector. This further increases their working capital requirements.

Most of the MSE units in this cluster are currently using conventional machines and are now looking at **upgrading their technology**. A lot of enterprises are looking at **adopting cleaner production tools** which is a preventive strategy that aims to reduce pollution at source. Investment proposals based on cleaner production give a very solid basis for achieving financial support from banks.

Majority of these **units are pollutant producing**, the state Pollution Control Board (GPCB) has stipulated all such enterprises to set up effluent treatment facilities or use the services of the facilities center which increases the necessity of holding cash or increasing operating expenses.

Besides the above mentioned reasons, the units are also looking for finance to get **quality certifications such as REACH certification** and other quality registrations.

Most of these units are **export oriented units** and internationally they are facing major competition from Chinese dyes producers. These Chinese units initially had advantages like low land cost, low labor cost, low power cost etc. over Indian producers but nowadays due to China's own economic

development most of them have faded out but the biggest advantage Chinese producers still enjoy is of low cost of capital. The cost of capital in China is around 5% while in India it is around 15-16%.

Another problem these units in the cluster sometimes face is that they have **restricted access to finance because they come under the restrictive list of industries.**

Working of Government Schemes

The Indian dyestuff industry is only about 40 years old though a few MNCs did set up dyestuff units in the pre independence era. Like the rest of the chemical industry, the dyestuff industry is also highly fragmented. Though the central government doesn't have any special schemes for this sector, the units tend to avail benefits of the major schemes being run for the benefit for MSME enterprises, such as Credit Linked Capital Subsidy Scheme (CLCSS) and Credit Guarantee Trust Scheme for Micro and Small Enterprises (CGTMSE).

Credit Linked Capital Subsidy Scheme (CLCSS)

Aimed at technology up gradation of the small scale enterprises, the MSME Ministry (earlier known as Ministry of SSI) has been operating the Credit Linked Capital Subsidy Scheme (CLCSS) since the year 2000. The scheme aims at facilitating technology up gradation for improvement in productivity of the SSI / MSE units, by providing them 15 per cent upfront subsidy with a ceiling of Rs.1crore. Though common ETP's and other equipments such as reactors, ice flakers, filtration system, product drying system, incinerators and blenders are covered under the scheme, the units in the Ahmedabad D&C cluster have not benefitted from it to the extent that they would have liked to.

Credit Guarantee Trust Scheme for Micro & Small Enterprises (CGTMSE)

The Credit Guarantee Fund Trust Scheme for small industries was introduced by the Government in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.25 lakh without collateral/ third party guarantees.

Banks in the cluster are very cautious about lending to micro & small units under the CGTMSE scheme in an effort to mitigate their risk. And hence they scrutinize the loan application with a major focus on checking the viability of the project, promoter's record, their payback capability before disbursing such loans. Also the banks charge a yearly service fee (0.75% of the sanctioned amount every year till the loan is paid back) plus a one-time fee (1.5%of the sanctioned amount), which increases the net effective interest rate for enterprises making it more unattractive for them.

Off late though, SIDBI has been trying hard to disburse loans under the scheme. SIDBI has compulsorily started processing all loans under Rs. 5 Lacs under the CGTMSE scheme after being

convinced of the business idea. For loans above Rs. 5 Lacs where money has not been dispersed under the CGTMSE scheme, the branch officers have to provide justification as to why credit was denied to the entity under the scheme.

Interest Reimbursement Scheme

Under this scheme the state government of Gujarat provides 5-7% interest reimbursement to the enterprises. Lot of units are availing the scheme are very happy with it, since it provides them access to short term capital at attractive rates. Enterprises initially pay the full interest (current prevailing interest rates ~14- 15%) to the banks and are reimbursed the amount at a later date.

JICA Line of Credit

SIDBI has arrangement with Japan International Cooperation Agency (JICA) for promoting Energy Saving projects in MSME sector in India. Under JICA line of credit, eligible projects are financed at a subsidized rate of interest. New / existing MSME units shall be eligible for assistance under the scheme. Units should have minimum acceptable internal rating of SIDBI

Bills Discounting

Units in the Ahmedabad cluster are also making use of bill discounting facility. This facility is being availed by units engaged in domestic as well as international trade. In international trade, trade bills drawn under Letters of Credit issued by banks are used to fund the receivables. This bill discounting facility is provided for a period of 3-6 months depending upon the tenor of the bill or Letter of Credit.

Channel Financing

Through Channel Financing, lots of units in this cluster who have business relationships with large companies are able to arrange for working capital finance. This is generally in the form of either cash credit facilities or as a bill discounting line of credit.

Packing Credit

A lot of units in the Ahmedabad D&C cluster are export oriented units and are dealing with international clients directly and are making use of Packing Credit facility. The units take loan for manufacturing, processing, purchasing or packing of goods meant for export against a firm order or Letter of Credit. There are however some difficulties that these players may face while trying to obtain such facilities from their bankers for several reasons, e.g. the exporter may be relatively new to export business, the extent of facilities needed by him may be out of proportion to the equity of the firms or the value of collateral offered by the exporter may be inadequate.

Descriptions of Products and Delivery Mechanisms

Bill Discounting

A lot of units in the Ahmedabad cluster are export oriented units and generally the time duration offered for payments is of between 120 -150 days, whereas the banks provide bill discounting facility to an unit owner for the period of 60-90 days.

The problem can be addressed if banks relax the current repayment period from 90 days and extend the same to 150 days to suit the requirements of the enterprises. Further, the covenants and returns on modified bills discounting should be worked out to get a viable funding model for MSEs.

Purchase Order Finance

It has been generally seen that in the Ahmedabad cluster most of the units are over leveraged and do not have any collateral based on which they can take the loan. In this scenario, they can make use of their orders placed by their clients by taking a loan based on the purchase order to address the problem of working capital financing. Another aspect which will make this product successful in this cluster is the fact that a lot of units here are selling to international clients, which will be a comforting factor to the lenders.

Purchase Order Finance (POF) is one such pre-shipment finance product, wherein a manufacturing unit is able to receive working capital funds from its bank based on the order placed by any credit worthy buyer. More importantly, it allows the unit to take on multiple orders and deliver them successfully. The POF mechanism works in the following way:

- The client/customer sends across the purchase order to the manufacturing unit (seller) with all documents.
- The seller then submits the purchase order to its bank for POF.
- The bank makes a partial advance to the manufacturing unit on the value of the purchase order. The advance is made to the unit or directly to its supplier to cover the costs of materials, trade goods and/or services.
- The supplier delivers the materials, goods and/or services to the seller for production of the product or assembly of the trade goods to fill the order.
- The manufacturing unit produces or assembles the goods and ships the products to the buyer.
- The unit then prepares and submits an invoice for the sale. Depending on the agreement, the invoice will go to the client/buyer or directly to the bank (or factoring company).

- The client pays the invoice according to the payment terms, usually directly to the bank.
- When the bank receives payment on the invoice from the client, the bank withholds the amount it advanced to the seller unit as repayment on the POF loan, and also deducts the agreed amount of interest and fees. The balance is then remitted to the seller.

The short terms of POF coupled with the transaction specific nature of this type of financing, the high leverage (typically with POF, only 10-40 percent of the total transaction value is advanced), and the resulting diversification of the lending portfolio help lower overall risk and provides greater flexibility. Loans can be structured in a variety of ways including to match payments to the borrower's cash flow cycle.

Pre-approved Equipment Financing Scheme in Association with GDMA (For adoption of Cleaner Technology)

Units in the cluster are looking at adopting new cleaner technology and also comply with government regulations regarding disposal of wastes by installing effluent treatment plants. In majority of the cases the units have to resort to unsecured loans or Loans against Property from various financial institutions at very high interest rates ranging from 16-24% or from the markets at even higher interest rates or use their very limited and precious Working Capital/ CC/OD limits. These loans are costly and are also of shorter duration (1-3 years), which further results in liquidity tightness in these small units. By the end of every financial year, a lot of working capital and reserves get stuck in these assets and thus cash position remains tight.

SIDBI currently has a credit delivery arrangement with the Gujarat State Plastic Manufacturers Association (GSPMA) for meeting the capital expenditure requirements of the member MSME plastic manufacturing units. **A similar arrangement could be struck by SIDBI and other banks with Gujarat Dye Manufacturers Association (GDMA) for extending the same arrangement to the credit worth units of Ahmedabad Dyes & Chemicals cluster.** Under this arrangement, the association recommends its well performing member units to SIDBI, based on a preliminary scrutiny provided by the bank for quicker dispensation of credit at a discounted rate. This assistance could be a pre-approved loan, which the units can make use of as required.

These loans can be intimated to such MSEs in the form of sanction letters valid for, say 6 months or more, so that at the time equipment is to be purchased, the disbursement can be made immediately, say, within 24-48 hours. These loans, as and when availed, shall be repaid through post-dated Cheques either in the form of Equated Monthly Installment (EMI) or wherever required, repayment can be staggered/ ballooned with gestation period. The enterprises would also be able to avail the Credit Linked Capital Subsidy @ 15% wherever applicable.

Lease Financing for Equipment Purchase

Lease financing could be another financial product which the formal financial institutions can extend to the units in the cluster to assist them in their equipment purchase. Based on promoter's record, the business's future potential in addition to unit's proven track record, banks can do lease financing for the acquisition of plant, machinery and the equipments for these units.

The typical term for the lease would be 3-5 years. The units would pay rentals to the bank for the period till when they have successfully repaid the cost of the equipment. The banks could also charge a processing fee and a lease management fee for the same. Till the time the entire amount has been paid back, the equipment/machinery would stand as the primary security. The possession of the equipment will remain with the borrower, while the bank would enjoy the full legal title. The equipment would become the property of the unit as soon as the debt is paid.

The major advantage of lease financing is that it enables the lessee (manufacturing unit) to plan its cash flows properly. The rentals can be paid out of the cash coming into the business from the use of the same assets.

Annexure I – Estimation Method for Credit Supply

ESTIMATION OF CREDIT SUPPLY TO THE AHMEDABAD DYES AND CHEMICALS CLUSTER			
	Item	Mar, 2011 Estimate	Remarks/Assumptions
1	Estimated Gujarat Dyes & Chemicals Industry Advances Outstanding - March, 2011 (Rs crores, Projected at an expected annual growth rate of 7%)	10,997	Expected growth rate is estimated from State Level Advances (SLA) growth Rate using SLA figures ending Mar, 2010 & Mar, 2011 Source - Table 4.9- Annual-Basic Statistical Returns of SCB, Mar '2010 Source - Statement 9: RBI Quarterly-Basic Statistical Returns of SCB, Mar '2011
2	Estimated Gujarat Dyes & Chemicals Industry Turnover - Mar, 2011 (Rs crores, Projected at an expected annual growth rate of 5.0% and - 1.0% for Year 2009-10 and 2010-11)	100,313	Expected growth rate is estimated from National IIP growth rates Source - Table 3 - ASI, Government of India, MOSPI, 2009 Source - Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug 2011
3	Cluster Sample Turnover (MSEs), Sample Size - 25 units in MSEs Sector (Rs crores)	68	D&B Survey
4	Total Number of MSE units (1,178) in Ahmedabad Dyes & Chemicals Cluster		From Ahmedabad Dyes & Chemicals Diagnostic Study (DS) Report
5	Estimated the Cluster Total Turnover (MSEs, Rs crores) using (3) & (4) for year ending Mar, 2011	2,730	
6	Estimated Proportion (P1) of Cluster Turnover to State Industry Turnover using (2) and (5) [$P1 = (5) / (2)$]	2.7%	
7	Estimated the Cluster Level Credit Supply [(1) * (6)] - Rs crores	168	Based on qualitative discussions we've had in the various parties in the cluster, regarding the pollution norms and effluent treatment, we have adjusted the supply figures
8	State Level Advances – Term Loan Advance (Small Enterprise - SE) to Total Advance (SE) Proportion (P2)	10%	Estimation based on RBI's Statistical Returns-SCB Source - Table 6.1, Statistical Tables Relating to Banks in India, 2009-10
9	Using (7) and (8) Working Capital Supply is [(1-P2)*(7)].	151	
10	Using (7) and (8) Term Credit Supply is [(P2)*(7)].	17	

Annexure II – Estimation Method for Credit Demand

ESTIMATION OF CREDIT DEMAND IN THE AHMEDABAD DYES AND CHEMICALS CLUSTER					
	Method		Item	Mar, 2012 Estimate	Remarks/Assumptions
	Nayak Committee Approach - Working Capital	1	Cluster Sample Turnover (MSEs), Sample Size - 25 units in MSEs Sector		D&B Survey
		2	Total Number of MSE units (1,178)		Ahmedabad Dyes and Chemicals Cluster Diagnostic Report
		3	Estimated the Cluster Sample Total Turnover (MSEs, Rs crores) for year ending Mar, 2011	68	D&B Survey
		4	Estimated the Cluster Total Turnover (MSEs, Rs crores) - Mar, 2012, Expected growth rate of 2.0%	2,785	Expected growth rate is estimated from National IIP growth rates Source- Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug, 2011
		5	Basis Nayak Committee Guidelines, Working Capital Funding Requirement is 20% of Projected Turnover calculated in (3)	557	
	D&B Approach - Term Capital	6	Cluster Sample "Investments in Plant & Machinery", Sample Size - 36 in MSE Sector (Rs crores)	19	D&B Survey
		7	Total Number of MSE Units (1,178)		Ahmedabad Dyes and Chemicals Cluster Diagnostic Report
		8	Estimated the Cluster Total "Investments in Plant & Machinery" (MSEs, Rs crores) using (1) & (2) for year ending Mar, 2011	470	
		9	Value in (8) projected to Mar, 2012 level using moving average growth rate of fixed capital for Industry-state wise (14%)	534	Source - Annual Survey of Industries (ASI) estimates on Fixed Capital for different industries within a state – MOSPI ASI Report, 2009-10
		10	(9) - (8) gives the growth in fixed capital	64	
		11	80% of (10) is estimated to be Term Credit Funding Requirement	51	
	Total Credit Demand	12	Total Credit Demand [557 + 51] calculated above in [(5) and (11)]	608	

Kolkata Leather Cluster

Overview

West Bengal is one of the states that have long been associated with the leather industry having two major industry clusters in Kolkata and Shantiniketan. The Kolkata leather cluster houses 4000 units (including organized and unorganized) and provides direct employment to close to 62,000 people. The turnover generated by the MSE units in the cluster, based on D&B survey estimates, amounts to Rs. 2,880 crores. This cluster produces a diverse range of products such as,

- *Finished leather*
- *Leather goods such as bags, wallets etc.,*
- *Footwear and,*
- *Industrial gloves.*

Kolkata leather cluster's share in India's export basket for leather goods remains at 60 per cent. The local industry comprises of various sub-sectors which operate in different stages of the value-chain, with major sub-sectors being tanning, leather goods, industrial products and footwear as listed in the table below.

Kolkata Cluster Information				
Sub-Sectors	Locations	Category	No. of Units	Employment
Tanneries	Bantala	Tanneries	224	8,450
Leather goods like bags, wallets etc.	Kasba, Topsia and Tangra	Manufacturer cum exporter	236	23,600
		Merchant exporters	96	1,920
		Fabricator cum manufacturer for the local market	1200	3,600
Footwear	Batanaga, Nungi, Janbazar, Rajabazar, College Street area and Bentick Street	Large scale manufacturing units (Bata)	1	3,000
		Small and medium enterprise manufacturers	19	1,000
		Manufacturer cum exporter	6	
		Fabricator and household units	2000	10,000
Industrial gloves	Belegkata	Manufacturer cum exporter	31	4,650
		Merchant exporter	11	220
		Fabricator	200	6,000

Source: Diagnostic Study Report on Kolkata Leather Cluster prepared by Entrepreneurship Development Institute of India (EDI)

Due to the importance of the leather industry to West Bengal, the Government of Bengal had setup the Calcutta Leather Complex on the eastern fringe of Kolkata in Bantala. It is envisaged to house all activities related to the leather industry. With the tanning capacity of close to 1,000 tons of raw hides per day, it is estimated that this complex when fully functional will generate approximately Rs. 5,000 crores worth of exports and provide employment to nearly 10,000 people. Though the leather complex was started with much fanfare, of late the complex has been plagued by infrastructure issues, which has led to some of the tanneries moving out of the complex.

Besides this various Government of India ministries in collaboration with multilateral aid agencies such as United Nations Development Program (UNDP), United Nations Industrial Development Organization (UNIDO), Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ under MSMEFDP) from time to time launch various projects for upliftment of units and workers engaged in these enterprises.

One of the biggest government initiatives has been the Integrated Development of Leather Sector (IDLS) scheme. The scheme is aimed at enabling existing tanneries, footwear, footwear components and leather products units to upgrade leading to productivity gains, right-sizing of capacity, cost cutting, design and development simultaneously encouraging entrepreneurs to diversify and set up new units. The financial assistance under the scheme is an investment grant to the extent of 30% of cost of plant and machinery for SSI / MSE and 20% of cost of plant and machinery for other units (i.e. non small scale units) subject to ceiling of Rs.50 lakh for technology up gradation /modernization and/or expansion and setting up a new unit. The rate of assistance is @ 20% for all units (both SSI and Non-SSI) above Rs. 50 lakhs subject to ceiling of Rs. 2 crores. Also, obtaining bank loan without collateral has been one of the main problems of small entrepreneurs. Besides, banks find lending to small enterprises as risky proposition. To take care of this problem, the Credit Guarantee Fund Trust Scheme for Micro and Small Enterprises (CGTMSE) was introduced by the Government (Ministry of Small Scale Industries) in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.10 lakh without collateral/ third party guarantees. The scheme is being operated through the Credit Guarantee Fund Trust for Small Industries (CGTSI) set up jointly by the Government of India and the Small Industries Development Bank of India (SIDBI). The loan limit under the scheme, which was Rs.10 lakh per borrower, has since been enhanced to Rs.25 lakh per borrower.

Even though the IDLS & CGTMSE schemes are some of the biggest initiatives undertaken by the government to support the leather sector and the MSE sector respectively in the country, but based on our interactions we found out the benefits of the schemes are not reaching the enterprises, especially the micro and small units in the Kolkata leather cluster.

Sources of Demand for Credit

Procurement and Primary Processing

Most of the tanneries procure the raw hides and skins from traders / local suppliers who source the skins from different places in the state and also from places as far as Bihar and Uttar Pradesh. In most of the cases it has been seen that the slaughter houses supplying raw hides lack proper modern infrastructure for collection of dead animals. Thus there is significant wastage in finished leather because of damages caused by rough handling at the slaughter houses.

To overcome the problem of wastages and to ensure quality and timely supply of finished leather, some of the larger manufacturing units such as Kalpataru International **run their own tanneries**. On certain occasions, **tanneries are also available on rent** where the manufacturers can process their own leather. In either case, there is a need for credit emanating from the tanning process.

Raw Material Procurement

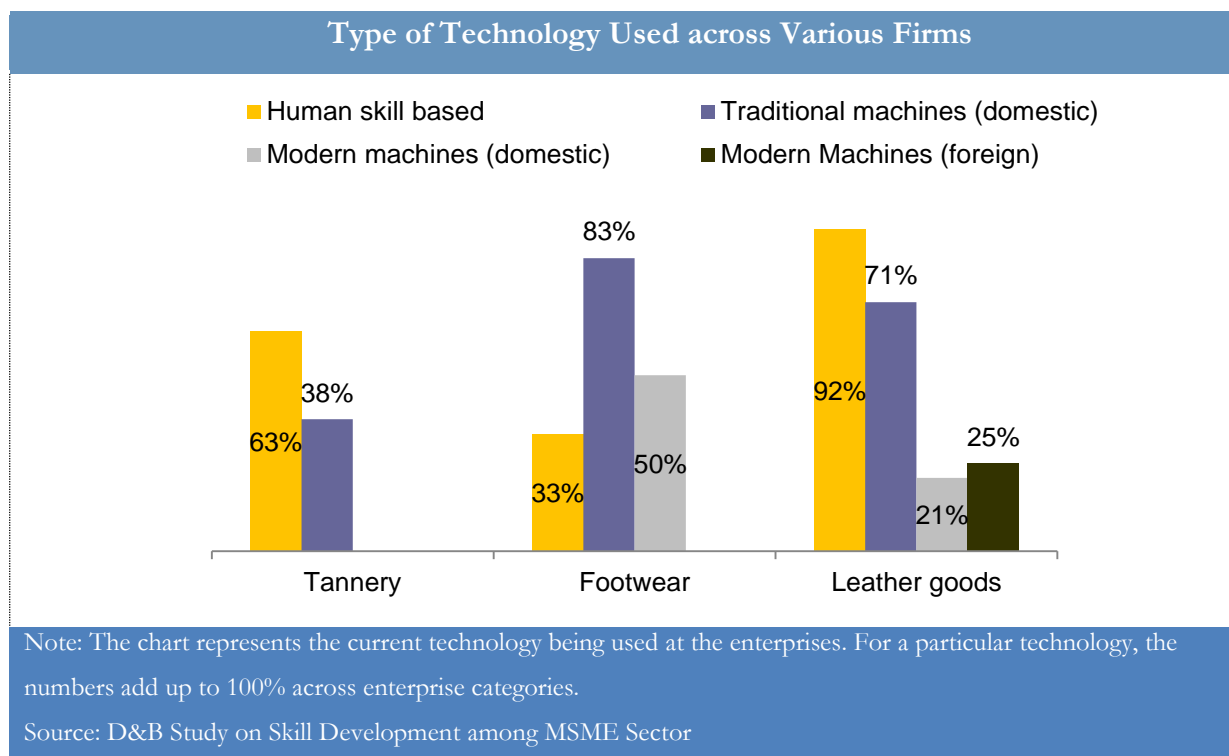
Arranging raw material is one of the prime concerns of almost all the product manufacturing firms in this cluster since the nearly 2/3rd of the product constitutes of leather cost. The manufacturers get credit period of up to 30 days for the raw material that they buy and they need to extend credit period of up to 60 days to the buyers. This leads to an increased need for working capital.

Nature of Technology Used

A significant chunk of units in the cluster are lagging behind in terms of adoption of modern technology and equipment. Majority of the tanneries have not upgraded their technology and still depend on human skills or older machines for carrying out the tanning process. It has sometimes also been alleged that some of the units employ child labor.

One of the primary reasons for using orthodox technology is the mindset of the owners who are not interested in latest technology trends or making any investments to upgrade their units. **Adoption of clean process technologies that consume significantly lower amount of harmful chemicals and water is a need in the cluster.**

In addition, the units also need to take care of the initial pretreatment processes that need to be carried out on the effluent before releasing it to the Common Effluent Treatment Plant (CETP).



The tanneries also need to invest in qualified staff who could advise them on the chemicals to be used in tanning to comply with the international regulations such as **REACH** (Registration, Evaluation, Authorization and Restriction of Chemicals). REACH is a European Union regulation which imposes restrictions on specific chemicals that can be used for tanning. Increasingly most of the foreign customers are insisting that the finished leather should be compliant with REACH regulations.

Lack of expertise and proper information avenues on technology have led to a major gap even at entrepreneurial level to ascertain the available technology. Hence, even adequate knowledge on what technology should be obtained and which of it is apt for own process is not known as well. Thus it can be categorically said that there is an urgent need for a more proactive approach especially from the tannery and footwear manufacturers' association to educate their members about the benefits of using modern technology.

The sustainability of the leather cluster requires adoption of modern and cleaner technologies and the consequent compliance to international regulations (such as REACH). This would require large capital investment by the leather units of Kolkata.

Sales Linkages

The finished leather produced by the small tanneries is primarily used by the domestic companies involved in manufacturing leather goods, footwear and industrial gloves. The tannery owners have well established customers who procure their entire output and thus these tanneries do not invest

much effort in marketing activities. The credit period extended by the tanneries to the manufacturing units ranges from up to 15-30 days for micro and small units to up to 60 for medium units.

The finished leather industry is also seasonal in nature, with demand being virtually non-existent during the monsoon months. In terms of forward linkages, majority of leather goods and industrial gloves manufacturers export their wares. While some of the firms have well established relationships and interact directly with foreign buyers, the rest are dependent on buyer seller meets for selling their products. The buyers generally demand a credit period of 30 days. Recently, The SIDBI-implemented MSMEFDP programme has enabled enterprises in Kolkata cluster to climb the value-addition ladder and manufacture high-end Fashion Gloves that yields a higher margin in the international market.

Leather footwear primarily caters to the domestic market and only a small quantity is exported. The bigger firms in the cluster such as Bata, Khadims and Sreeleathers have well established retail distribution network with majority of their production being outsourced to smaller units in the cluster.

Quality Management

A significant proportion of micro and small enterprises employ only **sensory quality checking** for their products. However the awareness level about European CE and other **standard quality norms** is quite good among the medium enterprises. The firms which are directly involved in exports also have good understanding of these norms. The owners of micro and the small units need to be made aware of quality standards and importance of formulating a standard quality process for the enterprise.

Also, while all the medium entrepreneurs are aware of the need for using pre-certified / tested raw materials, there is a gap in awareness among the micro and small units. Leather goods manufacturer must ensure that they use finished leather certified by Central Leather Research Institute (CLRI) or other agencies. In case of tanneries, the entrepreneurs must ensure that they use the proper chemicals as per international norms.

Financial Mismanagement

In the Kolkata Leather cluster the extent of sub-contracting is higher. Most of the firms in this cluster do not maintain proper books of accounts and state lower turnover in their books. This is done in order to save tax for the sub-contractor as well as the sub-contractee. The low turnover thus leads to lower working capital sanctions.

Supply of Credit to MSEs

Estimate of Outstanding Credit to MSEs in the Leather Cluster

The credit supply to the Kolkata Leather cluster is estimated to be Rs. 596 crores out of which Rs. 47 crores (8%) is term credit and Rs. 548 crores (92%) is working capital supply.

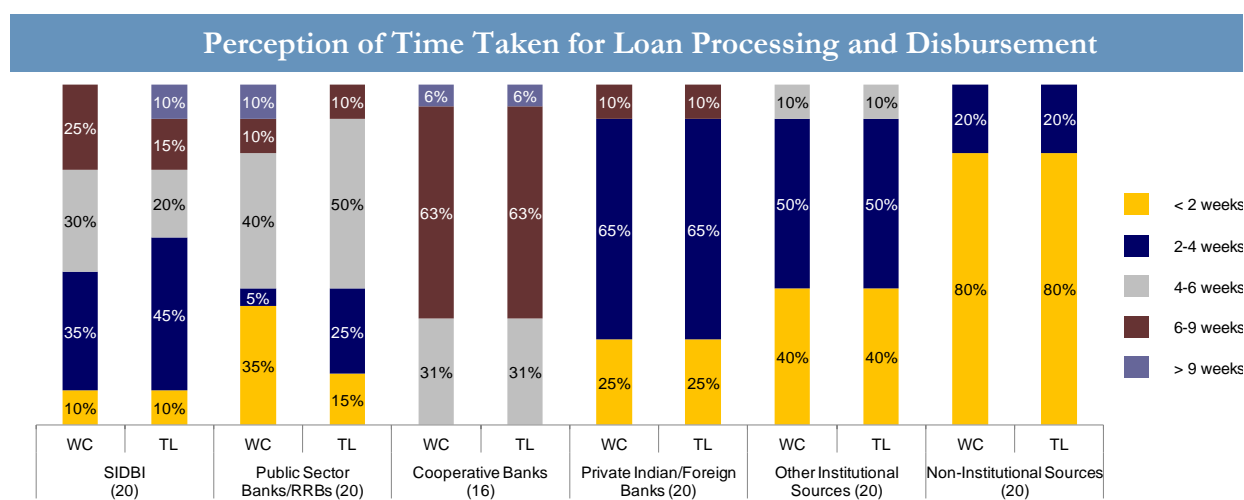
Enterprise turnover is one of the important criteria for loan appraisal process and it can be safely assumed that credit supply to the cluster is correlated to the turnover generated. Thus, D&B proposes to use the “Cluster Turnover proportion to Industry State Turnover” method to arrive at cluster level credit supply.

The steps for computation under the identified Methodology are detailed [Annexure I](#).

For the Kolkata district the lead bank scheme of Reserve Bank of India is not implemented and hence there is no segregated information being maintained by banks.

Responses were taken from 20 SIDBI customers on the overall perception of SIDBI, as well as on attributes such as time taken for loan disbursement and collateral requirement. While the respondents believed that Public Sector Banks and Private and Foreign Banks take lower time to disburse loan than SIDBI, non-institutional sources would take the least amount of time. Also, cooperative banks are believed to take longest time to process and disburse loans.

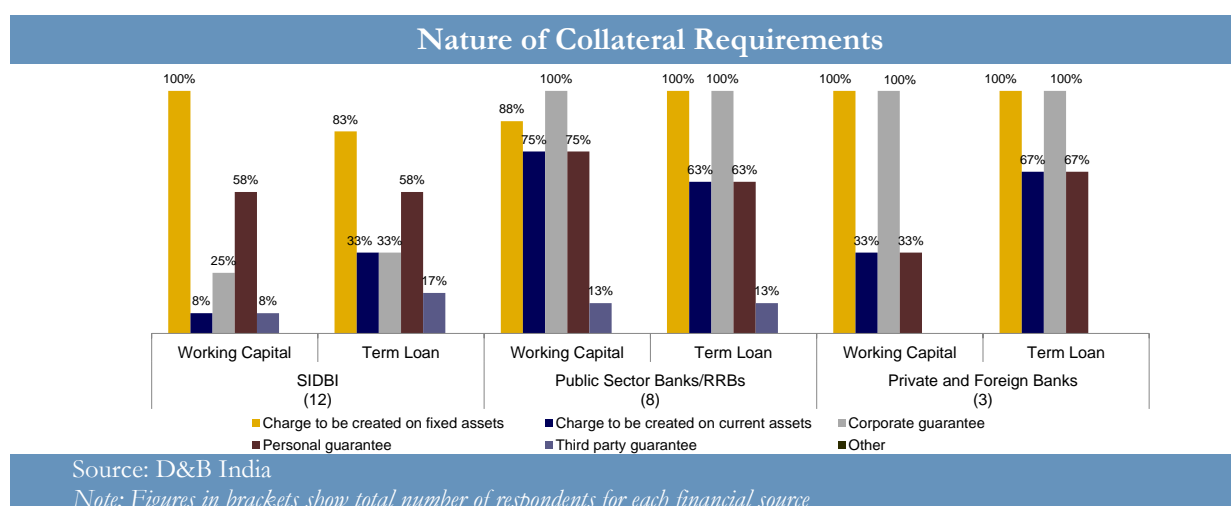
The following chart depicts perception among respondents of time taken for loan processing and disbursement by various financial sources.



Source: D&B India

Note: Figures in brackets show total number of respondents for each financial source

The following chart shows the nature of collateral requirements across various financial sources.



All financial sources are believed to have similar collateral requirements, and SIDBI term loans are believed to have significantly lower collateral requirements as compared to other sources.

Demand for Credit by MSEs

Estimate of Credit Demand by MSEs in the Leather Cluster

There are two methods that D&B India has followed to arrive at Total Credit Demand at cluster level, as mentioned in the methodology section. The methods involved are:

Nayak Committee-D&B Approach

- Working Capital Demand - Turnover Based Approach (Basis – Nayak Committee Guidelines)
- Term Capital Demand - D&B Approach (Basis – Growth in Fixed Capital)

Below are the highlights of the credit demand estimates in the cluster:-

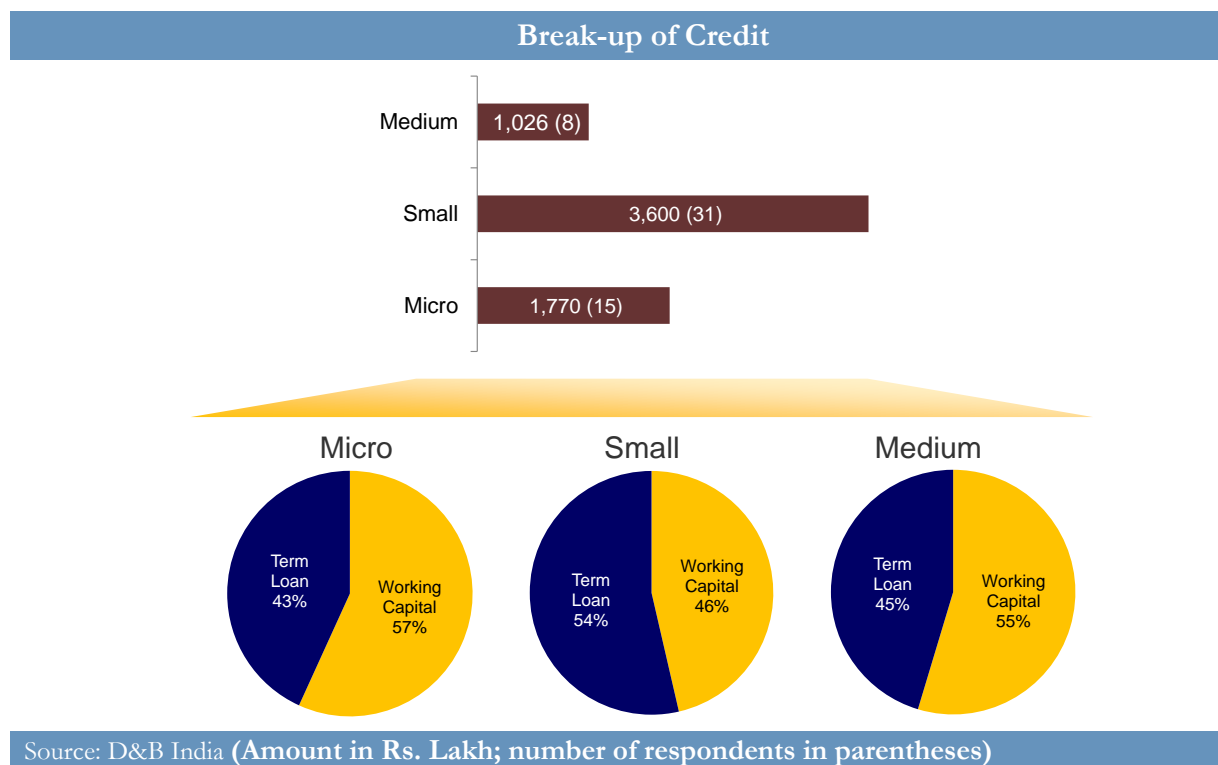
- ❖ Total number of Micro and Small units in the cluster is 4,023
- ❖ The turnover for the Kolkata Leather MSE cluster is pegged at Rs. 2,876 crores during 2010-11 from the D&B survey at cluster level.
- ❖ The turnover is estimated to rise by an annual average growth rate of 6.4% (IIP estimate) to Rs. 3,060 crores in the year 2011-12.
- ❖ Working Capital Requirement (Basis-Nayak Committee Guidelines) is estimated to be Rs. 612 crores
- ❖ Term Credit Requirement (Basis-Growth in Fixed Capital) is estimated to be Rs. 105 crores

❖ Total Credit Demand is thus obtained from above $[(612) + (105)]$ and is Rs. 717 crores

Most banks including the lead bank have indicated that for appraisals of working capital loan requirements, Nayak Committee Recommendations are being followed. The equity margin expected from promoters as per the recommendations is 20% of the working capital loan. It was also observed from the survey across categories of Micro, Small and Medium Enterprises that the average margin requirement is as high as 65% as compared to the prescribed Nayak Committee Norm of 20%. The equity margin contribution indicated by a sample of 50 enterprises in Kolkata tells us that it is 65%, 59% and 64% for micro, small and medium enterprises respectively.

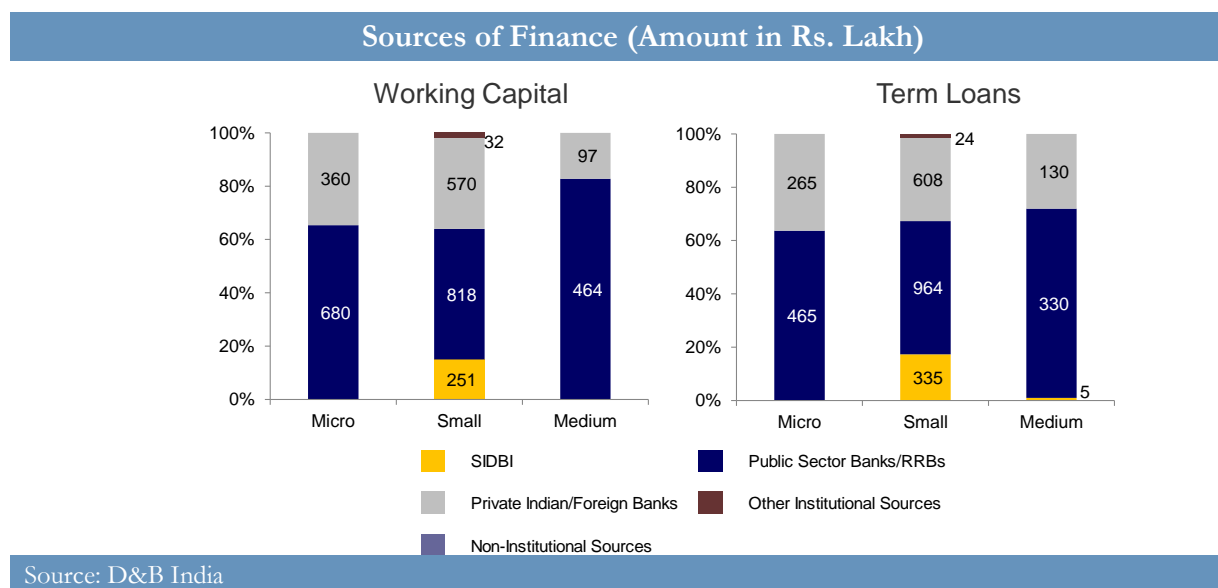
The primary reason for the high equity contribution among micro enterprises is because they are not able to provide adequate collaterals to support their financing needs and hence are required to provide a higher equity margin. Secondly, the nature of the product is seasonal and also faces risks of effluent treatment, animal skins etc. and hence banks are a little averse towards lending leather units and ask for higher equity contribution.

The following charts show the composition of credit among the 54 respondents interviewed in the survey. While 57% of the total respondents were small enterprises, 28% were micro and 15% were medium enterprises. Major requirement in the cluster is for working capital loans, in micro and medium categories, whereas it is term loans in small category.



The following chart shows composition of working capital and terms loans for the 54 respondents by sources of finance, separately for micro, small and medium enterprises. In case of working capital

and term loans, the major sources of finance for micro and medium firms are Public and Private Sector Banks, the small firms avail finance from SIDBI, Public Sector Banks and Private Sector Banks.



In summary, the total working capital credit across the surveyed 54 enterprises is around Rs. 30 crores while the term credit is also in the similar range. It is also important to note that SIDBI does not finance micro enterprises for working capital advances, while for term loans; it is actively financing small and also select medium enterprises.

Thus it can be concluded that there is a higher credit requirement for working capital needs. The following can be summarized as major reasons for the same:

- Largely seasonal and demand driven business involving in higher stocking of finished goods.
- Relatively riskier are the tanneries while the leather industries are facing issues of effluent treatment and hence, the risk perception of bankers' for this cluster is higher.
- Most of the enterprises have well-established backward linkages, however, the forward linkages depend largely on buyer-seller meets and hence, the sales realization is delayed.

From the various methods employed and explained before, the demand and supply side estimations of the cluster have been provided in the next section.

Credit Gap in the MSE Segment

For the current study, D&B considered the credit supply data of only scheduled commercial banks that form the major source of credit supply. The table below contains the estimated Credit Gap in the cluster on the basis of the two methods.

Method	Total Gap	Credit Supply	Total Credit Demand	Working Capital Demand	Term Capital Demand
Nayak Committee-D&B Method (In Rs. crores)	121	596	717	612	105

Summary of Credit Gap Assessment

There exists a significant gap in the total credit supplied to the Kolkata Leather cluster. D&B India has through its primary and secondary research identified possible reasons for why the credit demand is not being met. A summary of our findings is mentioned below,

- The cluster is considered as a high-risk cluster by the bankers mainly because most of the units are still using traditional techniques of production. This has made the cluster units uncompetitive when compared to the new-technology driven enterprises producing similar products using better technology in other parts of the country.
- The working capital need is higher because of most of units have to buy raw material on a month's credit, whereas they have to further extend credit period of up to 2 months. Raw material consists of significant chunk of their product costs, this leads to an increased need for working capital.
- Since the extent of sub-contracting is higher, the firms do not tend to maintain proper books of accounts; neither do the small enterprises encourage the micro supplier to do so. This is largely done to save tax of both the parties, the sub-contractor as well as the sub-contractee. At times, the size of the order or the total turnover stated is lower, which leads to lower working capital sanctions.
- Most of the units do not even approach the banks for their requirements with the apprehension of excessive documentation, site-audits and inspections etc.
- Quality standards are not followed which makes the product export-uncompetitive.

Additionally, quality of credit received by various enterprises can be judged from three factors viz., time taken for loan processing, loan interest rate, and adequacy of credit. It has been observed that around 77-80% of the lending for Kolkata Leather Cluster is routed through SBI and other nationalized banks, the perception of other banks like the private Indian and foreign banks is that

they tend to take lower time for processing the loans. Also, most of the times the loan actually received is much lower than the loan required by the enterprises.

The leather industry based in Kolkata is one the oldest and established industry in the state. With the kind of focus and support that the central and state governments along with various multilateral aid agencies are providing if the enterprises can modernize themselves then they stand to gain a lot in the long term given it's well established linkages. For the cluster to reach such a state and be able to exploit it the banks and other financial institutions will have to play the role of enablers by providing them easy access to credit for day to day operations and also for technology up gradation and modernization. This shall go a long way in the growth of the cluster.

A Note on BDS Programmes Implemented under MSMEFDP in Kolakata Leather Cluster

BDS intervention in skill development training, under the MSMEFDP saw a total of 1799 candidates being trained, a total of 1295 candidates getting employed and skill up-gradation of 133 candidates. One of the major focus areas was the BPL and unemployed youth section where the number escalated to 1285. The growth in employment was measured to be 12.8%. There were 5 public and 8 private BDSPs involved in these skill trainings.

Value-added production saw its manifestation in the high-end fashionable gloves that helped the cluster find an answer to low-end technology, non-tariff barriers, stiff market competition, low profit margin and recession and had very high demand in the international market. At the same time the low-end industrial gloves that were exported were no longer serving their purpose, leading to a need for product diversification. In this regard, a Skill Up-gradation Training programme was organized for manufacturing the high-end leather gloves. Since there was no specialized trainer available in the country, a German consultant by the name of Werner Morbach was hired to train them. A 6 member consortium-based initiative in the name of United Creations Pvt. Ltd. saw the cluster eventually moving up the value-addition ladder with better price realization, shifting from price-based to quality-based competition, opening up doors for newer markets, niche product manufacturing and streamlining the supply chain by allotting task of making quality leather to local tanneries. The value-added Fashion Gloves saw western countries adorning it as a fashion accessory with a higher profit margin from 0.3 \$ per pair of industrial gloves in 2010 to \$ 2.26 per pair of fashion gloves in 2011.

Productivity Implementation saw 9 units benefiting by BDSP Business Analyst Group with productivity increasing by 22-26% due to introduction of lean manufacturing process and better management practices. Implementation of ERP has benefited 6 MSMEs leading to improvements in inventory management, sub-contracting practices, export execution and follow-up, production process, financial management, etc. It has also led to improvements in overall control and management efficiency.

Recommended Products and Delivery Channels

The Kolkata leather cluster is one of the oldest leather hubs in the country and currently consists of more than 4000 micro and small units besides some medium and large units. The Kolkata Leather cluster exports 60 per cent of the country's leather goods (bags, purses, wallets) and 90 per cent of hand gloves.

Requirement of Capital

The units in the Kolkata leather cluster primarily have a greater need of capital for the following reasons,

- Raw material procurement
- Technology up gradation

Since the raw material (leather) cost consists of nearly 60% of the total product cost, the majority of the units tend to buy raw material in bulk based on their demand so as to get competitive prices for the same. Also, due to ages old flaying, curing, storing and handling practices, a significant portion of the hides and skins become low grade by the time they reach the tanneries. Since high quality of leather is required for manufacture of products for export, the units are looking at importing leather from Africa and Latin America. The raw material is procured by traders who further sell it in the Indian market. This presents an opportunity, whereby industry associations can get together and procure raw material from abroad as well as procure raw material domestically thereby removing middlemen (traders) and thus leading to cheaper raw material for the units.

Also, there are lots of micro units in the cluster who find it very difficult to arrange for finances, for example shoemaking units in Janbazar, Kolkata. Absence of savings, lack of any tangible assets that could act as collaterals, and no formal work order in lieu of surety are the primary reasons for banks to refuse credit to the cluster. The artisans procure loans from local money lenders at usurious terms - 5 to 6 per cent rates of interest per month. This also presents an opportunity for the banks, self-help group and micro finance institutions to provide finance to the units.

Most of the units, tanneries as well as manufacturing units, currently are using dated/traditional technology. Tanneries in the cluster are still using human skill based processed for tanning while a small percentage of units use traditional domestic machines. In addition to this most of the tanneries don't have an ETP.

The adoption of technology is a little better in the leather products sector since a lot of units are exporting to customers abroad.

Kolkata is home to few major footwear manufacturers such as Bata, Khadim, Sree Leathers who are servicing both domestic as well as international markets. Since investing in own production facilities involve incurring many additional costs and results in less flexibility, the units have consciously encouraged sub-contracting to small enterprises. Owing to all this the adoption of technology among these small enterprises is rising but there is a long way to go before they adopt the best in class technology.

Working of Government Schemes

The Leather Industry in India was for long time reserved for small scale sector, due to which the level of investment in the leather sector has been very low. This has resulted in smaller production base and poor productivity. Given the significance of the leather industry to the overall health of the Indian economy and its employment potential, the Government of India introduced special schemes such as the Integrated Development of Leather Sector (IDLS) scheme to help the Indian leather industry and improve its competitiveness in the global market. Besides IDLS, the units can also avail collateral free loan under the Credit Guarantee Trust Scheme for Micro and Small enterprises (CGTMSE).

Integrated Development of Leather Sector (IDLS)

The present scheme is aimed at enabling existing tanneries, footwear, footwear components, and leather products units to upgrade leading to productivity gains, right-sizing of capacity, cost cutting, design and development simultaneously encouraging entrepreneurs to diversify and set up new units. The financial assistance under the scheme is an investment grant to the extent of 30% of cost of plant and machinery for SSI / MSE subject to ceiling of Rs.50 lakh for technology up gradation /modernization and/or expansion and setting up a new unit.

Although many units have availed of the facility, but it was felt after speaking to many stakeholders that the process of providing the subsidy under this scheme needs to be made more transparent. It was felt by people engaged in the trade that units with greater lobbying power generally tend to land the subsidy. Another problem with the scheme was that units have to arrange for the margin money upfront for any equipment purchases since the money is disbursed by SIDBI only once the equipment is installed in the unit, which at times adversely impact the short term financing of the units.

Though there are some problems in the implementation of the scheme, but it was unanimously felt that the scheme is very beneficial for the sector and most of the units want the IDLS scheme to be extended beyond the current scheme period which expires on March 2012.

Credit Guarantee Trust Scheme for Micro & Small Enterprises (CGTMSE)

The Credit Guarantee Fund Trust Scheme for small industries was introduced by the Government in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.25 lakh without collateral/ third party guarantees.

The banks, with their focus on profit maximization and risk mitigation, have been cagey while distributing funds under this scheme and have distributed funds to projects after carrying out a detailed evaluation taking into consideration factors such as viability of the project, promoters record, their payback capability etc. The banks insist that since CGTMSE scheme is an insurance product, it should be used in contingency situations.

Also, the banks charge a one-time fee (1.5% of the sanctioned amount) plus a yearly service fee (to the tune of 0.75% of sanctioned amount payable every year till the entire loan amount is paid back). This increases the net effective interest rate for enterprises making it more unattractive for them.

Bills Discounting

There are lots of units who are producing leather goods in this cluster for established businesses. These units make use of bill discounting facility for domestic as well as international trade. In international trade, trade bills drawn under Letters of Credit issued by banks are used to fund the receivables. This bill discounting facility is provided for a period of 3-6 months depending upon the tenor of the bill or Letter of Credit.

Descriptions of Products and Delivery Mechanisms

Reverse Factoring

The extent of sub-contracting in the cluster is quite high. A prime example of that are the large footwear manufacturers (Khadims, Bata and Sreeleathers) who outsource their production to smaller units in the cluster. Since most of the units are small banks are hesitant towards extending any factoring products to these units. In such a scenario, we can look at introducing Reverse factoring, where the bank purchases accounts receivables only from high-quality buyers. The bank only needs to collect credit information and calculate the credit risk for buyer (in this case a large transparent, internationally accredited firm). In Reverse Factoring, the credit risk is equal to the default risk of the high-quality customer, and not the risky SME.

The buyers also stand to benefit from reverse factoring. By engineering a reverse factoring arrangement with a lender and providing its customers with working capital financing, the buyer may be able to negotiate better terms with its suppliers. For example, buyers may be able to extend the terms of their accounts payable to suit their convenience. In addition, the buyer benefits from

outsourcing its own payables management (e.g. the buyer can send a payment to one lender rather than many small suppliers).

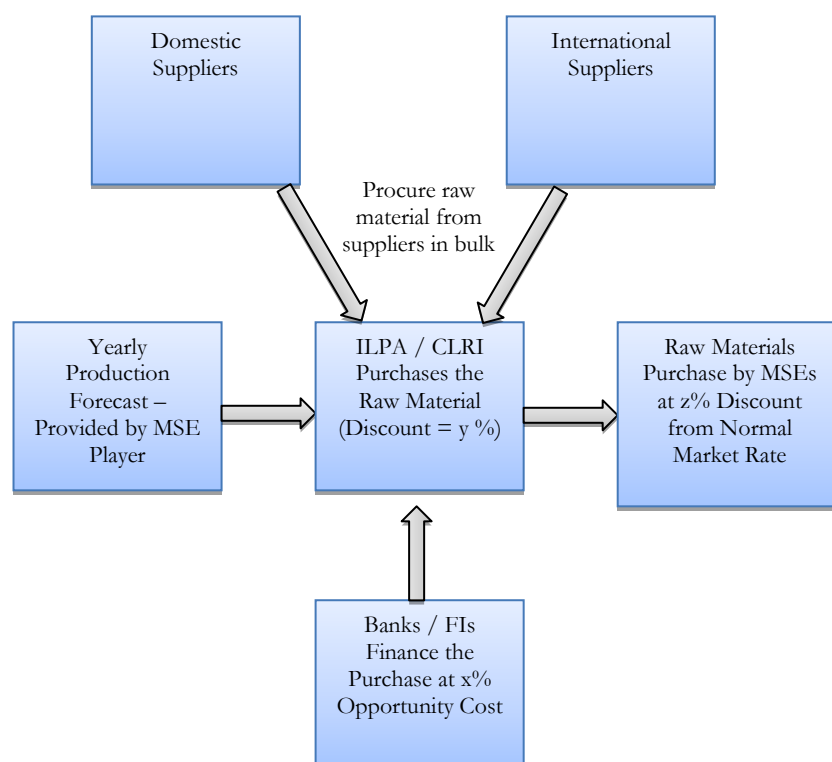
Raw Material Financing assisted by Industry Association

For leather industry the raw material cost consist of nearly 2/3rd of the product cost and hence it is essential for the enterprises to tie-up quality raw material at competitive rates.

One of the interesting ways to tackle the problem of raw material is to set up a raw material bank which will provide access to raw material to the leather units as per their requirement. In this scenario they do not have to buy and store raw material in advance, which typically impacts their cash credit cycle adversely.

In this scenario the industry association such as Indian Leather Products Association (ILPA) or the Central Leather Research Institute (CLRI) could play a larger role as being the implementing partner of the raw material bank. The individual units would provide/share their forecasted demand for raw material, which would be vetted by the association. The representatives of ILPA/CLRI would be better placed in assessing demand since they have a more minute understanding. Based on the total demand, the industry association would procure the raw material with financial institutions financing it. The raw material would serve as collateral and the industry association serving as facilitator / guarantor. The industry association could charge a nominal fee for providing this service.

Also, the quality of raw material available in India is poor and the domestic prices have also been rising steadily. In such a scenario, the raw material bank could look at also look at sourcing quality leather directly from the outside the country. This would not only help providing access to not only cheap but also quality raw material which would enable the manufacturers to convert it into better-quality products and move up the value chain.



For the loan facility to be economically feasible, the basic condition that may have to be checked at the cluster level would be $(y\%-z\% > x\%)$.

Up-scaling of Microfinance to Meet Credit Requirements of Micro enterprises

Microfinance has made significant inroads into West Bengal, which is one of the top 5 states in terms of microfinance clientele. The total number of microfinance clients in West Bengal (Credit Self Help Group (SHG) members and MFI Client put together) stood at roughly 1.0 crores in 2010, next only to Andhra Pradesh and Tamil Nadu. The various microfinance models have been tried, tested and have met with success, creating an overall conducive environment for microfinance. There are roughly 66 lakh credit SHG members in the state. Microfinance loans in West Bengal aggregated to Rs. 3,432 crores in 2010, with average loans outstanding per household standing at Rs. 8,251.

Of the 4000 leather units that form the Kolkata Leather Cluster, over 90% of the enterprises fall in the micro and unorganized category. These units are, typically, involved in tanning or work as sub-contractors to small, medium and large leather goods manufacturers. Most of these units do not even approach the banks for their requirements with the apprehension of excessive documentation, site-audits and inspections etc. There are a number of micro units engaged in production of leather goods and footwear that have working capital needs of less than Rs. 50,000. These units have no access to capital since they neither have any tangible assets which could act as collaterals nor any formal work order and hence banks refuse credit to the cluster.

Up-scaling MFIs would prove to a potent method to handle this issue. MFIs that upscale typically target the lower end of the SME spectrum that have more features in common with their existing microfinance clients, as reflected by the average loan size of micro firms. For micro firms operating on the verge of informality, up-scaling of micro-finance seems to have great potential. In such cases, up-scaling would comprise offering financial services/products that cater to the special needs of a micro enterprise. The benefits of up-scaling may encourage a transition from an informal to a formal enterprise.

MFI active in and around the Kolkata-Shantiniketan Leather cluster can modify their microfinance business models to incorporate SME operations by taking advantage of their market knowledge and network, and by adapting their microfinance methodologies.

Refinancing (or on-lending) and other support from development finance institutions, such as SIDBI, would be critical for helping MFIs adapt their current lending practices to serve the new clientele, as well as in building the MFIs' capacity in staff training and information management.

Further, a few issues need to be addressed before up-scaling of MFI can become a sustainable model:

- New Product Development

- Collection Cycle
- Recovery Mechanism
- Capacity Building for MFIs and Borrowers

Typically, MFIs have daily/weekly collection cycle, which calls for modification while serving micro and small manufacturing units. MFIs need to understand the borrower's business and particularly "Asset Conversion Cycle" and revise its credit collection cycle to suit the needs of borrowers and simultaneously ensure profitability of the lending business model. Suitable loan products and associated attributes (interest rate, tenure, and credit amount) need to be developed keeping in mind the nature of borrowers business. This shall be particularly important because the product and its attributes shall govern the efficacy of collections affecting top-line growth. Further, training would be needed both for MFIs and borrowing micro units on the business cycle, lending model, and practices adopted to ensure smooth implementation.

Historically, the MFI lending model had been successful despite the high borrowing rate of MFI from Banks. Companies in this space had built a sound base of foot-workers, creating an effective credit delivery and recovery mechanism and with the help of SHG/JLG model, they could cut down on transaction costs. This was a unique differentiator for MFIs compared to banks that did not have such effective mechanisms for credit delivery and reducing transaction costs. However, MFIs charged very high interest rate and allegedly followed coercive credit collection practices to make the lending model economically sustainable and these cast serious doubts on socially driven objective of MFIs. This has led to widespread criticism from different corners and threatened the very existence of MFIs. What followed was Andhra Pradesh MFI Act to regulate MFIs in the state and RBI Committee (Malegam Committee) Report on MFI sector detailing issues, concerns, and recommendations on the prevailing ill-effects of the MFI lending and recovery practices. The committee also reviewed the proposed Micro Finance (Development and Regulation) Bill 2010 and recommended few changes to it along with its own set of recommendations on MFI regulation.

Though, the recent MFI regulation in AP, and the more recent draft bill on MFIDR have put the MFI lending model under a scanner, the potential for such model to work effectively does exist.

Up-scaling MFI Lending – A Success Story under MSME-FDP Programme

Under the GIZ portion of MSMEFDP, an innovative financial product and delivery model for the upstream apparel supply chain had been worked out in association with a Delhi-based MFI named Satin Creditcare Network Ltd (SCNL). SIDBI had sanctioned a line of credit to SCNL for onward lending to the MSEs in the apparel supply chain. Capacity building support involved:

- A. Assistance to design and develop a special credit scheme with the following features:
1. Loan ticket size in the range of Rs.50000/- to Rs.200000/-;
 2. Loan to be available for investment in machinery or for work capital needs;
 3. Repayment period up-to 2 years;
 4. Repayment in fortnightly/monthly installments instead of daily installments depending on cash flow of the borrower;
 5. No collateral security;
- B. Assistance in HR development for appraising and risk assessment of credit to MEs
- C. Interactive sessions were held with apparel supply chain MEs to understand their needs followed by sensitization workshops to motivate them to borrow from SCNL. They were given an orientation course in accounting, finance, quality improvement and marketing after working hours.

The results of pilot intervention (started in late 2008) are as under:

1. SCNL granted loans to 60 MEs. Each ME, on an average, employed 40 workers and therefore this intervention impacted the lives of around 2400 families and around 12000 people at pilot stage;
2. The enterprises financed under the scheme have shown much better financial discipline and have been repaying installments in time with no default.

Lease Financing

A large proportion of tanneries in the cluster are using traditional forms of technology and are now looking at investing in plant and machinery as well as ETP's. Product manufacturing companies are also looking at investing in new machinery to improve their productivity and quality of merchandise.

The Government of India is running multiple schemes, where in a certain percentage of the equipment cost for technology up-gradation or setting up of an Effluent Treatment Plant is provided as subsidy. In some cases the units are found ineligible for the government grant.

In such cases, the formal financial institutions can help these units by financing their equipment purchase under lease financing. Based on promoter's record, the business's future potential in addition to unit's proven track record, banks can do lease financing for the acquisition of plant, machinery and the equipments for these units.

The typical term for the lease would be 3-5 years. The units would pay rentals to the bank for the period till when they have successfully repaid the cost of the equipment. The banks could also charge a processing fee and a lease management fee for the same.

The major advantage of lease financing is that it enables the lessee (manufacturing unit) to plan its cash flows properly. The rentals can be paid out of the cash coming into the business from the use of the same assets.

Annexure I – Estimation Method for Credit Supply

ESTIMATION OF CREDIT SUPPLY TO THE KOLKATA LEATHER CLUSTER			
	Item	Mar, 2011 Estimate	Remarks/Assumptions
1	Estimated West Bengal leather Industry Advances Outstanding - March, 2011 (Rs. crores, Projected at an expected annual growth rate of 12%)	1,010	Expected growth rate is estimated from State Level Advances (SLA) growth Rate using SLA figures ending Mar, 2010 & Mar, 2011 Source - Table 4.9- Annual-Basic Statistical Returns of SCB, Mar '2010 Source - Statement 9: RBI Quarterly-Basic Statistical Returns of SCB, Mar '2011
2	Estimated West Bengal Leather Industry Turnover - Mar, 2011 (Rs. crores, Projected at an expected annual growth rate of 10% and 11% for Year 2009-10 and 2010-11)	4,370	Expected growth rate is estimated from National IIP growth rates Source - Table 3 - ASI, Government of India, MOSPI, 2009 Source - Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug 2011
3	Cluster Sample Turnover (MSEs), Sample Size - 46 units in MSEs Sector (Rs. crores)	136	D&B Survey
4	Total Number of MSE units (4,023) in Kolkata Leather Cluster		From Kolkata Leather Cluster Diagnostic Study (DS) Report
5	Estimated the Cluster Total Turnover (MSEs, Rs crores) using (3) & (4) for year ending Mar, 2011	2,876	
6	Estimated Proportion (P1) of Cluster Turnover to State Industry Turnover using (2) and (5) [$P1 = (5) / (2)$]	65.8%	
7	Estimated the Cluster Level Credit Supply [(1) * (6)] - Rs crores	596	
8	State Level Advances – Term Loan Advance (Small Enterprise - SE) to Total Advance (SE) Proportion (P2)	8%	Estimation based on RBI's Statistical Returns-SCB Source - Table 6.1, Statistical Tables Relating to Banks in India, 2009-10
9	Using (7) and (8) Working Capital Supply is [(1-P2)*(7)].	548	
10	Using (7) and (8) Term Credit Supply is [(P2)*(7)].	47	

Annexure II – Estimation Method for Credit Demand

ESTIMATION OF CREDIT DEMAND IN THE KOLKATA LEATHER CLUSTER					
	Method		Item	Mar, 2012 Estimate	Remarks/Assumptions
	Nayak Committee Approach - Working Capital	1	Cluster Sample Turnover (MSEs), Sample Size - 46 units in MSEs Sector		D&B Survey
		2	Total Number of MSE units (4,023)		Kolkata Leather Cluster Diagnostic Report
		3	Estimated the Cluster Sample Total Turnover (MSEs, Rs crores) for year ending Mar, 2011	43	D&B Survey
		4	Estimated the Cluster Total Turnover (MSEs, Rs crores) - Mar, 2012, Expected growth rate of 6.4%	3,060	Expected growth rate is estimated from National IIP growth rates Source- Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug, 2011
		5	Basis Nayak Committee Guidelines, Working Capital Funding Requirement is 20% of Projected Turnover calculated in (3)	612	
	D&B Approach - Term Capital	6	Cluster Sample "Investments in Plant & Machinery", Sample Size - 46 in MSE Sector (Rs crores)	30	D&B Survey
		7	Total Number of MSE Units (4,023)		Kolkata Leather Cluster Diagnostic Report
		8	Estimated the Cluster Total "Investments in Plant & Machinery" (MSEs, Rs crores) using (1) & (2) for year ending Mar, 2011	874	
		9	Value in (8) projected to Mar, 2012 level using moving average growth rate of fixed capital for Industry-state wise (15%)	1,005	Source - Annual Survey of Industries (ASI) estimates on Fixed Capital for different industries within a state – MOSPI ASI Report, 2009-10
		10	(9) - (8) gives the growth in fixed capital	131	
		11	80% of (10) is estimated to be Term Credit Funding Requirement	105	
	Total Credit Demand	12	Total Credit Demand [612 + 105] calculated above in [(5) and (11)]	717	

Ludhiana Knit-Wear Cluster

Overview

Ludhiana is the largest industrial hub of Punjab state. Also known as the *Manchester of India*, the knitwear cluster of Ludhiana is famous for its woolen garments and contributes almost 80% of the total woolen garments output of the country. The product range of the cluster includes both summer and winter wear garments for men, women and children.

Though the cluster started off as a woolen knitwear cluster, it is gradually getting transformed into a highly diversified knitwear cluster on account of market dynamics extending better margins and market reach.

There are more than 14,000 MSME firms in the cluster, 70% of which fall under the category of micro enterprises. It is estimated that in the year 2009-10, the industry provided direct and indirect employment to more than four lakh people.

The following presents the overview of the Ludhiana Knitwear Cluster,

Ludhiana Cluster Information		
Particular	No. of Units	Employment Direct & Indirect (nos.)
Micro Units	9800	215,000
Small Units	2800	90,000
Medium Units	1400	40,000

Source: Diagnostic Study Report on Ludhiana Cluster prepared by Entrepreneurship Development Institute of India (EDI)

The MSE units in the Ludhiana knitwear cluster based on D&B survey estimates, amounts to Rs. 11,906 crores.

The cluster value chain is rather long but knitwear manufacturers are at the core of the value addition cycle. Activities post knitting of the yarn and up to the garment manufacturing stage constitute about 62% of the total value addition in the ex-factory price. While spinners, dyers and sub-contracting knitting units provide backward process support, dye manufacturers, machinery manufacturers and accessory suppliers extend the raw material feed to various processes. Subcontracting is a major critical attribute of Ludhiana cluster with a large number of small and micro knitting and knitwear firms extending production and manufacturing support to the bigger firms and direct exporters.

The cluster is highly labor-intensive and labor is mostly migratory and unskilled. However, there is also skilled and semiskilled labor workforce. The direct employment generated includes skilled, semi-skilled and unskilled workers as well as those earning their livelihood indirectly through this industry.

These indirect activities relate to the forward and backward linkages within the industry such as tailoring, embroidery, packing, retailing marketing etc.

Along with serving the needs of the domestic market the Ludhiana knitwear cluster exports a significant chunk of its production. In domestic markets the sales and marketing process is facilitated by intermediate agents, wholesalers and retailers. Similarly in the export markets, merchant exporters, buying agents and buying houses assist the firms in selling their wares.

Subcontracting is a major critical attribute of Ludhiana cluster with a large number of small and micro knitting and knitwear firms extending production and manufacturing support to the bigger firms and direct exporters.

To support the textile units in Ludhiana knitwear cluster and other such the units across the country, the Government of India has launched a scheme which makes funds available to the textile units. The Technology Up gradation Fund Scheme (TUFSS), is the flagship scheme of the Ministry of Textile and was launched on April, 1999 with the objective of making funds available to the domestic textile industry for upgrading technology of existing units and also to set up new units with state-of-the-art technology for enhancing their viability in the domestic and in international market.

The scheme provides for 5 per cent interest reimbursement of the normal interest charged by the lending institutions on rupee term loan. Through the scheme covers both large mills and small units such as handlooms, it has mostly been utilized by the large units. In the decentralized segment, the scheme also covers handlooms which account for 13 per cent of total cloth production in the country and also the power loom sector. In lieu of interest subsidy, an additional option of credit linked capital subsidy has been offered for decentralized textile sector. Under TUFSS, a power loom owner can reduce cost of borrowing capital either by (i) availing 20 per cent upfront credit linked capital subsidy from enlarged credit network that include cooperative banks and other genuine NBFCs recognized by RBI, or (ii) by obtaining 5 per cent interest subsidy on loan.

Also, obtaining bank loan without collateral has been one of the main problems of small entrepreneurs. Besides, banks find lending to small enterprises as risky proposition. To take care of this problem, the Credit Guarantee Fund Trust Scheme for Micro and Small Enterprises (CGTMSE) was introduced by the Government (Ministry of Small Scale Industries) in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.10 lakh without collateral/ third party guarantees. The scheme is being operated through the Credit Guarantee Fund Trust for Small Industries (CGTSSI) set up jointly by the Government of India and the Small Industries Development Bank of India (SIDBI). The loan limit under the scheme, which was Rs.10 lakh per borrower, has since been enhanced to Rs.25 lakh per borrower.

Sources of Demand for Credit

Raw Material

Material credit is the primary reason for most of the enterprises requiring working capital. The raw materials used in the cluster for knitwear garments are pure wool, recycled wool, cash melon and acrylic. Most of these raw material suppliers ask for upfront payments, mainly due to the cyclical nature of the industry.

The knitting and garmenting units are dependent on yarn producers and suppliers, chemical suppliers, accessory suppliers, packing material suppliers, fabricating units and distribution networks for making their end products. Raw Wool is procured by spinning units through cluster agents from countries such as Australia, New Zealand and China. Woollen yarn supplied by spinning units is the raw material used for fabric knitting. The period 2009-2011 experienced increase in the yarn prices that has posed significant challenges to the cluster. **The variability in raw material prices and the dependencies on external agencies put a lot of pressure on the working capital needs of a textile unit.**

Machinery and Maintenance

Majority of the machinery used in the cluster is domestic (94% of the units use domestic machinery), and it is largely out-dated and owing to this the extent of automation is very low. This has increased the needs for finance in the cluster, primarily for **modernization through technology up gradation**— either in form of installing new machinery or for automating the existing processes.

Also there are nearly 200-250 dyeing and processing units in the cluster. These units are engaged in dyeing of yarns, fibre and fabric. Dyeing units have conventional set-ups and now they are under pressure from Pollution Board for **installation of Effluent Treatment Plants (ETPs)**.

Labor Issues

Most of the labour is migratory in nature and comes mainly from Uttar Pradesh and Bihar. The percentage of migratory labour has registered a declining trend due to MGNREGA (Mahatma Gandhi National Rural Employment Guarantee Act) scheme of the Central Government, which ensures a minimum employment of 100 days in their home state.

This migratory and non-permanent nature of workers increases the **need to make labour payments on daily basis**. Also, due to the introduction of MGNREGA, the **demand for wages** asked by industrial labour has increased significantly.

Sales Linkages

Garments manufactured in Ludhiana have huge demand in domestic and international markets. However, payment receipts from most of the customers are not synchronized with the sales period.

While the orders are booked at the buyer-seller meets, payments are only realized after the goods are finally sold in the end-market. The buyers of these products deposit only 10-20% of the total value of goods as advance payments, which leaves the unit owners to arrange for working capital for the intermediate period.

Excise Payments

Under the excise regime, a new excise tax on finished goods has been imposed in the assessment year 2012-13. Effective March 1, 2011, a 10-percent excise tax will be collected on branded apparel and textile made-ups for retail sale in India. Previously, apparel and textile made-ups classified under Harmonized System (HS) chapters 61-63 were exempt from the tax. The 10-percent excise tax will be levied on both imported and domestically produced products. However, the tax will not apply to products for export. All such **taxes have to be paid by enterprises ex-factory, even before moving these finished goods to sales or inventories.** This has further increased the demand for cash from the enterprises. Further, due to elastic demand in the market, it is becoming increasingly difficult for manufacturers to pass this increase on to the customers.

Supply of Credit to MSEs

Estimate of Outstanding Credit to MSEs in the Knitwear Cluster

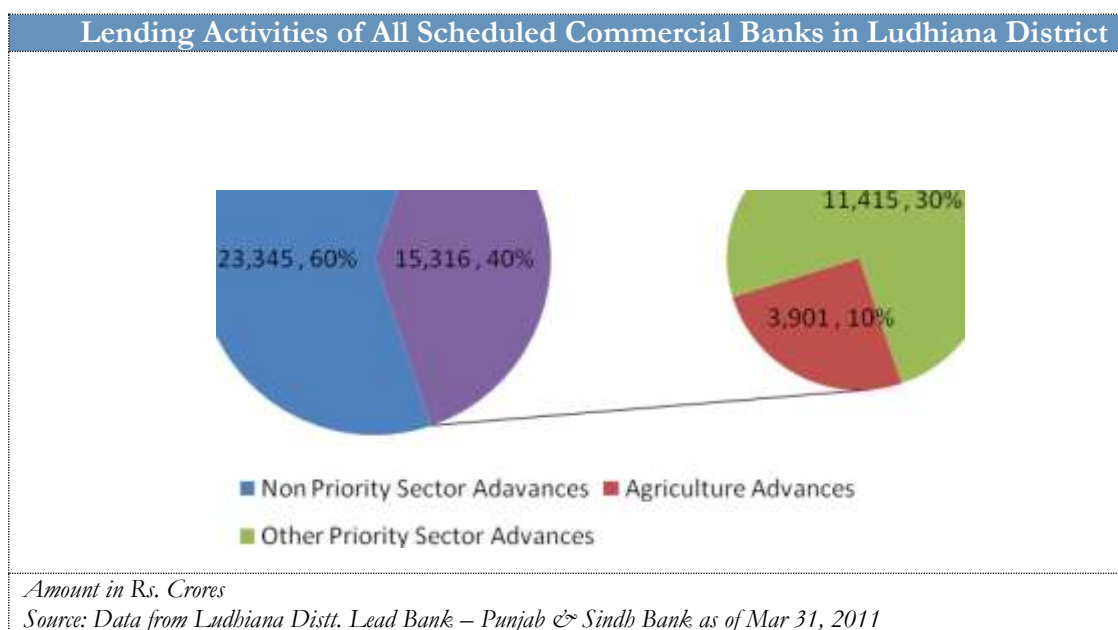
The credit supply to the Ludhiana Knitwear cluster is estimated to be Rs. 2144 crores out of which Rs. 276 crores (13%) is term credit and Rs. 1868 crores (87%) is working capital supply.

Enterprise turnover is one of the important criteria for loan appraisal process and it can be safely assumed that credit supply to the cluster is correlated to the turnover generated. Thus, D&B proposes to use the “Cluster Turnover proportion to Industry State Turnover” method to arrive at cluster level credit supply.

The steps for computation under the identified Methodology are detailed [Annexure I](#).

The data obtained through above methodology was further validated against the data on Outstanding Advances collected from the lead bank in Ludhiana district.

The RBI Lead Bank Scheme is implemented by Punjab & Sindh Bank as the lead bank in the cluster. According to the RBI Banking Statistical Returns, the outstanding credit for Ludhiana district stood at an aggregate of about Rs. 32,546 Crores (as of March 31, 2010)²⁰. Information obtained from the lead bank suggests that the outstanding credit to the priority sector could stand at Rs. 15,316 crores (40% of the total credit), which is close to the prescribed lending norm of 40% (of total advance). The following exhibit depicts the banking flow of credit in the Ludhiana District,

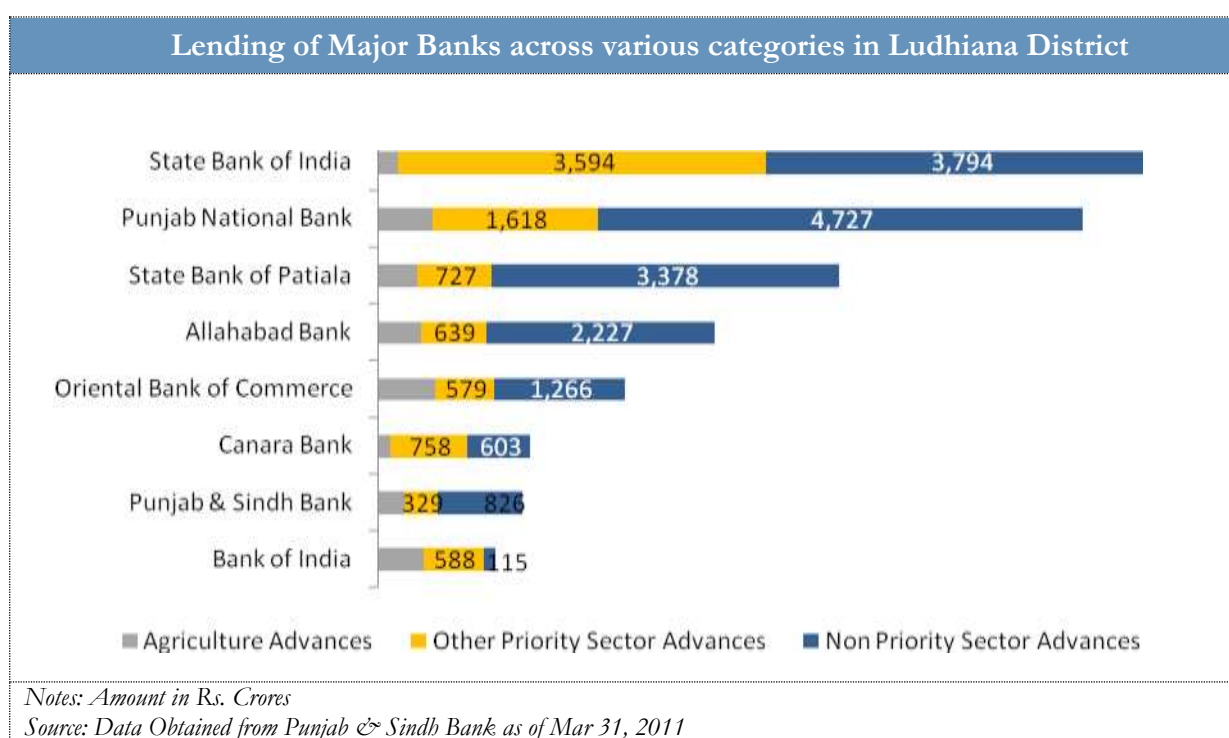


²⁰ Table 5.9, District Wise Classification of Outstanding Credit of SCBs, Basic Statistical Returns of SCBs in India, Vol 39 – Mar, 2010

Performance of Banks

Public sector banks contribute to 86% of the total credit and 91% of the priority sector credit. In contrast, private sector banks contribute to 13% of the total credit, and 8% of the priority sector credit. The Ludhiana district seems to be predominantly serviced by the public sector banks.

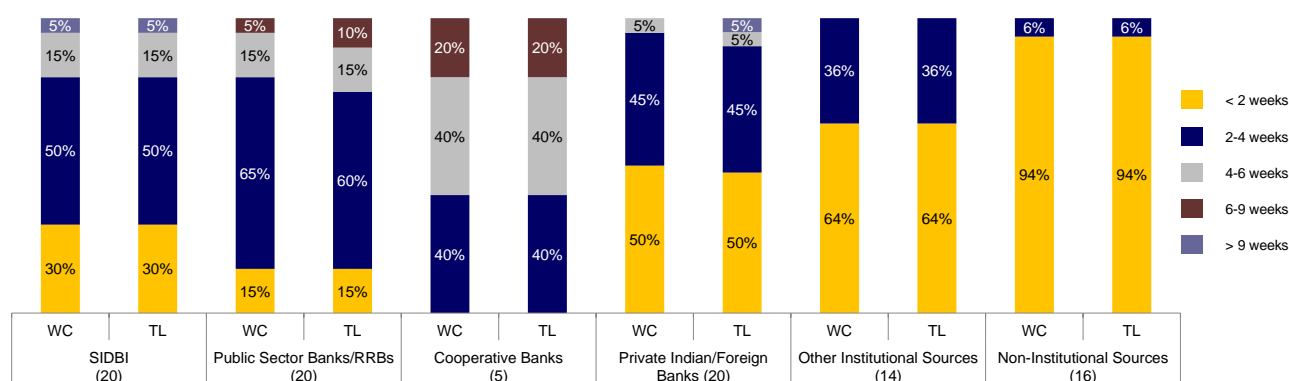
The following is the composition of Agriculture, Other Priority Sector and Non-Priority Sector credit in the Ludhiana district as of Mar 31, 2011, for the top banks. These banks contribute to 74% of the outstanding credit in the Ludhiana district. SBI has the largest outstanding credit portfolio. Punjab National Bank leads among the Public Sector Banks with largest priority sector lending portfolio.



D&B had interviewed 50 respondents on their overall perception of association with various institutional and non-institutional sources of credit supply w.r.t attributes such as time taken for loan disbursement and collateral requirement.

The following chart depicts perception among respondents of time taken for loan processing and disbursement by various financial sources.

Perception of Time Taken for Loan Processing and Disbursement



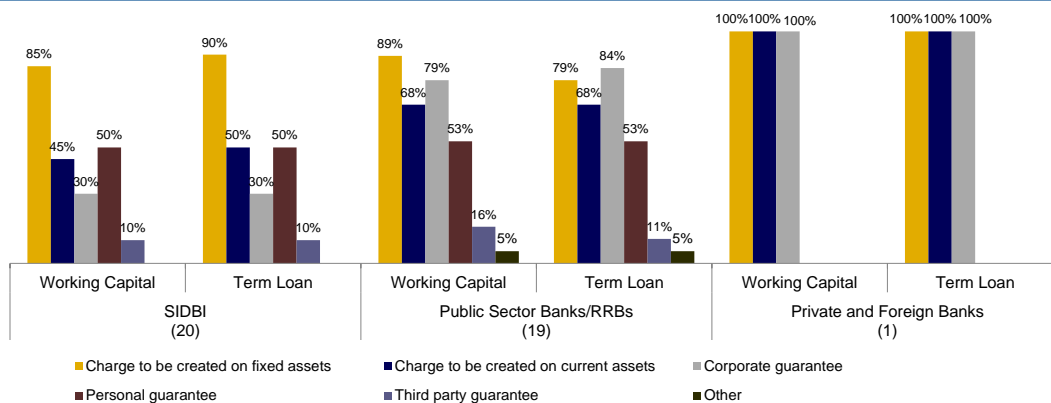
Source: D&B India

Note: Figures in brackets show total number of respondents for each financial source

Findings indicate that borrower firms believe that loans from public sector banks will take 2 to 6 weeks to get processed and disbursed, loans from co-operative banks will take up to 9 weeks to get processed and disbursed, and loans from other institutional and non-institutional sources will usually get disbursed within 2 weeks. 80% of the SIDBI customers indicated that it takes less than 4 weeks for SIDBI to sanction loans. The percentage is even higher in case of Private Indian / foreign banks.

The following chart shows the nature of collateral requirements across various financial sources,

Nature of Collateral Requirements



Source: D&B India

Note: Figures in brackets show total number of respondents for each financial source

Collateral requirements, apart from charges on fixed assets that are invariably created, are lower in case of SIDBI as compared to Public Sector Banks and Regional Rural Banks. The proportion of respondents reporting that a charge on current assets was created or a corporate guarantee was demanded is higher in case of PSBs vis-à-vis SIDBI. CGTSME loans which are collateral free are perceived as expensive by most of the enterprises, due to the guarantee fee and service fee charged over and above the interest.

Demand for Credit by MSEs

Estimate of Credit Demand by MSEs in the Knitwear Cluster

There are two methods that D&B India has followed to arrive at Total Credit Demand at cluster level, as mentioned in the methodology section. The methods involved are:

Nayak Committee-D&B Approach

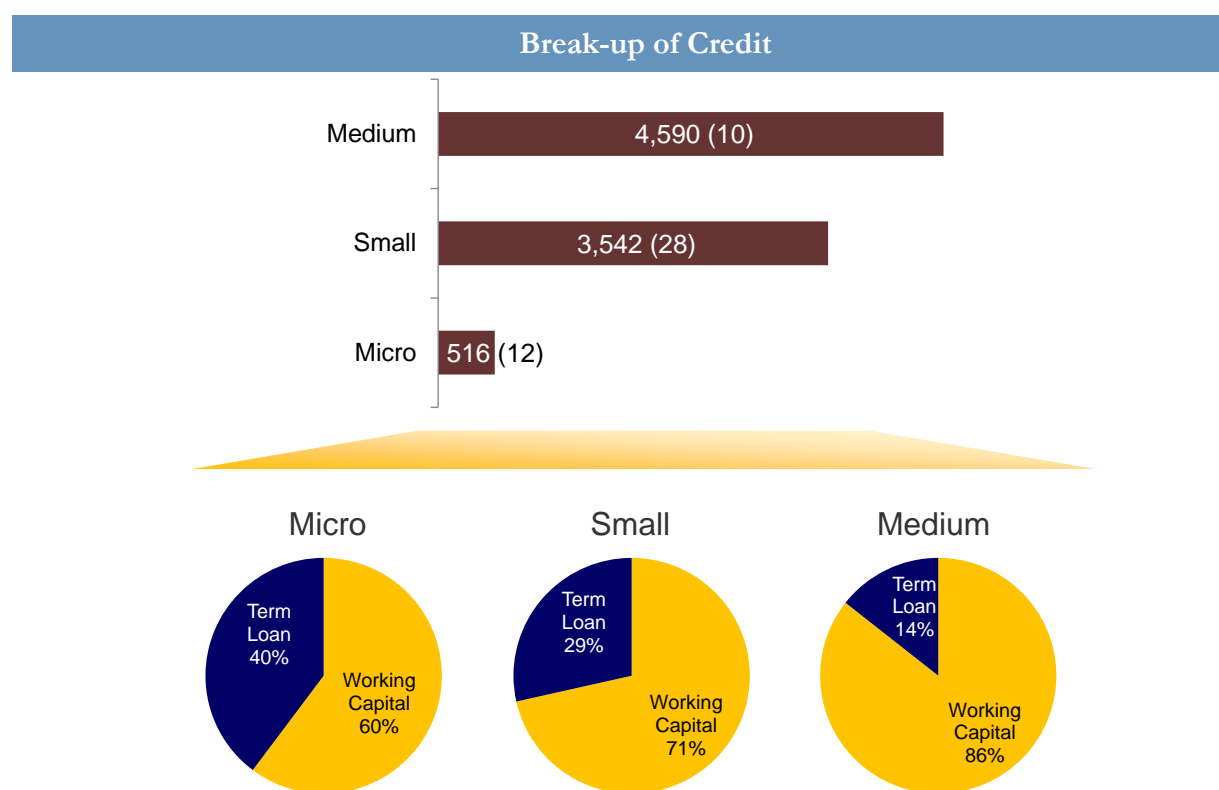
- a. Working Capital Demand - Turnover Based Approach (Basis – Nayak Committee Guidelines)
- b. Term Capital Demand - D&B Approach (Basis – Growth in Fixed Capital)

Below are the highlights of the credit demand estimates in the cluster:-

- ❖ Total number of Micro and Small units in the cluster is 12,600
- ❖ The turnover for the Ludhiana Knitwear MSE cluster, estimated based on the D&B survey at cluster level, is pegged at Rs. 11,906 crores for the 2010-11 fiscal.
- ❖ The turnover is estimated to de grow by -5.0% (IIP estimate) to become Rs. 11,307 crores in the year 2011-12.
- ❖ Working Capital Requirement (Basis-Nayak Committee Guidelines) is estimated to be Rs. 2,261 crores
- ❖ Term Credit Requirement (Basis-Growth in Fixed Capital) is estimated to be Rs. 111,8 crores
- ❖ Total Credit Demand is thus obtained from above [(2,261) + (1,118)] and is Rs. 3,379 crores

Most banks including the lead bank have indicated that for appraisals of working capital loan requirements, Nayak Committee Recommendations are being followed. The equity margin expected from promoters as per the recommendations is 20% of the working capital loan. However, in Ludhiana, it is observed that the borrower's contribution is around 50% on an average. While the average is 48% & 49% for micro and medium enterprises, it is 54% for small enterprises in the sample.

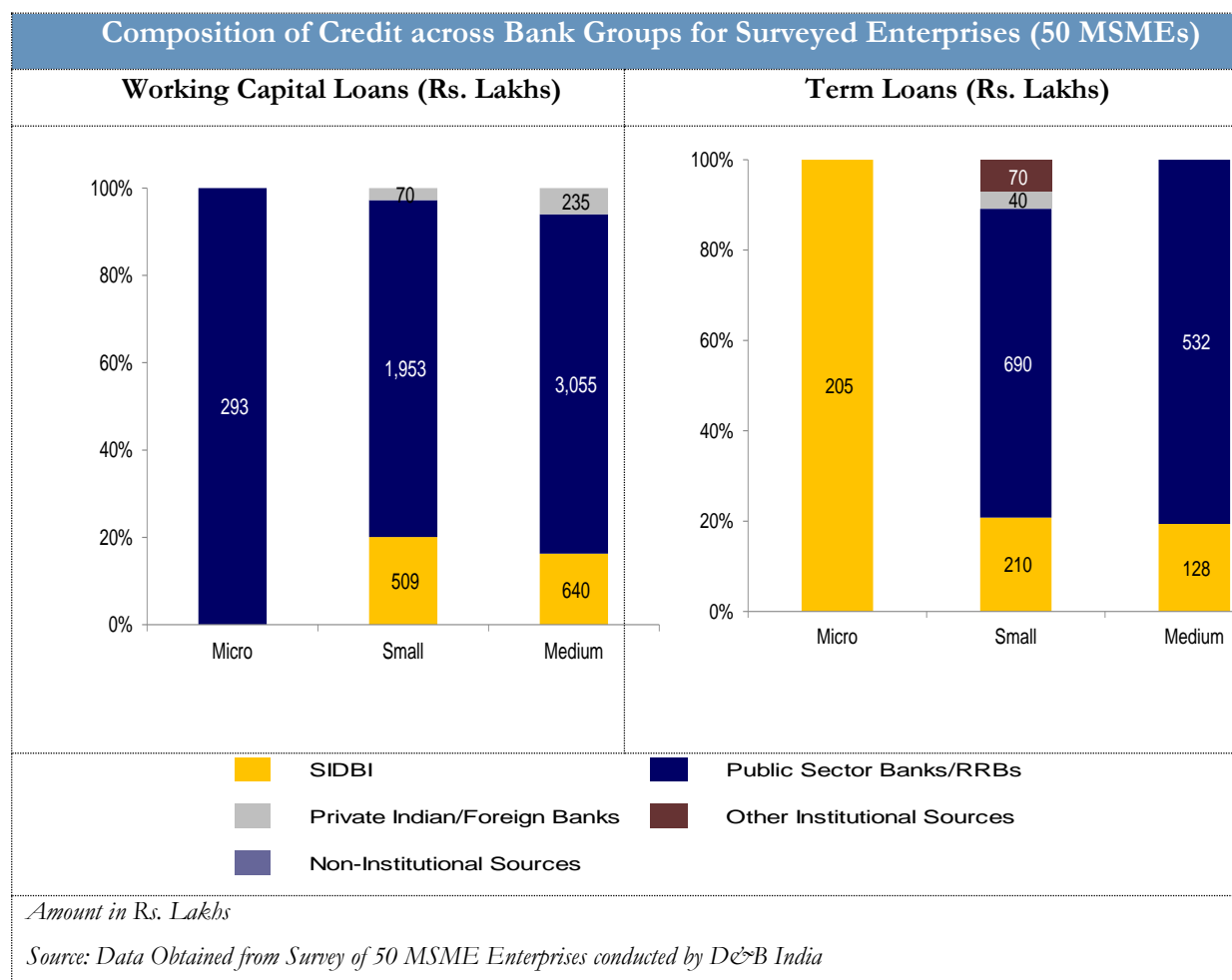
The following charts show the composition of credit among the 50 respondents interviewed in the survey.



Source: D&B India (Amount in Rs. Lakh; number of respondents in parentheses)

The primary credit requirements in the cluster are for working capital followed by term loans across all three types of enterprises. Firms in the Ludhiana Knitwear Cluster require credit right from the stage of order booking to payment realization. In terms of production as well, since there are limited instances of sub-contracting or inter-linkages amongst enterprises, working capital requirements are significant. Most of the sales in the cluster are routed to large retailers across the country through trade fairs, buyer-seller meets, and the time to realize the payments is higher. In terms of Term Loans, most of the demand is either for asset replacement or technology up gradation.

The following chart shows composition of working capital and terms loans for the 50 respondents by sources of finance, separately for Micro, Small and Medium enterprises. This data is only aggregated and presented for the sample covered, and is not extrapolated for the larger cluster.



As highlighted in the previous sections, there is an increasing need for working capital in the cluster primarily due to:

- Raw material suppliers insisting on advance payments
- The asset conversion cycle in Ludhiana in terms of number of days is large (around 180 days) from the date of order booking to realizing payments
- New trend amongst buyers (mainly retailers across country) – paying for only those products that are sold on the market and returning the unsold goods back to the enterprises increasing the uncertainty of receiving payments
- New excise imposition (10% on readymade garments) and need to settle these ex-factory
- Introduction of NREGA leading to increase in labor charges by at least 10-15%

From the various methods employed and explained before, the demand and supply side estimations of the cluster have been provided in the next section.

Credit Gap in the MSE Segment

For the current study, D&B considered the credit supply data of only scheduled commercial banks that form the major source of credit supply. The table below contains the estimated Credit Gap in the cluster on the basis of the two methods.

Method	Total Gap	Credit Supply	Total Credit Demand	Working Capital Demand	Term Capital Demand
Nayak Committee-D&B Method (In Rs. crores)	1,235	2,144	3,379	2,261	1,118

Summary of Credit Gap Assessment

In the Ludhiana Knitwear cluster the credit demand as well as gap owes largely to the working capital need of entrepreneurs in this cluster. D&B India has, through its primary & secondary research, identified possible reasons for why the credit demand is not being met, despite the fact that there are ample financial institutions in the district. A summary of the findings are mentioned below:

The micro enterprises require larger working capital loans as compared to the small and medium enterprises due to,

- Extent of sub-contracting is lower and most of the times; the order book depends on the changing market conditions.
- CGTMSE loans and SIDBI loans of small ticket size are rarely provided since bankers are interested in large value loans.
- Nature of labor hired is contractual, mainly due to seasonality of product and lack of affordability to hire full-time employees. This requires wages to be paid on daily basis most of the times.
- Due to smaller size, the bulk buyer's command a larger bargaining power and hence, these micro units have to accept unfavorable credit terms from their customers.
- Enterprises where traditional technology is currently used, inventories of machinery spares also have to be maintained increasing the working capital requirement.
- An important modification in the current credit products for micro enterprises could be a working capital loan for machinery maintenance, which can be provided on the collateral of the underlying machinery.
- The micro enterprises face major issues with collaterals and they find credit guarantee loans expensive.

There is also an observed problem of banks asking for a higher equity margins from the borrowers, since it is observed during the survey that the margin requirements are as high as 54% for small enterprises. The primary reasons for this are,

- The collateral requirements are not sufficient to cover first and second charge on the assets – mainly because most of the machinery itself is obsolete and does not fetch significant market value.
- Also, since the nature of products is seasonal, banks face the risk of non-repayment and hence ask for a larger margin contribution.

In terms of term credit, the requirement is mainly for equipment up gradation. The major issues faced in this case by most of the enterprises are,

- All equipments are not covered under the various schemes like TUFs and hence, irregular machineries and assets smaller than prescribed size cannot be procured under TUFs.
- Service needs like Common Facilities Center, Effluent Treatment Plants etc. are not covered under TUFs.
- Repayment period of TUFs loan has been restructured to 7 years from earlier limit of 10 years, making monthly payments expensive.
- The guarantee charges in CGTMSE loans are relatively higher and hence, even for term credit, micro and small borrowers tend to resort to non-institutional sources of financing.

Flexible repayments implying tolerance of delays in EMI payments, non-confiscation of the mortgaged or the hypothecated asset etc. are only possible with private banks, however, these banks ask for higher collateral and charge higher interest rates. Hence, smaller units tend to use the non-institutional credit channel.

Additionally, quality of credit received by various enterprises can be judged from three factors viz., time taken for loan processing, loan interest rate, and adequacy of credit. It has been observed that in the Ludhiana cluster although banks such as HDFC, OBC and BOI have been performing well in the cluster due to better customer services, faster loan processing times etc., though the differential rate of interest charged by these banks vis-à-vis DFIs like SIDBI range between 4-5% points.

The textile industry in Ludhiana cluster is one of the most important textile clusters in India. Although the government is rightfully bringing in lots of schemes with an aim to modernize and streamline the enterprises in this cluster, most of their schemes are not yielding the desired result. It can be said with enough certainty that if the challenges posed by the environment are met, then the Ludhiana Knitwear cluster with its well established business linkages has the potential to grow much bigger in future.

Recommended Products and Delivery Channels

The Ludhiana Knitwear cluster started off as a woolen knitwear cluster but it has gradually transformed itself into a highly diversified knitwear cluster on the back of various opportunities presented by the market, although it still retains its dominance in woolens manufacturing. The cluster at present has close to 11,600 micro and small units.

Requirement of Capital

D&B India spoke to multiple stakeholders in the Ludhiana cluster, from individual units to industry associations to commercial bank officials. Based on the interactions, D&B India has assessed that their main funding requirement is for working capital loan. The specific need of capital are discussed below,

- Raw material procurement for manufacturers
- Technology up gradation

Most of the units tend to do business through buyer seller meets where traders from across India come and place orders at a pre-determined price. Based on the orders placed, the units forecast the demand of raw material and buy the raw material from the yarn suppliers in bulk.

Also, most of the units tend to buy raw material in bulk so as to get competitive prices for the same. If the units ask for credit period from the yarn suppliers, they typically increase the price of yarn by 5-7%, which further places a strain on their finances. Further they have to extend credit of more than 100 days to their clients, which ties up the working capital finance. For the last few years the prices of yarn have been very volatile and this has posed significant challenges to the units in the cluster. Units using cotton as raw material have also been similarly impacted by the increasing cotton prices.

Most of the units in the cluster are looking at upgrading their machinery with an aim of becoming competitive. The market feedback suggests that units need to keep changing their machines every 2 to 3 years.

Working of Government Schemes

The textile industry occupies a unique place in our country. One of the earliest to come into existence in India, it accounts for 14% of the total Industrial production. The Government introduced special schemes for the development of sector such as the Technology Up gradation Fund Scheme (TUFS).

Technology Up gradation Fund Scheme (TUFS)

TUFS is the flag ship scheme of the Ministry of Textile with the objective of making funds available to the domestic textile industry for upgrading technology of existing units and also to set up new units with state-of-the-art technology. The scheme provides for 5 per cent interest reimbursement of the normal interest charged by the lending institutions on rupee term loan.

Through the scheme covers both large mills and small units but it has mostly been utilized by the large units. It has been seen that the awareness among the micro and small units is a little low and it is the general belief of all stakeholders that greater awareness needs to be raised about the plan. Units that are aware about the program have been able to avail the scheme quite effectively. In Ludhiana, the local associations have been helping units avail the scheme quite extensively.

Credit Guarantee Trust Scheme for Micro & Small Enterprises (CGTMSE)

The Credit Guarantee Fund Trust Scheme for small industries was introduced by the Government in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.25 lakh without collateral/ third party guarantees.

The units in the Ludhiana cluster find it very difficult to avail capital under the CGTMSE scheme. This is because the banks do not deem these units credit worthy. According to one statistic provided by a representative of an industry association, less than 10% of the total applicants get loans under the CGTMSE scheme. Also, those who avail the scheme are put off by the additional service charges (1.5% one time and 0.75% yearly service charge till repayment).

The general feel among the units and the industry association is that only way to make this scheme a success is by insisting on a statutory compliance by banks to distribute credit under the scheme.

Descriptions of Products and Delivery Mechanisms

Working Capital Term Loan

One of the major requirements for credit for units in Ludhiana is for arranging working capital finance for raw material purchases, wherein they require additional credit in excess of sanctioned credit limit. Such credit could be provided through a Working Capital Demand Loan (WC DL) account. Although this arrangement is presently applicable to borrowers having working capital requirement of Rs.10 crores or above, this service can extended to small enterprises with needs less than Rs. 10 crores as well.

On such additional credit, the borrower has to pay a higher rate of interest more than the normal rate of interest. Banks generally do not provide working capital finance without adequate security, but here the banks after assessing the past track record of the promoter and the company could extend the WCDLs without any additional security.

One of the major problems faced by the units in Ludhiana cluster is the credit limit set by the banks in the cluster is often not sufficient for the units to cover their working capital expenses. Since the Ludhiana cluster is a seasonal cluster, here the banks can approve separate limits for 'peak season' and 'non-peak season' which would further help the units.

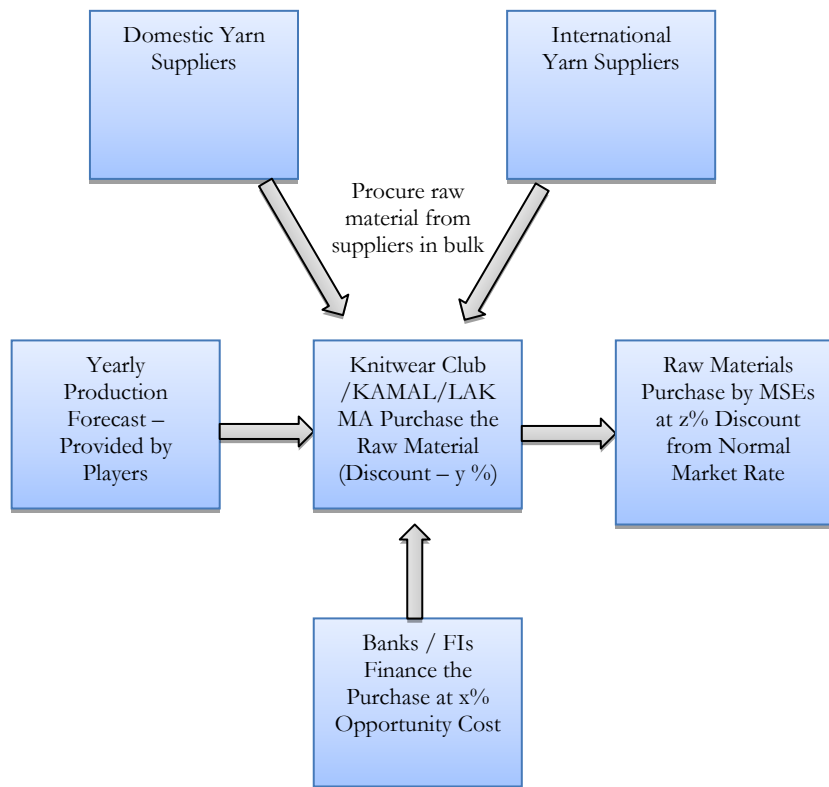
Financing MSMEs' working capital requirements through term loans will enable banks to reserve WC credit for sophisticated borrowers with established credit histories and a habit of using their bank account for business transactions.

Raw Material Financing Scheme through Industry Associations Organizing Buyer-Seller Meets

In the Ludhiana cluster, majority of the units selling woolen garments mainly sell their wares through buyer seller meets organized by various industry associations such as Knitwear club of Ludhiana, Knitwear and Apparel Manufacturers of Ludhiana (KAMAL), Ludhiana Apparel and Knitwear Manufacturer Association (LAKMA), etc. Generally the orders are placed by traders from all across the country, based on which the units assess their demand for raw material.

In such a scenario the association can play a more active role by helping the bank assess the cases of individual units and also acting as a facilitator in the whole process. Post the placement of orders by various buyers with individual firms, the associations can then aggregate the order book and raw material requirement of all the players participating in the fair and take it to any particular bank. The banks after checking the order book and after taking into account the past credentials of the unit and the local association's recommendation can extend finance for the purchase of the raw material.

Once the bank has processed the loan, the units would have to open an account with the bank to which all their receivables from the sales are directly payable to bank account the control of which resides with the bank. The major challenge would be to encourage MSE units to use bank account for their transactions, since many micro units prefer cash transactions for both purchase and receivables from customers.



For the loan facility to be economically feasible, the basic condition that may have to be checked at the cluster would be $(y\% - z\% > x\%)$.

Annexure I – Estimation Method for Credit Supply

ESTIMATION OF CREDIT SUPPLY TO THE LUDHIANA KNITWEAR CLUSTER			
	Item	Mar, 2011 Estimate	Remarks/Assumptions
1	Estimated Punjab Textile Industry Advances Outstanding - March, 2011 (Rs crores, Projected at an expected annual growth rate of 22%)	15,612	Expected growth rate is estimated from State Level Advances (SLA) growth Rate using SLA figures ending Mar, 2010 & Mar, 2011) Source - Table 4.9- Annual-Basic Statistical Returns of SCB, Mar '2010 Source - Statement 9: RBI Quarterly-Basic Statistical Returns of SCB, Mar '2011
2	Estimated Punjab Textile Industry Turnover - Mar, 2011 (Rs crores, Projected at an expected annual growth rate of 30% and 10% for Year 2009-10 and 2010-11)	28,358	Expected growth rate is estimated from National IIP growth rates Source - Table 3 - ASI, Government of India, MOSPI, 2009 Source - Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug 2011
3	Cluster Sample Turnover (MSEs), Sample Size - 40 units in MSEs Sector (Rs crores)	84	D&B Survey
4	Total Number of MSE units (12,600) in Ludhiana Knitwear Cluster		From Ludhiana Knitwear Cluster Diagnostic Study (DS) Report
5	Estimated the Cluster Total Turnover (MSEs, Rs crores) using (3) & (4) for year ending Mar, 2011	11,906	
6	Estimated Proportion (P1) of Cluster Turnover to State Industry Turnover using (2) and (5) [$P1 = (5) / (2)$]	42%	
7	Estimated the Cluster Level Credit Supply [(1) * (6)] - Rs crores	2,144	
8	State Level Advances – Term Loan Advance (Small Enterprise - SE) to Total Advance (SE) Proportion (P2)	13%	Estimation based on RBI's Statistical Returns-SCB Source - Table 6.1, Statistical Tables Relating to Banks in India, 2009-10
9	Using (7) and (8) Working Capital Supply is [(1-P2)*(7)].	1,868	
10	Using (7) and (8) Term Credit Supply is [(P2)*(7)].	276	

Annexure II – Estimation Method for Credit Demand

ESTIMATION OF CREDIT DEMAND IN THE LUDHIANA KNITWEAR CLUSTER					
	Method		Item	Mar, 2012 Estimate	Remarks/Assumptions
	Nayak Committee Approach - Working Capital	1	Cluster Sample Turnover (MSEs), Sample Size - 40 units in MSEs Sector		D&B Survey
		2	Total Number of MSE units (12,600)		Ludhiana Knitwear Cluster Diagnostic Report
		3	Estimated the Cluster Sample Total Turnover (MSEs, Rs crores) for year ending Mar, 2011	84	D&B Survey
		4	Estimated the Cluster Total Turnover (MSEs, Rs crores) - Mar, 2012, Expected growth rate of -5.0%	11,307	Expected growth rate is estimated from National IIP growth rates Source- Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug, 2011
		5	Basis Nayak Committee Guidelines, Working Capital Funding Requirement is 20% of Projected Turnover calculated in (3)	2,261	
	D&B Approach - Term Capital	6	Cluster Sample "Investments in Plant & Machinery", Sample Size - 40 in MSE Sector (Rs crores)	69	D&B Survey
		7	Total Number of MSE Units (12,600)		Ludhiana Knitwear Cluster Diagnostic Report
		8	Estimated the Cluster Total "Investments in Plant & Machinery" (MSEs, Rs crores) using (1) & (2) for year ending Mar, 2011	6,987	
		9	Value in (8) projected to Mar, 2012 level using moving average growth rate of fixed capital for Industry-state wise (20%)	8,385	Source - Annual Survey of Industries (ASI) estimates on Fixed Capital for different industries within a state – MOSPI ASI Report, 2009-10
		10	(9) - (8) gives the growth in fixed capital	1398	
		11	80% of (10) is estimated to be Term Credit Funding Requirement	1,118	
	Total Credit Demand	12	Total Credit Demand [2,261 + 1,118] calculated above in [(5) and (11)]	3,379	

Chennai Leather Cluster

Overview

Tamil Nadu is one of the largest contributors to the Indian leather industry contributing nearly 60% of the output. Of this the Chennai cluster accounts for 25% of the state's production and 15% of national output. United Nations Industrial Development Organization (UNIDO) in its Industrial Development Report 2009 identified the Chennai leather cluster as one of the 10 most dynamic industrial locations in the world.

Most of the firms in this cluster have graduated slowly from trading & exporting raw hides & skin, subsequently moved up the value chain trading semi – finished leather and finally on to product manufacturing over the period of the century.

The leather and leather products cluster of Chennai is closely integrated with global value-chains due to convenient access to large raw material, tannery base and port facilities. The Chennai cluster is estimated to contribute over Rs.1, 000 crores in terms of leather exports. The major export clientele include orders from all the sophisticated world market including Germany, France, Italy, Spain, UK etc. The cluster is estimated to have about 1140 units in the micro and small segment and about 60 units in medium sector.

The following exhibit summarizes the information about the leather cluster,

Chennai Cluster Information		
Particular	No. of Units	Employment (nos.)
Finished Leather (Tannery)	150	15,000
Product Manufacturer	300	25,000
Goods & Components (Micro Units)	700	
Large Integrated Units	4	

Source: Diagnostic Study Report on Chennai Leather Cluster prepared by Entrepreneurship Development Institute of India (EDI)

The turnover generated by the MSE units in the cluster, based on D&B survey estimates, amounts to Rs. 3,060 crores.

Since the leather industry in Tamil Nadu generates sizeable turnover and provides employment opportunities to lot of people directly and indirectly, the State Government and various Government of India ministries in collaboration with multilateral aid agencies such as United Nations Development Program (UNDP), United Nations Industrial Development Organization (UNIDO),

Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) from time to time launch various projects for upliftment of units and workers engaged in these enterprises.

One of the biggest government initiatives has been the Integrated Development of Leather Sector (IDLS) scheme. The scheme is aimed at enabling existing tanneries, footwear, footwear components and leather products units to upgrade leading to productivity gains, right-sizing of capacity, cost cutting, design and development simultaneously encouraging entrepreneurs to diversify and set up new units. The financial assistance under the scheme is an investment grant to the extent of 30% of cost of plant and machinery for SSI / MSE and 20% of cost of plant and machinery for other units (i.e. non small scale units) subject to ceiling of Rs.50 lakh for technology up gradation /modernization and/or expansion and setting up a new unit. The rate of assistance is @ 20% for all units (both SSI and Non-SSI) above Rs. 50 lakhs subject to ceiling of Rs. 2 crores.

Also, obtaining bank loan without collateral has been one of the main problems of small entrepreneurs. Besides, banks find lending to small enterprises as risky proposition. To take care of this problem, the Credit Guarantee Fund Trust Scheme for Micro and Small Enterprises (CGTMSE) was introduced by the Government (Ministry of Small Scale Industries) in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.10 lakh without collateral/ third party guarantees. The scheme is being operated through the Credit Guarantee Fund Trust for Small Industries (CGTSSI) set up jointly by the Government of India and the Small Industries Development Bank of India (SIDBI). The loan limit under the scheme, which was Rs.10 lakh per borrower, has since been enhanced to Rs.25 lakh per borrower.

The MSME Development Institute and SIDBI have been raising awareness among manufacturers and financial institutions alike about these programs (IDLS & CGTMSE) in the Chennai leather cluster. But during our interactions with various stakeholders, we have found out that the financial institutions especially banks are forthcoming to extend support to the micro and small units.

Sources of Demand for Credit

Procurement and Primary Processing

The tanneries source raw hides from hide merchants/ commission agents and slaughter houses located in and around the cluster.

The slaughter houses supplying raw hides lack proper modern infrastructure for collection of dead animals. Thus there is significant wastage in finished leather because of damages caused by rough handling at the slaughter houses. The tanneries generally get 1 months credit from their suppliers.

Raw Material Procurement

Most of the times the micro and small enterprises need to buy raw material either by paying cash or they get a credit period of at most 15-30 days. The raw material costs consist of 60-70% of the product cost. Further, the entire cash realization cycle for the enterprises ranges from 3-6 months for units with foreign clients. This leads to an increased need for working capital.

Nature of Technology Used

Environment is a major concern for the tanning industry as lots of chemicals are used in the tanning process. On top of that the tannery sector is still predominantly dependent on traditional technology for the tanning process. The effluent that is released from the traditional tanning process contains high chrome content and other harmful chemicals. Central Leather Research Institute (CLRI) has developed several cleaner processing technologies but the adoption rate for these is very low among the tanneries. There is urgent need to train tannery staff and owners about clean process technologies which would reduce their effluent discharge, energy and water consumption. In addition there is a lack of knowledge about the initial pretreatment processes that need to be carried out on the effluent before releasing it to the Common Effluent Treatment Plant (CETP).

Even among the manufacturing/production units in the Chennai cluster, the adoption rate of modern technological tools is minimum and most of the units are using dated technology and now need to make upgrade their technology in order to remain competitive in the market.

Progress on adoption of energy efficiency, water conservation and cleaner production fronts has been made under the SIDBI-implemented MSMEFDP programme in recent years.

Sales Linkages

Forward linked firms include domestic market traders, merchant exporters/importing agents. Increasingly many SMEs and practically all large firms do not make use of this channel and directly

export to their international clients. In such a scenario, these units need to invest a lot towards building direct sales linkages with their international clients which requires a lot of capital.

The smaller product manufacturers largely cater to the domestic market through traders while the bigger ones employ all three channels – some directly exporting, some indirectly through agents and others catering to the domestic market through traders.

Quality Management

A significant proportion of micro and small enterprises employ only **sensory quality checking** for their products. However the awareness level about European CE and other **standard quality norms** is quite good among the medium enterprises. Also, while all the medium entrepreneurs are aware of the need for using pre certified / tested raw materials, there is a gap in awareness among the micro and small units.

The Chennai leather cluster is mainly an export hub with significant number of units in the cluster directly involved in exports. These units are becoming aware of these norms such as REACH, ISO etc. and are now looking at investing at aggressively looking at adopting technology, since a large majority of international buyers insist that the production units should comply with the same certifications.

Financial Mismanagement

In the Chennai Leather cluster sub-contracting is quite higher, with most of the medium and even some small units are sub-contracting their work to other micro and small enterprises. Most of the firms in this cluster do not maintain proper books of accounts and state lower turnover in their books. This is done in order to save tax for the sub-contractor as well as the sub-contractee. The low turnover thus leads to lower working capital sanctions.

Supply of Credit to MSEs

Estimate of Outstanding Credit to MSEs in the Leather Cluster

The credit supply to the Chennai Leather cluster is estimated to be Rs. 588 crores out of which Rs.135 crores (23%) is term credit and Rs. 453 crores (77%) is working capital supply.

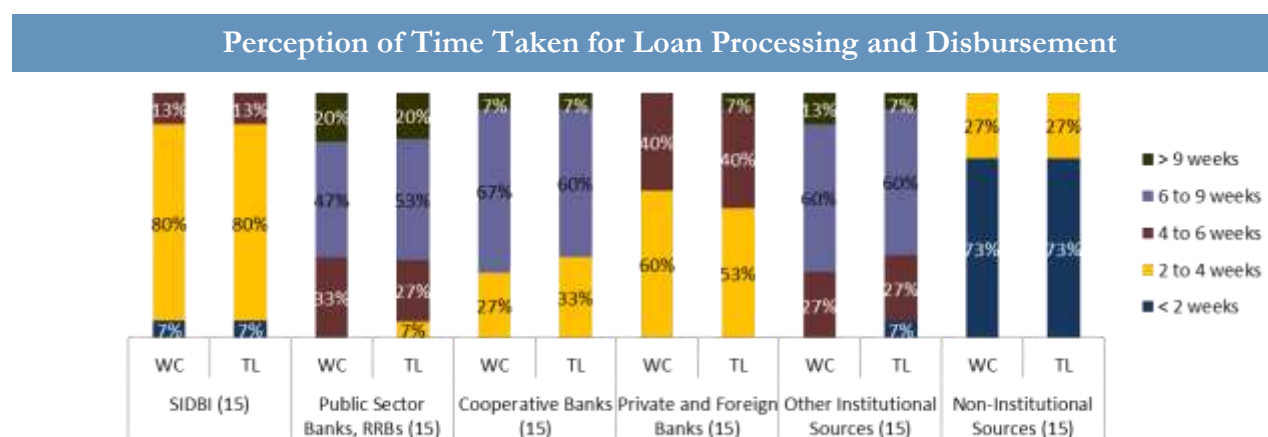
Enterprise turnover is one of the important criteria for loan appraisal process and it can be safely assumed that credit supply to the cluster is correlated to the turnover generated. Thus, D&B proposes to use the “Cluster Turnover proportion to Industry State Turnover” method to arrive at cluster level credit supply.

The steps for computation under the identified Methodology are detailed [Annexure I](#).

For the Chennai district the lead bank scheme of Reserve Bank of India is not implemented and hence there is no segregated information being maintained by banks.

37 MSMEs were interviewed on the overall perception of their association with various institutional (including SIDBI) and non-institutional sources w.r.t to time taken for loan disbursement and collateral requirement.

The following chart depicts perception among respondents of time taken for loan processing and disbursement by various financial sources,



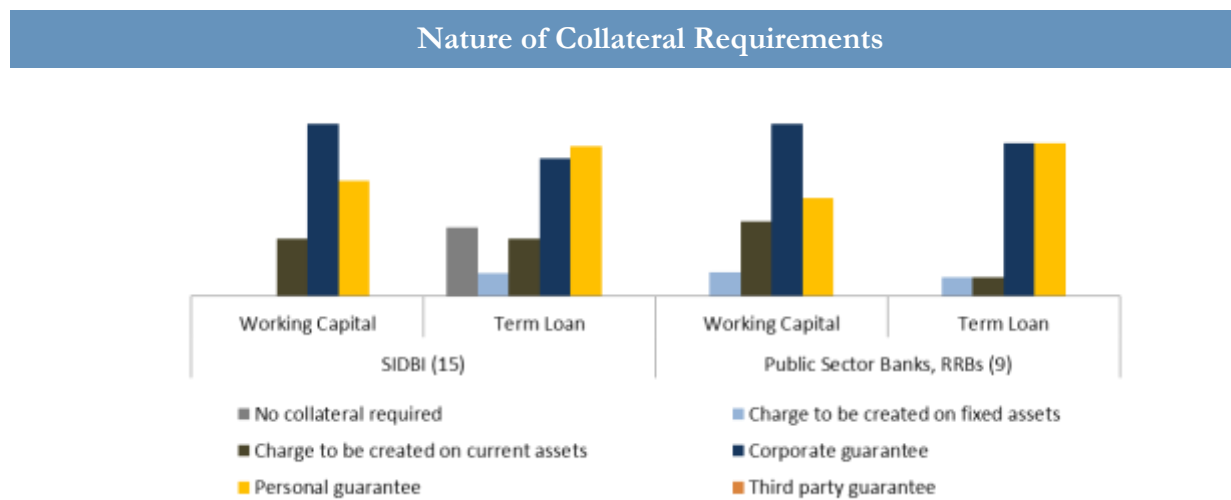
Source: D&B India

Note: Figures in brackets show total number of respondents for each financial source

SIDBI is predominantly perceived to process and disburse loans within 4 weeks, and a smaller proportion of respondents believe that it may up to 6 weeks. Private and Foreign Banks are also believed to disburse loans within 6 weeks. The perception associated with Public Sector Banks is that they may take longer than SIDBI and Private and Foreign Banks – up to 9 weeks. Non-institutional

sources of finance are believed to be the fastest in terms of loan disbursement, with over 70% of the respondents saying that funds are made available within 2 weeks' time.

The following chart shows the nature of collateral requirements across various financial sources.



Source: D&B India

Note: Figures in brackets show total number of respondents for each financial source

A majority of the respondents in the cluster claimed that they are asked for corporate and personal guarantees for loans. A relatively smaller proportion is also asked for a charge on fixed and current assets. The proportion of such respondents is similar for SIDBI customers as it is for other public sector banks and RRBs.

Demand for Credit by MSEs

Estimate of Credit Demand by MSEs in the Leather Cluster

There are two methods that D&B India has followed to arrive at Total Credit Demand at cluster level, as mentioned in the methodology section. The methods involved are:

Nayak Committee-D&B Approach

- a. Working Capital Demand - Turnover Based Approach (Basis – Nayak Committee Guidelines)
- b. Term Capital Demand - D&B Approach (Basis – Growth in Fixed Capital)

Below are the highlights of the credit demand estimates in the cluster:-

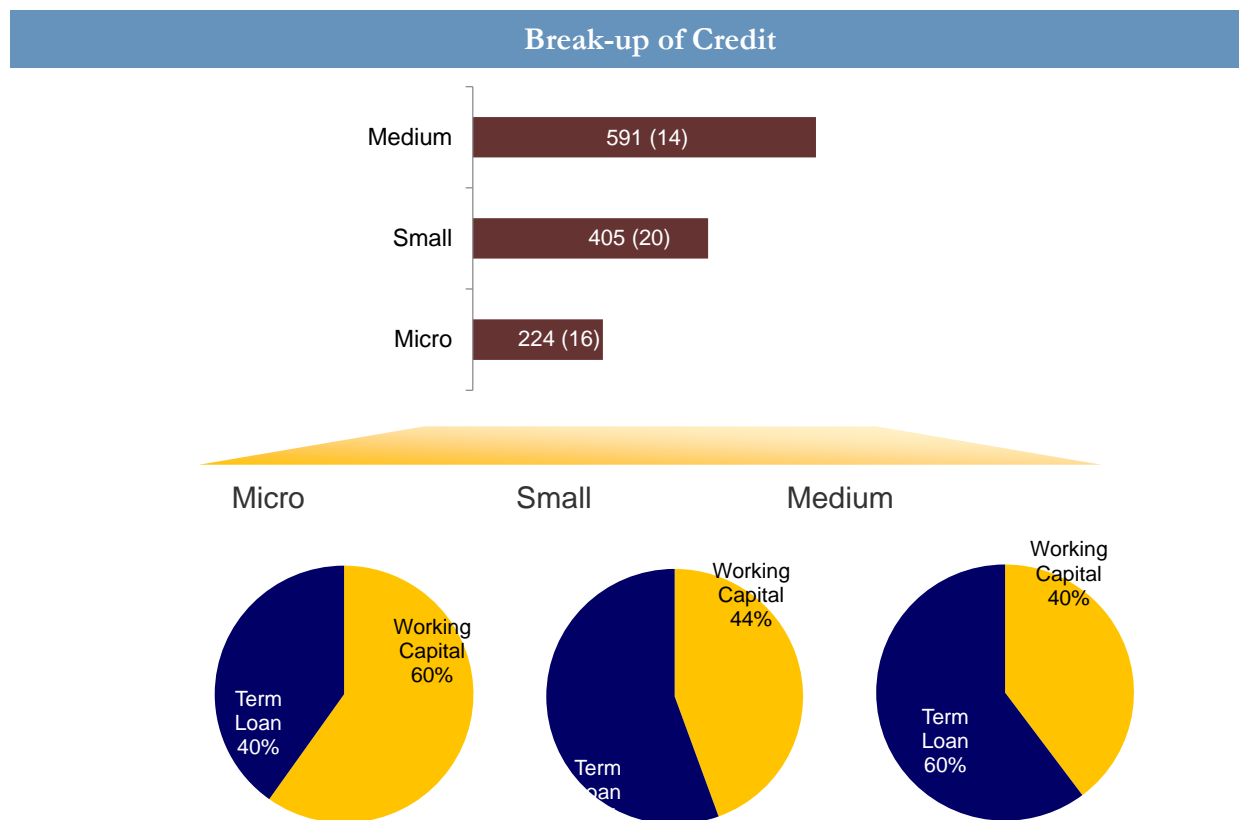
- ❖ Total number of Micro and Small units in the cluster is 1,140
- ❖ The turnover for the Chennai Leather MSE cluster is pegged at Rs. 3,060 crores during 2010-11 from the D&B survey at cluster level.
- ❖ The turnover is estimated to rise by an annual average growth rate of 6.4% (IIP estimate) to Rs. 3,256 crores in the year 2011-12.
- ❖ Working Capital Requirement (Basis-Nayak Committee Guidelines) is estimated to be Rs. 651 crores.
- ❖ Term Credit Requirement (Basis-Growth in Fixed Capital) is estimated to be Rs. 211 crores
- ❖ Total Credit Demand is thus obtained from above $[(651) + (211)]$ and is Rs. 862 crores

Most banks have indicated that for appraisals of working capital loan requirements, Nayak Committee Recommendations are being followed. The equity margin expected from promoters as per the recommendations is 20% of the working capital loan. In Chennai's case it was observed from the survey that the equity contribution varies from 28% for medium enterprises, to 33% for small enterprises and is the highest for micro enterprises at 40%.

The primary reason for a higher margin contribution demand from banks is because micro enterprises are not able to provide adequate collaterals to support their financing needs. Secondly, the nature of the product is seasonal and also faces risks of effluent treatment, animal skins etc. and

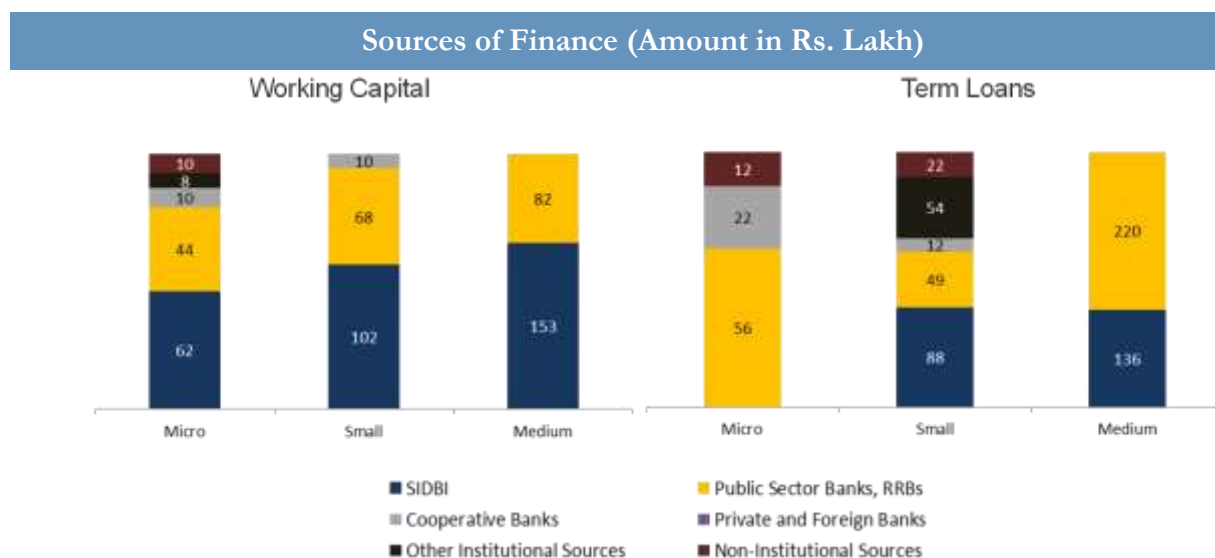
continuous agitations related to the same. Also, innovative and competitive products are available in the country at cheaper costs thereby making the units in the cluster less competitive.

The following charts show the composition of credit among the 37 respondents from the leather clusters that were interviewed in the survey. While 43% of the total respondents were micro enterprises, 37% were small and 20% were medium enterprises. Major demand among micro units is for working capital loans, and among small and medium units is for term loans.



Source: D&B India (Amount in Rs. Lakh; number of respondents in parentheses)

The following chart shows composition of working capital and terms loans for the 37 respondents by sources of finance, separately for Micro, Small and Medium enterprises. In case of working capital, SIDBI and Public Sector Banks come out to be the major sources of finance for all enterprises. In case of term loans, while micro firms largely avail the facility from Public Sector Banks and Cooperative Banks, small and medium firms avail the facility largely from SIDBI and Public Sector Banks.



Source: D&B India

A higher requirement for working capital is observed in Chennai. The following can be summarized as major reasons for the same:

- Most of the times, the manufacturers need to pay cash or at most get 15-30 days credit. Raw materials constitute 60-70% of the product cost.
- Relatively riskier are the tanneries while the leather industries are facing issues of effluent treatment and hence, the risk perception of bankers' for this cluster is higher.
- Most of the enterprises have well-established backward linkages, however, the forward linkages depend largely on buyer-seller meets and hence, the sales realization is delayed

From the various methods employed and explained before, the demand and supply side estimations of the cluster have been provided in the next section.

Credit Gap in the MSE Segment

For the current study, D&B considered the credit supply data of only scheduled commercial banks that form the major source of credit supply. The table below contains the estimated Credit Gap in the cluster on the basis of the two methods.

Method	Total Gap	Credit Supply	Total Credit Demand	Working Capital Demand	Term Capital Demand
Nayak Committee-D&B Method (In Rs. crores)	274	588	862	651	211

Summary of Credit Gap Assessment

The working capital need among the micro and small units in the Chennai Leather cluster is higher as compared to term credit need, which also translates into a significant gap in working capital credit. D&B India has, through its primary & secondary research, identified possible reasons for why the credit demand is not being met, despite the fact that there are ample financial institutions in the district. A summary of the findings are mentioned below:

- The working capital need is higher because of most of units have to buy raw material on very less or almost no credit, whereas they have to further extend credit period of up to 3-6 months. Since raw material consist of 60-70% of their product costs, this leads to an increased need for working capital.
- Since the extent of sub-contracting is higher, the firms do not tend to maintain proper books of accounts; neither do the small enterprises encourage the micro supplier to do so. This is largely done to save tax of the parties, the sub-contractor as well as the sub-contractee. At times, the size of the order book or the total stated turnover is lower which leads to lower working capital sanctions.
- The cluster is considered as a high-risk cluster by the bankers mainly because most of the units are still using traditional techniques of production. This has made the cluster units uncompetitive when compared to the technology driven enterprises producing similar products using better technology in other parts of the country.
- Lastly, the extent of manufacturing and engineering activity in Chennai is relatively higher thereby most of the focus of the banking credit is directed towards these activities.
- Some of the micro and small players also in need of term loans for technology up gradation.

Additionally, quality of credit received by various enterprises can be judged from three factors viz., time taken for loan processing, loan interest rate, and adequacy of credit. Qualitative interactions have indicated that private sector banks and certain cooperative banks require lower time for processing. The extent of NBFC based financing is also larger in Chennai, typically led by loans backed by gold (personal collaterals). It can be clearly concluded that enterprises tend to borrow from the private banks or other institutional sources mainly because of shorter processing time taken by these institutions.

The adequacy of credit can also be judged by the extent of equity margin contribution that the enterprises need to bring in for availing the loans, which in Chennai's case is high and ranges between 28-40% for micro and small enterprises.

Chennai leather cluster is one of the leading leather clusters in India and is growing at 10-15% yoy, but the entrepreneurs in this cluster feel that if get proper support from financial institutions in form of working capital and term loans, they could grow at a much faster rate.

A Note on BDS Programmes Implemented under MSMEFDP in Chennai Leather Cluster

The MSMEFDP project, as a first step, introduced multipronged measures to control input and manufacturing cost:

- Introduction of energy efficiency methods: Energy efficiency measures were implemented in 15MSMEs had resulted in saving of energy to the tune of 15 to 20% (Rs.20.25lakhs in value) per year
- Methods to obtain raw materials at the lowest cost: Common bulk purchase of dyes and chemicals through SPV at Rs.260/kg as against Rs.400/kg has registered 30% gain in material procurement
- Introduction of lean manufacturing methods: Implementation of Lean Manufacturing in 4 units resulted in increase in production of about 50% to 75%, Improved machinery utilization by 50%; reduction in rework level by 12% to 4% and Overall operation cost reduced about 10% to 5%

Adoption of Cleaner Production Technology in 2 tanneries resulted in saving in water by 20% valued at Rs.1.12 lakh/year/unit, recovery and re-use of chemicals leading to a saving of Rs.14.40 lakh/year/unit apart from reduction in effluent discharge.

Simultaneously the Project focused in introducing SA 8000 certification among 11 MSMEs. This is to achieve the commitment of employer to social accountability, increased productivity and reduced absenteeism, response from workforce increased and Increase in safety consciousness.

The use of MIS has also been introduced to MSMEs to ensure scientific and sustained control of business parameters leading to cost control and efficiency. Training was given on latest TALLY version.

The third area of focus of the project has been in setting up three specialized SPVs/agencies to ensure sustainability of the actions demonstrated by this Project. A SPV, PTCCPL, was formed for procurement of dyes and chemicals. A New Association AFCAMMI formed for components and accessories to bridge the missing gap. Energy efficiency cell was established at BMO (PTIETC) to carry out Energy Audit to 167 tanners.

The Fourth area of focus has been to help MSMEs get a larger market share by having their own websites. Over 50 MSMEs are using this facility without project support.

The project impact is demonstrated by the fact that, 22 MSME registered a turnover of more than Rs. 20 crores in 2010-11 as against just 8 units 2008-09. Similarly 20 units showed a turnover of Rs. 3 to 5 crores in 2010-11, compared to only 11 units in 2008-09.

The MSME classified based on the export performance during 2008-09 to 2010-11 indicate that 22 units have registered more than Rs.20crores worth of export in 2010-11 as against just 7 in 2008-09. In the same way 13 MSME did exports of more than Rs.5crores in 2010-11 compared to 8 units in 2008-09. This trend has clearly demonstrated that the MSME are in the process of enhancing their exports year after year.

The sustainability of the Project initiatives is ensured as by the end of the project 2010-11, 90% of the MSME have appreciated the utility of BDSP and remaining are in the processing utilizing the BDSP.

The project had a direct impact on poverty alleviation as 20% of the participants of the training programs were from the lower income group. This skill development training improved their employability as well as wage earning capacity. This sector employs persons below poverty line and the average employment per MSME which was 130 in 2009-10 and has increased to 137 in 2010-11. In case of men, the percentage increase is 4% over the two years as against 6% for women.

Recommended Products and Delivery Channels

The Chennai leather cluster, which is also a major export hub, currently consists of 1140 micro and small units besides some medium and large units.

Requirement of Capital

The units in the Chennai leather cluster have a greater need of working capital financing as compared to term loan financing. The specific need of capital arises out of the following,

- Raw material procurement for manufacturers
- Technology up gradation
- Complying with certifications (such as REACH, ISO)
- Investments on marketing and development services

Since the raw material (leather) cost consists of nearly 60% of the total product cost, the majority of the units tend to buy raw material in bulk based on their demand so as to get competitive prices for the same. Also, due to ages old flaying, curing, storing and handling practices, a significant portion of the hides and skins become low grade by the time they reach the tanneries. Since high quality of leather is required for manufacture of products for export the units are looking at importing leather. The raw material is procured by traders who further sell it in the Indian market. This presents an opportunity, whereby industry associations can get together and procure raw material from abroad as well as domestically leading to cheaper raw material costs to the units.

Most of the units, tanneries as well as manufacturing units, currently are using dated/traditional technology. To comply with the government and client dictates (Effluent Treatment Plant) and to remain competitive (as compared to other international players) the units are now investing in technology.

The Chennai leather cluster is an export hub of leather goods and a big chunk of units in the cluster are producing for international markets either directly or indirectly. Most of these units need to comply with a host of certifications such as REACH, ISO etc. as the clients insist on the same. So the manufacturing units need to continuously keep upgrading their process to comply with the certifications.

The small scale players who are looking at working independently and sell in export markets need spend a significant amount of money on marketing and development services so as to build permanent sales linkages.

Most of the units have already leveraged their fixed assets previously and hence find it difficult to arrange for collateral for the loans. For working capital finance, the banks can look at look at developing a product based on their current assets (inventory of raw material & finished products) to better suit the needs of the units in the cluster.

Similarly, the units that comply with the quality certifications need to continuously update their process which also requires investment on part of the units. The banks could come up with loan product where the units could get a loan preapproved from the bank and avail of the loan in small chunks through the year. This would serve the needs of the units arising out of adhering to quality standards and expenses made towards marketing and development services.

Working of Government Schemes

The Leather Industry in India was for long time reserved for small scale sector, due to which the level of investment in the leather sector has been very low. This has resulted in smaller production

base and poor productivity. Given the significance of the leather industry to the overall health of the Indian economy and its employment potential, the Government of India introduced special schemes such as the Integrated Development of Leather Sector (IDLS) scheme to help the Indian leather industry and improve its competitiveness in the global market. Besides IDLS, the units can also avail collateral free loan under the Credit Guarantee Trust Scheme for Micro and Small enterprises (CGTMSE).

[Integrated Development of Leather Sector \(IDLS\)](#)

The present scheme is aimed at enabling existing tanneries, footwear, footwear components, and leather products units to upgrade leading to productivity gains, right-sizing of capacity, cost cutting, design and development simultaneously encouraging entrepreneurs to diversify and set up new units.

The financial assistance under the scheme is an investment grant to the extent of 30% of cost of plant and machinery for SSI / MSE subject to ceiling of Rs.50 lakh for technology up gradation /modernization and/or expansion and setting up a new unit.

After speaking to various stakeholders, from representative of PIU's such as CLRI to units ultimately benefiting from the scheme, it can be safely said that the IDLS scheme has been very well accepted by the enterprises, though it must be said that much more awareness needs to be raised about the scheme among the micro units. The benefit under the scheme is that a unit with multiple product lines can take subsidy for all the product lines separately.

One of the problems which units face with the IDLS scheme is that the units have to arrange for the margin money upfront for any equipment purchases since the money is disbursed by SIDBI only once the equipment is installed in the unit, which at times adversely impact the short term financing of the units. This represents a product opportunity for banks to provide for a short term loan around the margin money.

Based on the feedback received from units and the feedback received by CLRI on the scheme, it can be said that the units want the IDLS scheme to be extended beyond the current scheme period which expires on March 2012.

[Credit Guarantee Trust Scheme for Micro & Small Enterprises \(CGTMSE\)](#)

The Credit Guarantee Fund Trust Scheme for small industries was introduced by the Government in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.25 lakh without collateral/ third party guarantees.

The banks, with their focus on profit maximization and risk mitigation, have been cagey while distributing funds under this scheme and have distributed funds to projects after carrying out a detailed evaluation taking into consideration factors such as viability of the project, promoters record, their payback capability etc. The banks insist that since CGTMSE scheme is an insurance product, it should be used in contingency situations.

Also, the banks charge a one-time fee (1.5% of the sanctioned amount) plus a yearly service fee (to the tune of 0.75% of sanctioned amount payable every year till the entire loan amount is paid back). This increases the net effective interest rate for enterprises making it more unattractive for them.

Bills Discounting

The small enterprises in the Chennai leather cluster are making use of bill discounting facility for domestic as well as international trade. In international trade, trade bills drawn under Letters of Credit issued by banks are used to fund the receivables. This bill discounting facility is provided for a period of 3-6 months depending upon the tenor of the bill or Letter of Credit.

Packing Credit

Many small enterprises who are dealing with international clients directly in the Chennai cluster are making use of this product. The units take loan for manufacturing, processing, purchasing or packing of goods meant for export against a firm order or Letter of Credit. There are however some difficulties that these players may face while trying to obtain such facilities from their bankers for several reasons, e.g. the exporter may be relatively new to export business, the extent of facilities needed by him may be out of proportion to the equity of the firms or the value of collateral offered by the exporter may be inadequate.

Descriptions of Products and Delivery Mechanisms

Purchase Order Finance

It has been generally seen that most of the units are over leveraged and do not have any collateral based on which they can take the loan. In this scenario, they can make use of their orders placed by their clients by taking a loan based on the purchase order to address the problem of working capital financing.

Purchase Order Finance (POF) is one such pre-shipment finance product, wherein a manufacturing unit is able to receive working capital funds from its bank based on the order placed by any credit worthy buyer. More importantly, it allows the unit to take on multiple orders and deliver them successfully. The POF mechanism works in the following way:

- The client/customer sends across the purchase order to the manufacturing unit (seller) with all documents.
- The seller then submits the purchase order to its bank for POF.
- The bank makes a partial advance to the manufacturing unit on the value of the purchase order. The advance is made to the unit or directly to its supplier to cover the costs of materials, trade goods and/or services.
- The supplier delivers the materials, goods and/or services to the seller for production of the product or assembly of the trade goods to fill the order.
- The manufacturing unit produces or assembles the goods and ships the products to the buyer.
- The unit then prepares and submits an invoice for the sale. Depending on the agreement, the invoice will go to the client/buyer or directly to the bank (or factoring company).
- The client pays the invoice according to the payment terms, usually directly to the bank.
- When the bank receives payment on the invoice from the client, the bank withholds the amount it advanced to the seller unit as repayment on the POF loan, and also deducts the agreed amount of interest and fees. The balance is then remitted to the seller.

The short terms of POF coupled with the transaction specific nature of this type of financing, the high leverage (typically with POF, only 10-40 percent of the total transaction value is advanced), and the resulting diversification of the lending portfolio help lower overall risk and provides greater flexibility. Loans can be structured in a variety of ways including to match payments to the borrower's cash flow cycle.

Raw Material Financing assisted by Industry Association

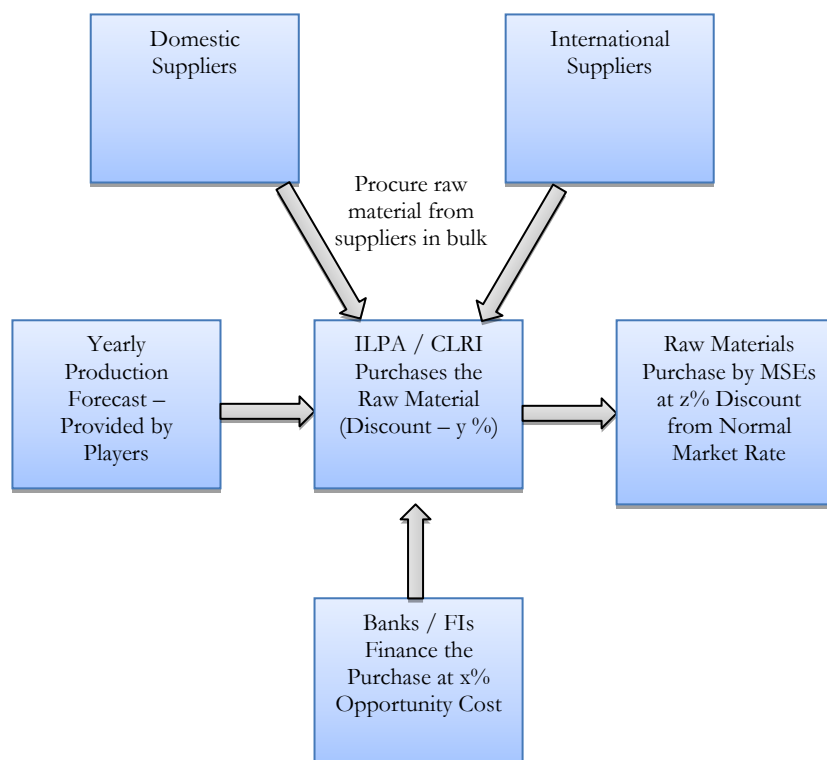
For leather industry the raw material cost consist of nearly 2/3rd of the product cost and hence it is essential for the enterprises to tie-up quality raw material at competitive rates.

One of the interesting ways to tackle the problem of raw material is to set up a raw material bank which will provide access to raw material to the leather units as per their requirement. In this scenario they won't have to buy and store raw material in advance, which typically impacts their cash credit cycle adversely. Bulk purchase has already been successfully tried for dyes and chemicals in the

cluster through a SPV (PTCCPL), under the SIDBI-implemented MSMEFDP BDS programmes, as described above.

In this scenario the industry association such as Indian Leather Products Association (ILPA) or the Central Leather Research Institute (CLRI) could play a larger role as being the implementing partner of the raw material bank. The individual units would provide/share their forecasted demand for raw material, which would be vetted by the association. The representatives of ILPA/CLRI would be better placed in assessing demand since they have a more minute understanding. Based on the total demand, the industry association would procure the raw material with financial institutions financing it. The raw material would serve as collateral and the industry association serving as guarantor. The industry association could charge a nominal fee for providing this service.

Also, the quality of raw material available in India is poor and the domestic prices have also been rising steadily. In such a scenario, the raw material bank could also look at sourcing quality leather directly from the outside the country. This would not only help providing access to not only cheap but also quality raw material which would enable the manufacturers to convert it into better-quality products and move up the value chain.



For the loan facility to be economically feasible, the basic condition that may have to be checked at the cluster would be $(y\% - z\% > x\%)$.

Lease Financing

Majority of the units in the cluster are using outdated technology in their tanning as well as manufacturing processes. The units are now looking at upgrading their technology but the major problem facing these units is that of arranging the finance for the same.

The Government of India is running multiple schemes, where in a certain percentage of the equipment cost for technology up-gradation or setting up of an Effluent Treatment Plant is provided as subsidy. In some cases the units are found ineligible for the government grant.

In such cases, the formal financial institutions can help these units by financing their equipment purchase under lease financing. Based on promoter's record, the business's future potential in addition to unit's proven track record, banks can do lease financing for the acquisition of plant, machinery and the equipments for these units.

The typical term for the lease would be 3-5 years. The units would pay rentals to the bank for the period till when they have successfully repaid the cost of the equipment. The banks could also charge a processing fee and a lease management fee for the same. Till the time the entire amount has been paid back, the equipment/machinery would stand as the primary security. The possession of the equipment will remain with the borrower, while the bank would enjoy the full legal title. The equipment would become the property of the unit as soon as the debt is paid.

The major advantage of lease financing is that it enables the lessee (manufacturing unit) to plan its cash flows properly. The rentals can be paid out of the cash coming into the business from the use of the same assets.

Annexure I – Estimation Method for Credit Supply

ESTIMATION OF CREDIT SUPPLY TO THE CHENNAI LEATHER CLUSTER			
	Item	Mar, 2011 Estimate	Remarks/Assumptions
1	Estimated Tamil Nadu Leather Industry Advances Outstanding - March, 2011 (Rs crores, Projected at an expected annual growth rate of 22%)	2,592	Expected growth rate is estimated from State Level Advances (SLA) growth Rate using SLA figures ending Mar, 2010 & Mar, 2011 Source - Table 4.9- Annual-Basic Statistical Returns of SCB, Mar '2010 Source - Statement 9: RBI Quarterly-Basic Statistical Returns of SCB, Mar '2011
2	Estimated Tamil Nadu Leather Industry Turnover - Mar, 2011 (Rs. crores, Projected at an expected annual growth rate of 28% and 18% for Year 2009-10 and 2010-11)	11,078	Expected growth rate is estimated from National IIP growth rates Source - Table 3 - ASI, Government of India, MOSPI, 2009 Source - Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug 2011
3	Cluster Sample Turnover (MSEs), Sample Size - 37 units in MSEs Sector (Rs. crores)	173	D&B Survey
4	Total Number of MSE units (1,140) in Chennai Leather Cluster		From Chennai Leather Cluster Diagnostic Study (DS) Report
5	Estimated the Cluster Total Turnover (MSEs, Rs. crores) using (3) & (4) for year ending Mar, 2011	3,060	
6	Estimated Proportion (P1) of Cluster Turnover to State Industry Turnover using (2) and (5) [$P1 = (5) / (2)$]	27.6%	
7	Estimated the Cluster Level Credit Supply [(1) * (6)] – Rs. Crores	588	
8	State Level Advances – Term Loan Advance (Small Enterprise - SE) to Total Advance (SE) Proportion (P2)	23%	Estimation based on RBI's Statistical Returns-SCB Source - Table 6.1, Statistical Tables Relating to Banks in India, 2009-10
9	Using (7) and (8) Working Capital Supply is [(1-P2)*(7)].	453	
10	Using (7) and (8) Term Credit Supply is [(P2)*(7)].	135	

Annexure II – Estimation Method for Credit Demand

ESTIMATION OF CREDIT DEMAND IN THE CHENNAI LEATHER CLUSTER					
	Method		Item	Mar, 2012 Estimate	Remarks/Assumptions
	Nayak Committee Approach - Working Capital	1	Cluster Sample Turnover (MSEs), Sample Size - 37 units in MSEs Sector		D&B Survey
		2	Total Number of MSE units (1,140)		Chennai Leather Cluster Diagnostic Report
		3	Estimated the Cluster Sample Total Turnover (MSEs, Rs crores) for year ending Mar, 2011	173	D&B Survey
		4	Estimated the Cluster Total Turnover (MSEs, Rs crores) - Mar, 2012, Expected growth rate of 6.4%	3,256	Expected growth rate is estimated from National IIP growth rates Source- Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug, 2011
		5	Basis Nayak Committee Guidelines, Working Capital Funding Requirement is 20% of Projected Turnover calculated in (3)	651	
	D&B Approach - Term Capital	6	Cluster Sample "Investments in Plant & Machinery", Sample Size – 37 in MSE Sector (Rs crores)	33	D&B Survey
		7	Total Number of MSE Units (1,140)		Chennai Leather Cluster Diagnostic Report
		8	Estimated the Cluster Total "Investments in Plant & Machinery" (MSEs, Rs crores) using (1) & (2) for year ending Mar, 2011	607	
		9	Value in (8) projected to Mar, 2012 level using moving average growth rate of fixed capital for Industry-state wise (43%)	872	Source - Annual Survey of Industries (ASI) estimates on Fixed Capital for different industries within a state – MOSPI ASI Report, 2009-10
		10	(9) - (8) gives the growth in fixed capital	264	
		11	80% of (10) is estimated to be Term Credit Funding Requirement	211	
	Total Credit Demand	12	Total Credit Demand [651 + 211] calculated above in [(5) and (11)]	862	

Hyderabad Pharmaceuticals Cluster

Overview

The pharmaceutical cluster of Hyderabad is known for its bulk drug products & formulations and it currently contributes a lion's share of the total bulk drug production of Andhra Pradesh. The cluster is spread in a radius of 60 km and includes units/enterprises spread in Hyderabad, Ranga Reddy, Medak and Nalgonda districts.

The cluster which has been in existence for just 25 years, constitutes of 361 units and provides employment to 20,000 people. The key success factors for the development of Hyderabad pharmaceuticals cluster can be attributed to the strong technical knowledge of entrepreneurs, their past working experience with large and medium pharmaceutical organizations and proactive steps taken by state government in the development of infrastructure.

The following presents the overview of the Hyderabad cluster,

Hyderabad Cluster Information			
Type of Manufacturers	Type of Firm	No. of Units	Employment
Bulk Drugs	Small	86	3500
	Medium	150	12000
Formulations	Small	75	2000
	Medium	50	2500

Source: Diagnostic Study Report on Hyderabad Pharmaceutical Cluster, July 2009, prepared by APITCO

The turnover generated by the MSE units in the cluster, based on D&B survey estimates, amounts to Rs. 1,378 crores.

The units in the cluster act as contract manufacturers to large pharmaceutical organizations with majority of the units in the cluster supply bulk drugs to large organizations which are export oriented. However, with respect to pricing and contracting, the smaller firms are exploited by the larger firms through lower prices, stringent delivery schedules etc. The smaller firms also lack access to the export markets directly.

The product range of the cluster includes bulk drugs and formulations. Bulk drugs are active pharmaceutical ingredients (APIs) and formulations include tablets, syrups, capsules, ointments, orals and injectibles. Of the total production volume of the cluster, around 20-25% of bulk drugs production and around 18-22% of formulations production is exported.

Sources of Demand for Credit

Raw Material Procurement

In many cases the nearly 50% of the product cost is contributed by the cost of raw materials. Although many raw materials for various formulations are available locally, in some of the cases it has to be imported from overseas markets. Presence of middle men in this mix, sometimes leads to issues regarding quality of material supplied and also timely delivery of supply.

Most of the pharma SME's in the Hyderabad cluster are first generation entrepreneurs. Their financial status is also not very strong to tide over any short term financial requirements. Majority of these pharma SMEs either work as contract manufacturers to large pharma units or distribute their product through traders, in either cases they are not in a position to bargain terms to their advantage or realization of their bills would take longer period. There is an urgent need to provide a steady credit facility to such firms to tide over any urgent / short term financial requirements.

Quality Compliance

Pharma industry the world over is a heavily regulated industry, with lots of acts and certifications being put in place for the drug manufacturers. In India the pharma industry is covered by Drug & Cosmetic act 1945 which governs the manufacturing and quality control practices of the industry. All pharmaceutical manufacturers whether they are micro, small or large are covered under this act and are expected to follow Good Manufacturing Practices (GMP) program.

Organizations that have complied with the local GMP norms and wish to enter into outside markets, they need to upgrade their GMP norms to meet such regulations, for ex., organization to enter into US market need to meet USFDA GMP norms, to European market it is EDQM norms etc. In general there is no serious difference in any of these regulations, expect how the regulatory bodies evaluate.

It has been felt by some of the cluster firms that soft loans by way of concessional interest and higher moratorium to meet the cost facility up gradation will help the industry. Also they have indicated that any special products / packages from financial institutions for GMP implementation and up gradation will help the industry in a big way.

Manpower

With frequent changes in technology and regulations, arranging for employable manpower is a big challenge for all pharma SMEs in this cluster. Also GMP implementation requires experienced

personnel, and most of the small and medium enterprises are unable to afford such personnel to employ on a full time basis. Few SMEs are engaging external consultants on retainer basis or few are engaging some of GMP personnel of large organization on informal basis. This gap in availability of qualified personnel increases the manpower cost of the pharma SMEs.

Supply of Credit to MSEs

Estimate of Outstanding Credit to MSEs in the Pharmaceutical Cluster

The credit supply to the Hyderabad Pharmaceutical cluster is estimated to be Rs. 297 crores out of which Rs. 24 crores (8%) is term credit and Rs. 273 crores (92%) is working capital supply.

Enterprise turnover is one of the important criteria for loan appraisal process and it can be safely assumed that credit supply to the cluster is correlated to the turnover generated. Thus, D&B proposes to use the “Cluster Turnover proportion to Industry State Turnover” method to arrive at cluster level credit supply.

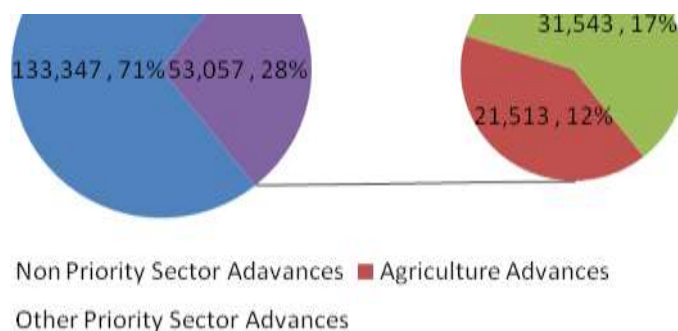
The steps for computation under the identified Methodology are detailed [Annexure I](#).

The data obtained through above methodology was further validated against the data on Outstanding Advances collected from the lead bank in Hyderabad, Ranga Reddy, Medak and Nalgonda district, since the Hyderabad pharmaceutical cluster is spread over these four districts.

The RBI Lead Bank Scheme is implemented by State Bank of Hyderabad in Hyderabad, Ranga Reddy and Nalgonda district, while State Bank of India is the lead bank in Medak district. According to the RBI Banking Statistical Returns, the outstanding credit for the 4 districts stood at an aggregate of about Rs. 154,214 Crores (as of March 31, 2010)²¹. Information obtained from the lead bank suggests that the outstanding credit to the priority sector could stand at Rs. 53,057 crores (29% of the total credit). The following exhibit depicts the banking flow of credit in these 4 districts. Priority Sector Advances in these districts is much lower than the prescribed lending norm of 40% (of total advance).

²¹ Table 5.9, District Wise Classification of Outstanding Credit of SCBs, Basic Statistical Returns of SCBs in India, Vol 39 – Mar, 2010

Lending Activities of All Scheduled Commercial Banks in Hyderabad, Ranga Reddy, Medak and Nalgonda District



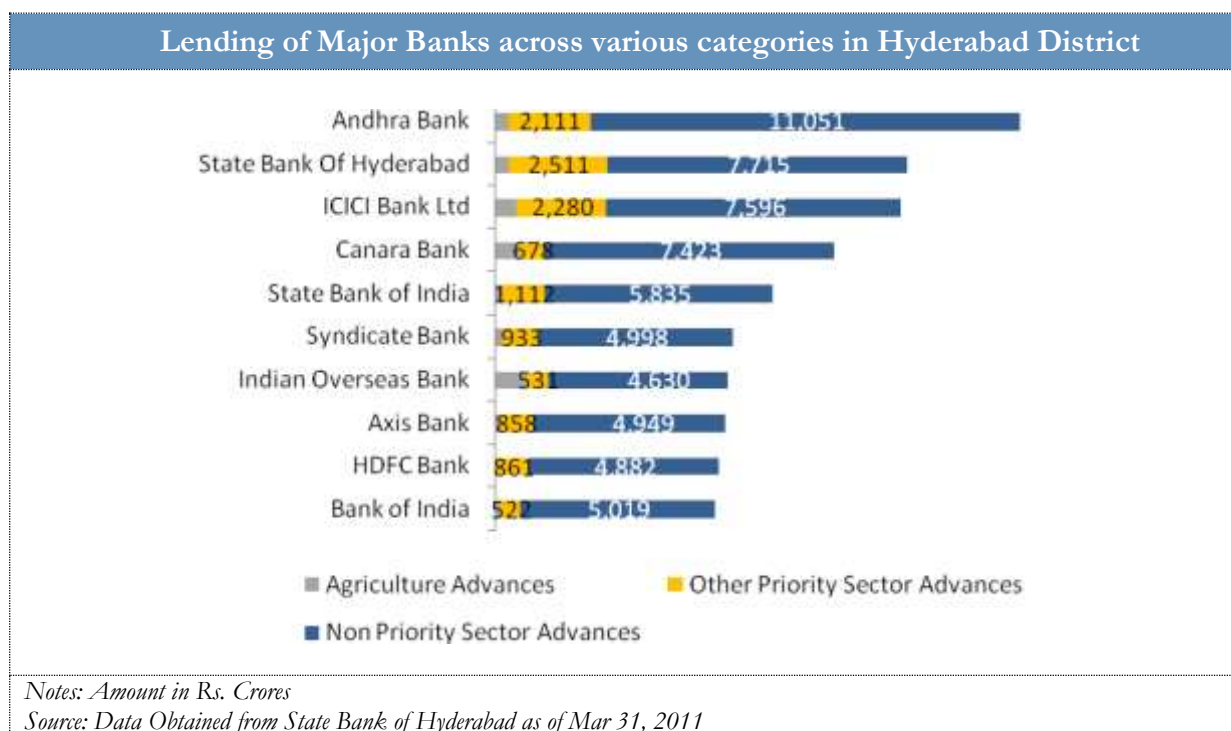
Amount in Rs. crores

Source: Data from AP SLBC website²² as of Mar 30, 2011

The lead bank scheme for the Hyderabad district is implemented by State Bank of Hyderabad. The public sector banks take the lead here contributing close to 76% of the total credit and 74% of the priority sector credit. In contrast, private sector banks contribute to 23% of the total credit, and 24% of the priority sector credit. The rest of the credit is advanced by few cooperative banks that operate in the district.

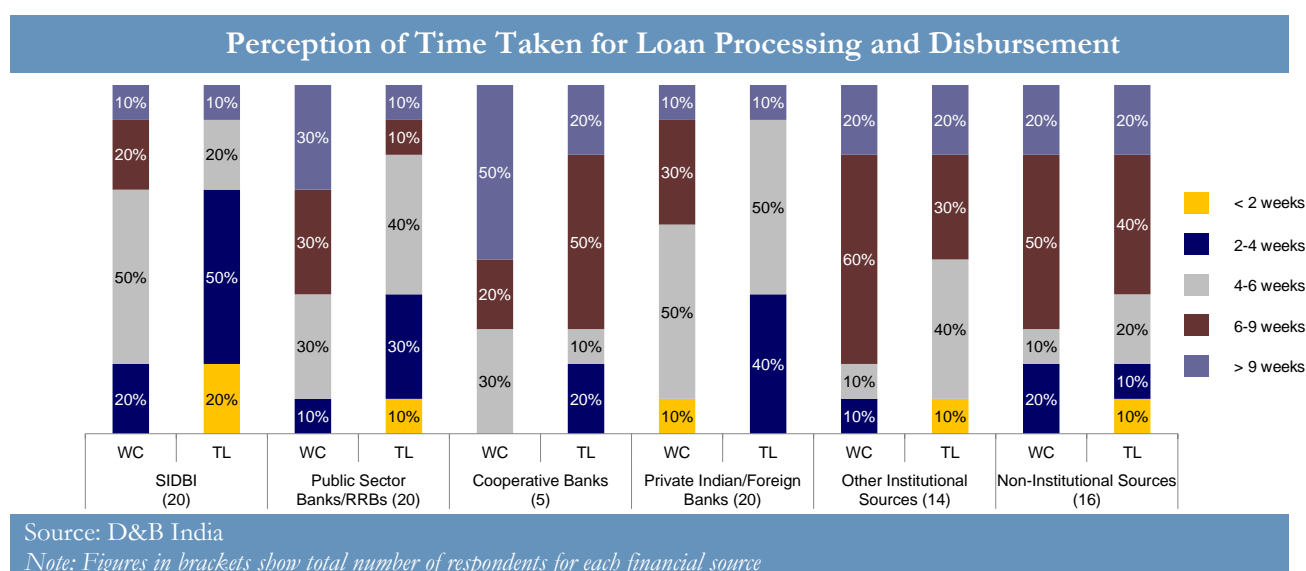
The following is the composition of Agriculture, Other Priority Sector and Non-Priority Sector credit in Hyderabad district as of Mar 31, 2011, for the top ten banks. The top 10 banks contribute to 55% of the outstanding credit in the Hyderabad district with Andhra Bank being the largest lender. ICICI Bank leads among the Private Sector Banks with the largest advances and priority sector lending portfolio.

²² Information from AP SLBC - www.slbcap.nic.in/pages/keyindicators.aspx



In the Hyderabad pharmaceutical cluster, enterprises were interviewed on the overall perception of their association with various institutional (including SIDBI) and non-institutional sources w.r.t to time taken for loan disbursement and collateral requirement.

The following chart depicts perception among respondents of time taken for loan processing and disbursement by various financial sources.

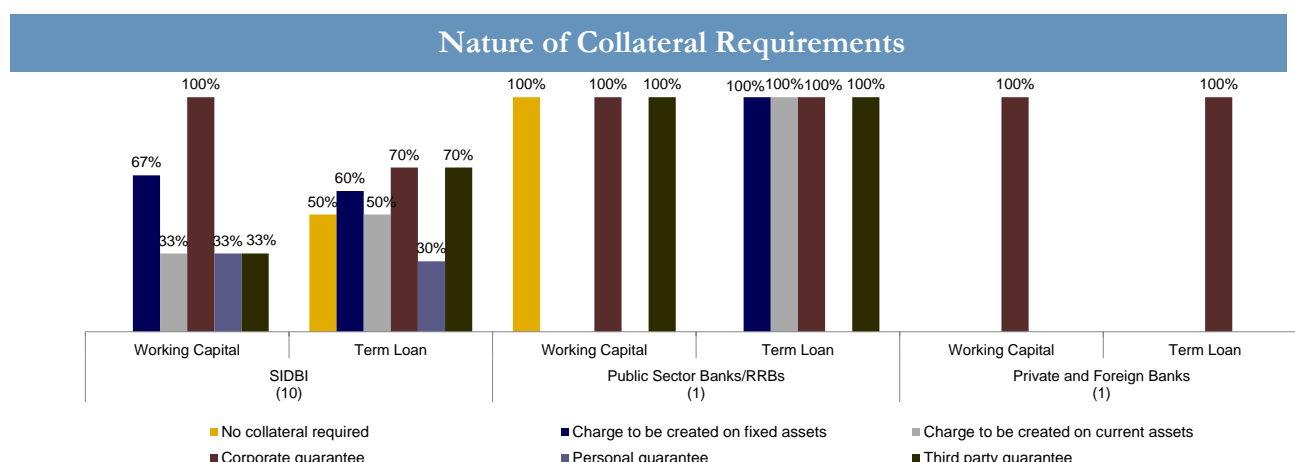


Many MSMEs are of the opinion that high loan processing time is a major issue with respect to availing of loans from public sector banks. As per the survey, 60% respondents believe that public sector banks take more than 1.5 months to process and disburse working capital loan, and more than

1 month to process and disburse term loan. Some also believed the time taken to be around 3 months.

80% of the SIDBI customers reported that SIDBI took less than 4 weeks to process applications in case of term loans – the best record among all forms of lenders. This was, however, higher in case of WC limits / loans. The following chart shows the nature of collateral requirements across various financial sources for the respondents from the Pharmaceuticals Cluster.

The following chart shows the nature of collateral requirements across various financial sources for the respondents from the Pharmaceuticals Cluster.



Source: D&B India

Note: Figures in brackets show total number of respondents for each financial source

SIDBI customers are asked for either charge on fixed assets, charge on current assets, corporate guarantee, personal guarantee, or a mix of various options. Many respondents have also availed collateral-free loans. The respondents believe that public sector banks need to actively implement government schemes such as CGTMSE, CLCSS, etc. to MSME sector. Lack of initiative in implementation of such schemes is one area which currently hinders the availability of collateral-free loans to MSMEs.

Demand for Credit by MSEs

Estimate of Credit Demand by MSEs in the Pharmaceutical Cluster

There are two methods that D&B India has followed to arrive at Total Credit Demand at cluster level, as mentioned in the methodology section. The methods involved are:

Nayak Committee-D&B Approach

- a. Working Capital Demand - Turnover Based Approach (Basis – Nayak Committee Guidelines)

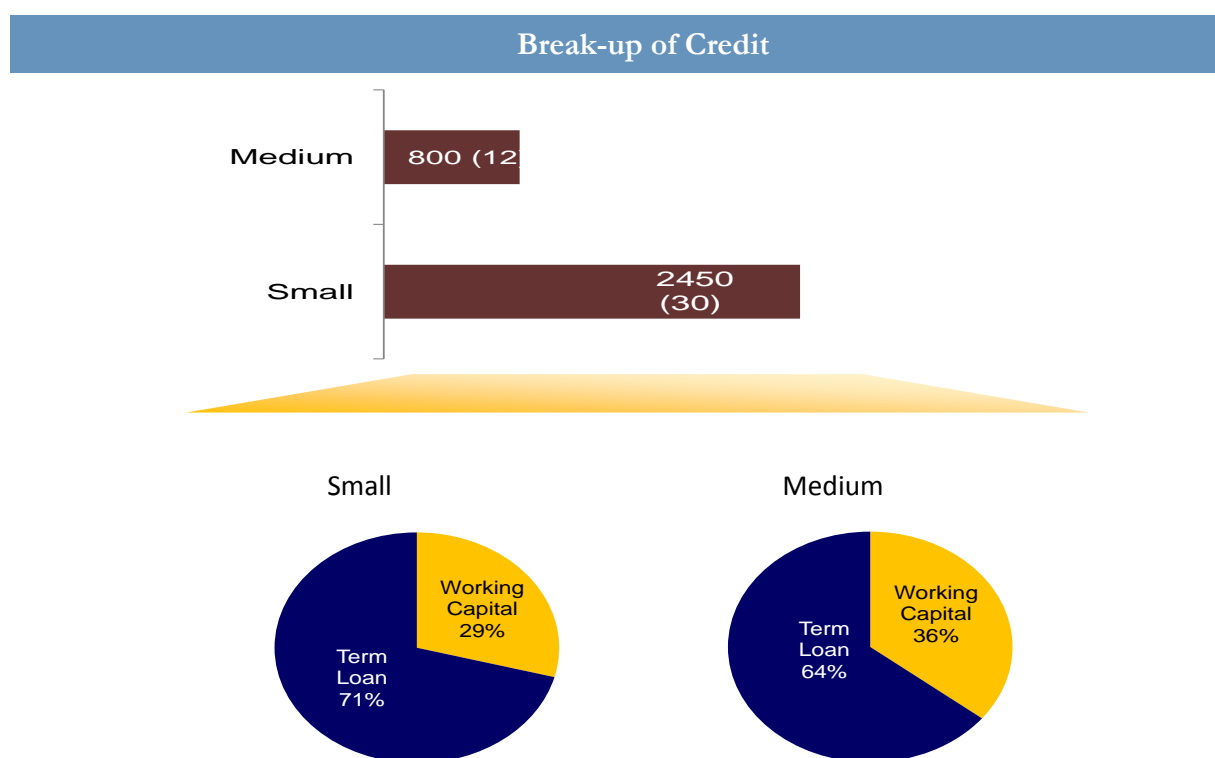
b. Term Capital Demand - D&B Approach (Basis – Growth in Fixed Capital)

Below are the highlights of the credit demand estimates in the cluster:-

- ❖ Total number of Micro and Small units in the cluster is 161
- ❖ The turnover for the Hyderabad Pharmaceutical MSE cluster is pegged at Rs. 1,378 crores during 2010-11 from the D&B survey at cluster level.
- ❖ The turnover is estimated to rise by an annual average growth rate of 2.6% (IIP estimate) to Rs. 1,414 crores in the year 2011-12.
- ❖ Working Capital Requirement (Basis-Nayak Committee Guidelines) is estimated to be Rs. 283 crores
- ❖ Term Credit Requirement (Basis-Growth in Fixed Capital) is estimated to be Rs. 120 crores
- ❖ Total Credit Demand is thus obtained from above [(283) + (120)] and is Rs. 403 crores

Most banks including the lead bank have indicated that for appraisals of working capital loan requirements, Nayak Committee Recommendations are being followed. The equity margin expected from promoters as per the recommendations is 20% of the working capital loan. However, during a survey of carried out among 36 enterprises, it was observed that this ratio has varied considerably with small enterprises having an equity margin of 24.1% and medium enterprises having an equity margin of 29.8%. It can be concluded that a higher equity margin is required, specifically from small enterprises.

The following charts show the composition of credit among the 50 respondents interviewed in the survey. The key areas where term loans are required are purchase of new machinery, up gradation of existing machinery, setting up of effluent treatment plants, and increasing the capacity of existing effluent management systems.

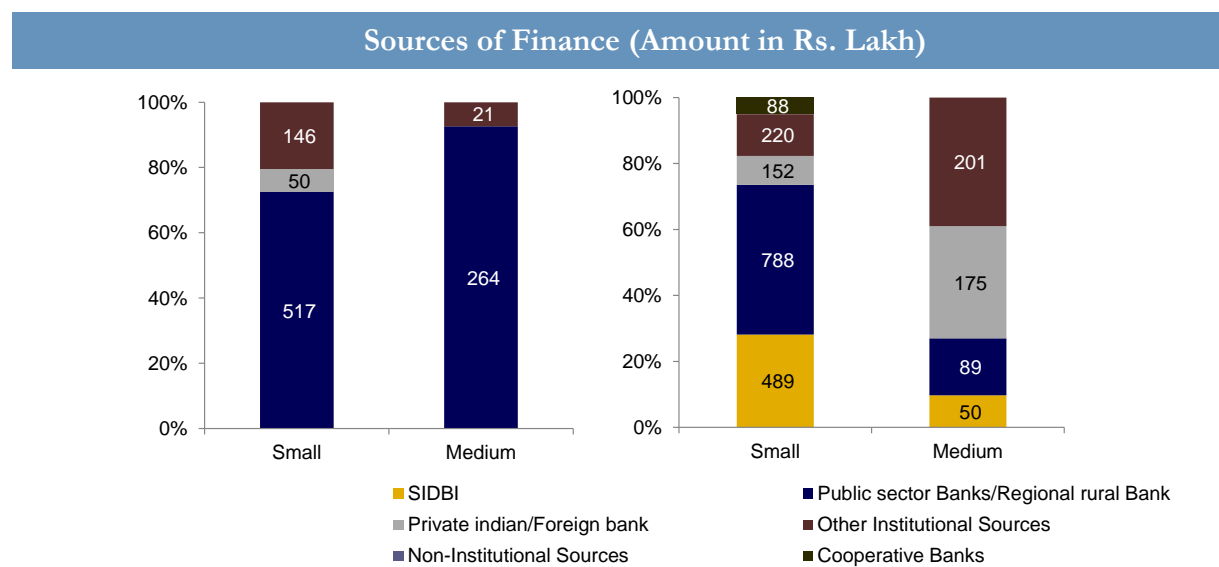


Source: D&B India (Amount in Rs. Lakh; number of respondents in parentheses)

According to SME enterprises looking to avail working capital loans, the immediate financing needs of the cluster are short term in nature and capital is mostly required for purchase of raw materials, quick realization of bills, etc. The cluster lacks sufficient support from financial institutions to fulfill the short term financing needs of the units. Bankers are hesitant to lend to units because of the units' inability to service working capital loans. The reason is that pharmaceutical MSMEs are largely contract manufacturers to large organizations and are dependent on them to a large extent. The realization of bills has become a major hindrance to servicing the working capital loans. Most of the promoters in the cluster are first generation entrepreneurs and are not strong enough financially to tide over any short term financial crisis. The entrepreneurs tend to borrow money from non-institutional sources to fulfill their short term requirements, which depletes the profits of the units as the interest rates from non-institutional sources are very high (36 – 48% p.a.).

Most of the pharmaceutical units have realized the importance of GMP certification and are looking to upgrade the units to GMP compliance status. This enables the units to get export orders and enhances their capacity to produce high quality products. There is a greater need to fulfill the financial need for c-GMP status as it would help in increased growth and export competitiveness of the cluster. There is a need to develop a cluster specific product to address the requirements and to simplify the loan application form. Also, a single window loan appraisal would aid in the reducing the loan processing time.

The following chart shows composition of working capital and terms loans for the 36 respondents by sources of finance, separately for Small and Medium enterprises in the Pharmaceuticals Cluster. Public Sector Banks and Regional Rural Banks are the major sources of Working Capital loans across all sizes of enterprises, whereas SIDBI, Public Sector and Regional Rural Banks, as well as Private India and Foreign Banks are significant contributors to Term Loans.



Source: D&B India

In summary, it can be noted that there is both term credit and working capital needs of the units. As mentioned earlier, the immediate financing needs of the cluster is borne out for raw material purchase, realization of bills etc. Term credit needs is due to machinery up-gradation, GMP implementation etc. Though SIDBI is primarily into term loan requirements, it also does provide working capital loan through SIDBI-IDBI partnership. Units are able to avail loan from SIDBI for Multiple Effect Evaporator installation, which is required as per APPCB norms. Additionally, Public Sector Banks and Regional Rural Banks do finance working capital needs. The following can be summarized as major reasons for the term credit needs:

- Most of the enterprises are traditional and older units and hence are now undergoing modernization and capacity expansions. Also, requirement for automation has increased due to avoid risks of contamination
- Newer tools like Good Manufacturing Practices (GMP) require capital investments and these are now a pre-requisite in most of the export markets. GMP certifications also require regular working capital infusions
- In order to comply with the pharmaceutical practices like Schedule M, Schedule H etc., pollution and effluent treatment plants are being set up by small and medium enterprises within their premises and hence, additional capital investments are required

From the various methods employed and explained before, the demand and supply side estimations of the cluster have been provided in the next section.

Credit Gap in the MSE Segment

For the current study, D&B considered the credit supply data of only scheduled commercial banks that form the major source of credit supply. The table below contains the estimated Credit Gap in the cluster on the basis of the two methods.

Method	Total Gap	Credit Supply	Total Credit Demand	Working Capital Demand	Term Capital Demand
Nayak Committee-D&B Method (In Rs. crores)	106	297	403	283	120

Summary of Credit Gap Assessment

The Hyderabad cluster which is a pharmaceutical cluster also experiences a gap in the credit requirements and supply. D&B India has, through its primary & secondary research, identified possible reasons for why the credit demand is not being met, despite the fact that there are ample financial institutions in the district. A summary of the findings are mentioned below:

- The level of knowledge about product patenting and Intellectual Property knowledge is lower in small enterprises. As a consequence, copying across the enterprises is prevalent leading to intense competition. A major reason often cited is poaching of employees for higher salaries. Therefore, in order to retain work-force, enterprises tend to resort to retention techniques like increasing wages frequently. This increases their primary requirement for cash.
- Certain chemicals which are raw materials for pharmaceuticals are produced by the chemical firms only twice or thrice in a year. Such chemicals are often consumed over the entire year. E.g. Omeprazole (gastro drug) is required around the year, however, the chemical constituent for the same is produced only twice a year. For such Active Pharmaceutical Ingredients (APIs), inventories have to be carried around the year. This increases the requirement for working capital.
- Compliance with Schedule H and Schedule M requires additional expenses like testing and quality certification from designation labs, printing on product blisters, specification of product blisters like Aluminum-PVC or PVC-PVC etc. This regulation also often increases expenses.
- Safety, health and environment standards require clean room techniques, no contamination and maximum extent of automation possible.

- Smaller units do not have the space and potential to establish an in-house effluent treatment plant (ETP). These plants are mandatory as per the order of the Andhra Pradesh Pollution Control Board (APPCB). Since smaller units cannot afford these, they tend to use services of common facilities center which are expensive.
- Where ETP services are not used, the products are sold without entering in the books of accounts. This reduces the extent of audited turnover, thereby reducing the working capital limits.
- The labor has to be frequently updated and trained about revisions and changes in norms. Therefore, cost of training increases.

Along with working capital needs for the cluster, the small and medium enterprises also require a higher amount of term credit. While technology up gradation is one of the primary reasons for the same, other reasons are cited below,

- Most of the medium enterprises tend to export their products. As a compliance requirement, these units require to be GMP certified. Good Manufacturing Practices (GMP) has its associated implementation costs.
 - GMP is a process and certification may require 1-2 years once GMP is initiated. Therefore, most of the enterprises seek term credit for GMP implementation
 - GMP also requires machinery to be procured from GMP certified vendors. These machineries are costlier than the regular machineries. Therefore, this increases the existing requirement of term loans
- To avoid contamination and health related risks, most of the medium enterprises are installing automation in production and packaging lines. Computer aided manufacturing (CAM) is becoming a norm in the cluster and hence, term loan requirements are increasing
- Certain medium enterprises are also installing the ETPs within their facilities. For such requirements, term loan is required for the installation and commissioning of the ETP and also for obtaining additional land, if required.

It can be stated that the quality of credit received by various enterprises can be judged from three factors viz., time taken for loan processing, loan interest rate, and adequacy of credit. It has been observed in Hyderabad that the cooperative banks and PSBs/RRBs typically tend to take a longer processing time as compared to SIDBI with marginally higher interest rate as well.

The pharmaceutical cluster in Hyderabad is part of the hyper competitive world of global pharmaceutical industry. It can be said that for these units to remain globally competitive they not only need support from various financial institutions to not only setup mechanisms so that they adhere to multiple regulations and also manage their cash credit cycle effectively.

Recommended Products and Delivery Channels

The Hyderabad Pharmaceutical cluster is a major pharmaceutical manufacturing base of the country with about 161 small units. Being a capital intensive business, no micro player can exist in the pharmaceutical industry.

Requirement of Capital

The units in the Hyderabad cluster need credit primarily for the following reasons,

- Quality certifications such as GMP
- Setting up Effluent Treatment Plant
- Raw material procurement
- Delay in payment from buyers

Almost all the units in the Hyderabad cluster have to adhere to Good Manufacturing Practices (GMP) program to be able to produce drugs in their units, which could be for the installing new machinery. Units wanting to export to international markets have to adhere to the GMP program of importing countries. Besides the above, according to the latest norms laid by the state pollution control board, all the pharmaceutical units are mandated by the law to install effluent treatment plants for treatment of wastes. Enterprises generally approach the financial institutions for term loans for the same.

A lot of small units are working as sub-contractor for domestic firms. In such a scenario, the buyer generally provides all the raw materials to the seller which manufactures the drug and sends it back to the buyer. But increasingly there are a lot of players who are looking at working for international drug manufacturers. In such cases, the units have to arrange for raw material on their own. Also, in some cases the raw materials have to be imported from outside the country. In such a scenario, the units need financing help from financial institutions to tide over any short term financing needs.

One major problem plaguing this cluster is the non-adherence to payment schedules by drug buyers. As discussed, most of the small units in the cluster are either suppliers or do sub-contracting work for large enterprises and they are totally dependent on them. So because of higher bargaining power of large enterprises they are able to dictate terms to the small enterprises. This is the primary reason for which the financial institutions have stopped providing the bill financing products to the units in this cluster.

Working of Government Schemes

Though there are no dedicated schemes launched by the government for the pharmaceutical unit in Hyderabad, the units can avail finances under the Credit Linked Capital Subsidy Scheme (CLCSS) and Credit Guarantee Trust Scheme for Micro and Small Enterprises (CGTMSE).

Credit Linked Capital Subsidy Scheme (CLCSS)

Aimed at technology up gradation of the small scale enterprises, the MSME Ministry (earlier known as Ministry of SSI) has been operating the Credit Linked Capital Subsidy Scheme (CLCSS) since the year 2000. The scheme aims at facilitating technology up gradation for improvement in productivity of the SSI / MSE units, by providing them 15 per cent upfront subsidy with a ceiling of Rs.1crore.

The units in Hyderabad cluster are extensively making use of this scheme, though some units have requested that the current cap of Rs. 3 lakhs could be increased. Also, if the units have once availed the scheme, they are ineligible for a repeat subsidy.

Credit Guarantee Trust Scheme for Micro & Small Enterprises (CGTMSE)

The Credit Guarantee Fund Trust Scheme for small industries was introduced by the Government in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.25 lakh without collateral/ third party guarantees.

The banks tend to distribute funds to projects with good track record or promoters who have successfully implemented other projects in the past. The bank officials are very cautious while extending loan to units under this scheme. The officials also agreed to the fact that the service charges levied by the banks (onetime fee of 1.5% & a yearly service fee of 0.75% of sanctioned amount payable every year till the entire loan amount is paid back) makes it unattractive for the units to avail loan under this scheme.

Bills Financing

Bills refinance as a product is not successful in the cluster and a lot of banks have now discontinued this product, because buyers fail to adhere to payment schedule. Most of the small units in the cluster are dependent on large units and the bargaining power of these small units is less. So even though bills financing is one of the requirements of pharma units in this cluster, banks are not currently able to support the need because of existing cluster dynamics.

Descriptions of Products and Delivery Mechanisms

Reverse Factoring

A large proportion of the units in Hyderabad Pharmaceutical cluster are either working as suppliers or are working as sub-contractors for large firms in the cluster. This cluster has been plagued by payment indiscipline on part of the larger player (buyers) who generally tend to delay the payment to the sellers (small units). This has led to the banks almost removing the bill discounting facility from the market, which has impacted the small scale units.

In this sort of scenario, we can look at introducing Reverse factoring, where the bank purchases accounts receivables only from high-quality buyers. The bank only needs to collect credit information and calculate the credit risk for buyer (in this case a large transparent, internationally accredited firm). In Reverse Factoring, the credit risk is equal to the default risk of the high-quality customer, and not the risky SME.

The buyers also stand to benefit from reverse factoring. By engineering a reverse factoring arrangement with a lender and providing its customers with working capital financing, the buyer may be able to negotiate better terms with its suppliers. For example, buyers may be able to extend the terms of their accounts payable to suit their convenience. In addition, the buyer benefits from outsourcing its own payables management (e.g. the buyer can send a payment to one lender rather than many small suppliers).

Purchase Order Finance

There are a sizeable number of units who are looking at working for international drug manufacturers. In such a scenario, the units in Hyderabad pharmaceutical cluster need to arrange for working capital finance to deliver the products. In some cases, the units have to import raw materials from outside the country, for which they need sizeable amount of capital. Here the units can avail of a pre shipment finance product such as Purchase Order Finance (POF), where the units on back of the order placed by a credible credit worthy foreign buyer is able to receive working capital funds from its bank. The POF mechanism works in the following way:

- The client/customer sends across the purchase order to the manufacturing unit (seller) with all documents.
- The seller then submits the purchase order to its bank for POF.
- The bank makes a partial advance to the manufacturing unit on the value of the purchase order. The advance is made to the unit or directly to its supplier to cover the costs of materials, trade goods and/or services.

- The supplier delivers the materials, goods and/or services to the seller for production of the product or assembly of the trade goods to fill the order.
- The manufacturing unit produces or assembles the goods and ships the products to the buyer.
- The unit then prepares and submits an invoice for the sale. Depending on the agreement, the invoice will go to the client/buyer or directly to the bank (or factoring company).
- The client pays the invoice according to the payment terms, usually directly to the bank.
- When the bank receives payment on the invoice from the client, the bank withholds the amount it advanced to the seller unit as repayment on the POF loan, and also deducts the agreed amount of interest and fees. The balance is then remitted to the seller.

The short terms of POF coupled with the transaction specific nature of this type of financing, the high leverage (typically with POF, only 10-40 percent of the total transaction value is advanced), and the resulting diversification of the lending portfolio help lower overall risk and provides greater flexibility. Loans can be structured in a variety of ways including to match payments to the borrower's cash flow cycle.

Preapproved GMP Implementation Finance Scheme

Most of the units in the cluster need to comply with the GMP norms for they have keep updating their processes and at times have to engage the services of consultants to guide them through the process of adhering to the norms. The expenses incurred towards the same sometimes adversely impacts the working capital finances of the firm.

Towards meeting these expenses the banks can issue a preapproved term loan to the units, which they can avail as and when the units require. While going for GMP certification the units have to upgrade their systems as well as facilities. GMP guidelines typically comprise strong recommendations on quality management, personnel, production facilities and equipment, documentation & records, production, packaging, storage etc. Since this is long and cumbersome process soft loans by way of concessional interest and higher moratorium can help the industry.

This loan can be issued based on the firm's past track record and their promoter's experience. The industry associations such as BDMA or the local associations such as NDMA or PASS can play an active role by assisting the banks in helping in the screening process.

A similar arrangement currently operates in the Faridabad Auto and Light Engineering cluster, where SIDBI and FSIA work in tandem to sanction a pre-approved loan facility that can be tapped anytime during the year. The association is responsible for processing of application, doing appraisals, recommending limits as per prescribed norms and providing it to SIDBI, as well as verifying the pro-

forma invoice, ensuring margin payment, asset value, etc. Banks / SIDBI and BDMA can strike a similar arrangement in the Hyderabad Pharmaceutical Cluster.

However, it is important to note a major potential hurdle in implementing such a scheme in the cluster. The pharmaceutical units in Hyderabad are spread far and wide and an intervention of the kind operative in Faridabad may not be operationally feasible. The units of the cluster do not share the information on products and processes among themselves. Hence, an initiative by the association may not work. To start with, a survey in the cluster can be conducted by the association to gauge the potential cooperation and cost-benefit perception of units, given the proposal of setting up such a scheme.

Annexure I – Estimation Method for Credit Supply

ESTIMATION OF CREDIT SUPPLY TO THE HYDERABAD PHARMACEUTICAL CLUSTER			
	Item	Mar, 2011 Estimate	Remarks/Assumptions
1	Estimated Andhra Pradesh Pharmaceutical Industry Advances Outstanding - March, 2011 (Rs. crores, Projected at an expected annual growth rate of 18%)	11,245	Expected growth rate is estimated from State Level Advances (SLA) growth Rate using SLA figures ending Mar, 2010 & Mar, 2011 Source - Table 4.9- Annual-Basic Statistical Returns of SCB, Mar '2010 Source - Statement 9: RBI Quarterly-Basic Statistical Returns of SCB, Mar '2011
2	Estimated Andhra Pradesh Pharmaceutical Industry Turnover - Mar, 2011 (Rs crores, Projected at an expected annual growth rate of 17% and 3% for Year 2009-10 and 2010-11)	22,145	Expected growth rate is estimated from National IIP growth rates Source - Table 3 - ASI, Government of India, MOSPI, 2009 Source - Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug 2011
3	Cluster Sample Turnover (MSEs), Sample Size - 38 units in MSEs Sector (Rs crores)	252	D&B Survey
4	Total Number of MSE units (161) in Hyderabad Pharmaceutical Cluster		From Hyderabad Pharmaceutical Cluster Diagnostic Study (DS) Report
5	Estimated the Cluster Total Turnover (MSEs, Rs. crores) using (3) & (4) for year ending Mar, 2011	1378	
6	Estimated Proportion (P1) of Cluster Turnover to State Industry Turnover using (2) and (5) [$P1 = (5) / (2)$]	6.2%	
7	Estimated the Cluster Level Credit Supply [(1) * (6)] – Rs. crores	297	
8	State Level Advances – Term Loan Advance (Small Enterprise - SE) to Total Advance (SE) Proportion (P2)	8%	Estimation based on RBI's Statistical Returns-SCB Source - Table 6.1, Statistical Tables Relating to Banks in India, 2009-10
9	Using (7) and (8) Working Capital Supply is [(1-P2)*(7)].	273	
10	Using (7) and (8) Term Credit Supply is [(P2)*(7)].	24	

Annexure II – Estimation Method for Credit Demand

ESTIMATION OF CREDIT DEMAND IN THE HYDERABAD PHARMACEUTICAL CLUSTER					
	Method		Item	Mar, 2012 Estimate	Remarks/Assumptions
	Nayak Committee Approach - Working Capital	1	Cluster Sample Turnover (MSEs), Sample Size - 38 units in MSEs Sector		D&B Survey
		2	Total Number of MSE units (161)		Hyderabad Pharmaceuticals Cluster Diagnostic Report
		3	Estimated the Cluster Sample Total Turnover (MSEs, Rs crores) for year ending Mar, 2011	252	D&B Survey
		4	Estimated the Cluster Total Turnover (MSEs, Rs crores) - Mar, 2012, Expected growth rate of 2.6%	1414	Expected growth rate is estimated from National IIP growth rates Source- Latest National IIP figures – Statement II in “MOSPI Press Release on IIP Estimates”, Aug, 2011
		5	Basis Nayak Committee Guidelines, Working Capital Funding Requirement is 20% of Projected Turnover calculated in (3)	283	
	D&B Approach - Term Capital	6	Cluster Sample "Investments in Plant & Machinery", Sample Size - 38 in MSE Sector (Rs crores)	63	D&B Survey
		7	Total Number of MSE Units (161)		Hyderabad Pharmaceuticals Cluster Diagnostic Report
		8	Estimated the Cluster Total "Investments in Plant & Machinery" (MSEs, Rs crores) using (1) & (2) for year ending Mar, 2011	332	
		9	Value in (8) projected to Mar, 2012 level using moving average growth rate of fixed capital for Industry-state wise (45%)	482	Source - Annual Survey of Industries (ASI) estimates on Fixed Capital for different industries within a state – MOSPI ASI Report, 2009-10
		10	(9) - (8) gives the growth in fixed capital	150	
		11	80% of (10) is estimated to be Term Credit Funding Requirement	120	
	Total Credit Demand	12	Total Credit Demand [283 + 120] calculated above in [(5) and (11)]	403	

Annexure A.1 (Summary – Recommended Products & Delivery Mechanisms)

Scheme, Purpose & Benefits	Implementation Process	Clusters Where Applicable	Pre-requisites
<p>Scheme for Financing of Raw Material Procurement</p> <p>✓ Raw materials need to be purchased in bulk during certain months of the year</p> <p>✓ Bulk purchase enables MSEs to benefit from discounted prices</p>	<p>↓ Group of banks catering to cluster form a consortium and enter into a common MoU with an implementation agency</p> <p>↓ Forecast of annual production of MSE units and annual raw material requirements to be prepared basis inputs from MSEs, industry associations (say, MCCIA in Pune), large sub-contracting industrial buyers (say, Khadims / Sreeleathers in Kolkata), cluster sector-specific research institutions (say, Central Leather Research Institute – CLRI in Chennai)</p> <p>↓ Implementation agency to procure the raw material with MoU banks / FIs financing the purchase</p> <p>↓ Raw material procured to serve as collateral with implementation agency serving as facilitator / guarantor</p> <p>↓ Implementation agency becomes the primary raw material supplier. Discount obtained by acquiring the raw material in bulk may be passed on to MSEs after deducting fee towards costs of provision of the service by implementation agency</p>	<p>Pune Fruit and Vegetables - Through Agriculture Produce Market Committee</p> <p>Ludhiana Knitwear - Through Knitwear Club / KAMAL / LAKMA</p> <p>Rourkela Engineering - Through Orissa State Industrial Corporation (OSIC)</p> <p>Kolkata Leather Through Indian Leather Products Association (ILPA)</p> <p>Chennai Leather / Central Leather Research Institute</p>	<p>👉 Implementation agency should be an existing integral stakeholder in the raw material procurement process or an agency implementing a cluster-specific government scheme</p> <p>👉 Interest charged by the bank for financing will be the predominant cost of service. For the raw material financing scheme to be economically viable, the costs of service must be less than or equal to the difference in procurement price and sale price to MSEs</p>
<p>Factoring (or reverse factoring)</p> <p>✓ Reliance on CC while there is high proportion of receivables in working capital cycle and sales/cash flows fluctuations, leads to intermittent over / under financing</p> <p>✓ Factoring involves extension of working capital finance on ongoing basis against invoices raised by MSEs on buyers</p> <p>✓ Factoring ensures :</p> <ul style="list-style-type: none"> • Improved cash flows • Fixed assets freed up for collateralization elsewhere • Benefit of sales ledger management • Ability to extend open account terms • Better receivable days & current ratio 	<p>↓ 'Factor' (bank / FI offering service) obtains control over the sales ledger of the client. In effect, the entire receivables management is taken over by the factor</p> <p>↓ Client make an application to factor with last 3 years' statements Factor conducts the client's appraisal and approves/disapproves</p> <p>↓ Credit line is based on financial strength of borrowing client's debtors, as well as on the borrower's own financial strength</p> <p>↓ Client submits sales ledger of customers to factor Sanction limit is assigned based on the quality of customers</p> <p>↓ Factor sends notification to client buyers. Upon acceptance, a factoring agreement is signed between the client and factor</p> <p>↓ Based on the invoices, factor makes advance prepayments (up to 80% of invoice value) and subsequently manages the client's ledger and sends due reminder to client customers</p>	<p>Rajkot and Coimbatore Engineering Clusters</p> <p>Hyderabad Pharmaceutical Cluster</p> <p>Kolkata Leather Cluster</p>	<p>👉 Strong inter-linkages and sub-contracting of manufacturing activities exist</p> <p>👉 Open account sales are preferred between larger buyers and smaller sellers</p> <p>👉 If factors are hesitant to offer services to MSEs (as the case may be for Kolkata Leather and Hyderabad Pharmaceutical clusters), 'Reverse Factoring' can be looked at as an alternative, where banks purchase accounts receivables only from high-quality buyers</p>

Scheme, Purpose & Benefits	Implementation Process	Clusters Where Applicable	Pre-requisites
<p>Pre-approved Collateral-free Equipment Finance Scheme</p> <p>✓ Would enable quick acquisition of critical equipment. MSEs often face situations where suppliers are offering a discount or where the equipment is required for complying with a norm within a deadline</p> <p>✓ Would enable acquisition of a number of small-value equipments through the year. Formal application processes are considered tedious with no certainty of sanction. Hence, either costly unsecured loans are sourced or WC credit is employed</p>	<p>↓ A bank / financial institution will enter into an MoU with a local industry association, which is truly representative of the cluster MSMEs</p> <p>↓ The local industry association will be responsible for processing of loan applications, conducting appraisals, recommending limits as per prescribed norms and providing them to banks / financial institutions, as well as verifying the pro-forma invoice, ensuring margin payment, asset value, etc</p> <p>↓ A collateral-free line of credit is sanctioned to enterprises, which can avail this facility any time during the year, either in full or in parts, for purchasing equipment</p> <p>↓ Disbursals can be made within 2-3 days on a pre-approved loan</p> <p>↓ Loans, when availed, can be repaid through PDCs either in the form of EMIs. If required, repayment can be staggered/ ballooned with gestation period</p>	<p>Rajkot and Coimbatore Engineering units - for upgrading technology</p> <p>Hyderabad Pharmaceutical cluster units - implementation of technology-intensive Good Manufacturing Practices (GMP)</p> <p>Ahmadabad Dyes and Chemicals cluster - compliance with state pollution control norms, that involve acquisition of ETPs</p>	<p>👉 Industry association should be representative of the cluster with a large member base</p> <p>👉 Units should not be spread far and wide, as such an intervention may not be operationally feasible</p> <p>👉 Units should share information on products and processes among themselves</p>
<p>Purchase Order Financing</p> <p>✓ Absence of appropriate collateral common reason for loan applications to be rejected. Many MSEs over leveraged and lack collateral for fresh loans</p> <p>✓ POF is pre-shipment finance that enables an MSE to receive WC funds based on orders placed by their credit worthy buyers</p> <p>✓ Allows seller to receive funds far sooner than if it had to wait for buyer to pay and even sooner than if invoice is discounted</p> <p>✓ POF allows the unit to take on multiple orders and deliver them successfully</p>	<p>↓ Buyer send PO to seler and furnishes comfort letter to bank detailing seller information and credibility</p> <p>↓ Seller then submits PO to bank for POF. Bank advance is made to the unit or directly to its supplier to cover the costs of materials, trade goods and/or services</p> <p>↓ Seller produces or assembles the goods and ships the products to the buyer</p> <p>↓ Seller submits invoice directly to bank and buyer pays according to payment terms, usually directly to the bank</p> <p>↓ Bank receives payment from buyer, withholds amount advanced to seller as repayment on POF loan, and also deducts agreed amount of interest and fees. The balance is then remitted to the seller</p>	<p>Rajkot and Coimbatore Engineering Clusters</p> <p>Hyderabad Pharmaceutical Cluster</p> <p>Kolkata Leather Cluster</p>	<p>👉 Strong linkages exist between large and established buyers and a host of small and medium enterprises that carry out sub-contracted work</p> <p>👉 Payment discipline on the part of large established buyers</p>

Scheme, Purpose & Benefits	Implementation Process	Clusters Where Applicable	Pre-requisites
<p>Working Capital Term Loan (WCTL)</p> <ul style="list-style-type: none"> ✓CCs & ODs assist MSMEs through transitory (fluctuating) WC requirements. WCTLs cover core (permanent) part of WC ✓MSMEs possess lower control over WC and lack expertise in managing loan funds intended for meeting WC requirements; hence WCTL as more appropriate 	<ul style="list-style-type: none"> ↓If MSMEs extend credit of > 120 days to clients (like in Ludhinana), it ties up the WC finance. In many cases, credit limit set by the banks in the cluster is often insufficient for units to cover their WC expenses ↓Such shortages of credit in the Ludhiana cluster could be provided through a Working Capital Term Loan (WCTL) accounts ↓Although this arrangement is presently applicable to borrowers having working capital requirement of Rs.10 crores or above, this service can extended to small enterprises with needs less than Rs. 10 crores as well 	<p>Ludhinana Knitwear Cluster - Orders booked at buyer-seller meets, but payments realized after goods are sold in end-markets</p>	<ul style="list-style-type: none"> 👉 Requirement of credit in excess of sanctioned limit, often for seasonal bulk raw material procurement 👉 Expenses financed through WCTL should be permanent component of WC and not transitory
<p>Receivables-linked Bridge Financing Scheme</p> <ul style="list-style-type: none"> ✓Factor inhibiting Bills Discounting is lack of payment discipline amongst buyers. MSEs are often unable to procure future orders ✓Bridge Financing enables temporary loan that maps sales receivables cycle to future order procurement to facilitate continuous operation of MSEs ✓Can be used to maintain liquidity in the scenario of anticipated cash inflows. 	<ul style="list-style-type: none"> ↓MSEs deliver the previous order goods to customers ↓Bills Receivables created on the executed order ↓MSEs procures next order ↓FIs finance to MSEs for new order based on Bills Receivables as collateral ↓New order execution starts after bank finance ↓At around the same time, bank may be repaid out a payment received by MSE from an earlier transaction 	<p>Small units, such as those in the Rourkela Engineering Cluster, would find this as an effective method for overcoming difficulties with the current bill-discounting schemes</p>	<ul style="list-style-type: none"> 👉 Continuity in terms of execution of past orders, receipt of fresh orders and payments on earlier transactions, is a must
<p>Up-scaling of Micro Finance Programs</p> <ul style="list-style-type: none"> ✓Can prove potent for unorganized micro units that do not approach banks due to required documentation, site-audits and inspections etc. ✓Many do not have any tangible assets which could act as collaterals nor any formal work order and hence banks refuse credit ✓May encourage transition from informal to formal enterprise. 	<ul style="list-style-type: none"> ↓MFIs can target lower end of SME spectrum that have features in common with existing clients - Average loan size of micro firms (say ~INR 1.0 L) ↓MFI can modify microfinance business models to incorporate SME operations by taking advantage of their market knowledge and network, and by adapting their microfinance methodologies ↓Reasons for the recent MFI regulation in AP, and draft bill on MFIDR 2011 that have put MFI lending model under scanner to be taken into consideration 	<p>Unorganized micro enterprises in the Coimbatore, Rourkela and Kolkata clusters that carry out sub-contracted work for larger enterprises</p> <p>Microfinance has made significant inroads into Tamil Nadu, Orissa and West Bengal.</p>	<ul style="list-style-type: none"> 👉 Refinancing / on-lending and other support from DFI, etc crucial for helping MFIs adapt current practices to serve MSEs 👉 Following to be addressed: <ul style="list-style-type: none"> • Development of suitable loan products and attributes • MFI collection cycle and recovery mechanism to adapt to MSEs Asset Conversion Cycle • Capacity Building / Training for MFIs and Borrowers

Annexure A.2 (Survey Questionnaire)

A) RESPONDENT DETAILS	
1. Name of Enterprise	
2. Address of Enterprise	
3. Name of Respondent	
4. Designation	
5. Investment in Plant & Machinery.	
a) <input type="checkbox"/> less than Rs. 25 lakhs	d) <input type="checkbox"/> Rs. 3 Cr to Rs. 5 Cr
b) <input type="checkbox"/> Rs. 25 lakhs to Rs. 1 Cr	e) <input type="checkbox"/> Rs. 5 Cr to Rs. 10 Cr
c) <input type="checkbox"/> Rs. 1 Cr to Rs. 3 Cr	f) <input type="checkbox"/> Above Rs. 10 Cr
<i>To FRA – Please terminate the interview if the respondent selects option (f) for question no. 5.</i>	
6. Year of establishment / registration	
7. Form of organization	
<i>(To FRA – Use show card no. 1 to explain the options to the respondent)</i>	
a) <input type="checkbox"/> Sole Proprietorship	e) <input type="checkbox"/> Public limited company
b) <input type="checkbox"/> Family owned business	f) <input type="checkbox"/> Private limited company
c) <input type="checkbox"/> Partnership	g) <input type="checkbox"/> Other, please specify
d) <input type="checkbox"/> Limited liability partnership	_____
8. Please indicate which of the following is applicable to you	
a) <input type="checkbox"/> Existing SIDBI customer	d) <input type="checkbox"/> During initial interactions realized that the loan would not be available as per my terms and conditions
b) <input type="checkbox"/> Past SIDBI customer. SIDBI loan successfully repaid, no amount outstanding	e) <input type="checkbox"/> Defaulted on SIDBI loan
c) <input type="checkbox"/> SIDBI rejected my loan application	f) <input type="checkbox"/> Never applied for a SIDBI loan
<i>To FRA –</i>	
<i>If for question no.8, the respondent selects option (f), then administer only “Section C – Credit Gap Assessment” to that respondent and skip “Section B – Customer Satisfaction”.</i>	
<i>If for question no.8, the respondent selects any of the options other than option (f), then administer both “Section B – Customer Satisfaction” and “Section C – Credit Gap Assessment” to that respondent.</i>	

B) CUSTOMER SATISFACTION	
B.1) Product / service related	
9. Please indicate which of the following attributes would you associate with SIDBI.	
a) <input type="checkbox"/> SIDBI takes lower time to disburse the loan as compared to other banks	d) <input type="checkbox"/> SIDBI has lower collateral requirements w.r.t. other banks
b) <input type="checkbox"/> SIDBI offers lower interest rates w.r.t. other banks	e) <input type="checkbox"/> SIDBI officials are more helpful or proactive as compared to other banks
c) <input type="checkbox"/> SIDBI has lower margin requirements w.r.t. other banks	f) <input type="checkbox"/> Project appraisal process of SIDBI is more transparent as compared to other banks
<i>To FRA – Use Show Card No.2 to explain the terms Other Institutional and Other Non-Institutional Sources of Finance for question no. 10.</i>	

10. Please indicate the time taken for processing and disbursement of the loan from SIDBI with respect to the other banks / entities listed below as per your knowledge.

(To FRA: Please capture the understanding / perception across all products and financial institution types, though the respondent may say that he did not approach some of these institutions)

	SIDBI		Public Sector Banks / Regional Rural Banks		Cooperative Banks		Private Indian Banks / Foreign Banks		Other Institutional Sources of Finance		Other Non-Institutional Sources of Finance	
	Working Capital	Term Loan	Working Capital	Term Loan	Working Capital	Term Loan	Working Capital	Term Loan	Working Capital	Term Loan	Working Capital	Term Loan
Less than 2 weeks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2 to 4 weeks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4 to 6 weeks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6 to 9 weeks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
More than 9 weeks	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

11. What reasons were quoted by SIDBI for offering you a lower rate of interest?

(To FRA: If the respondent selects option (e) for this question, please probe further)

- | | |
|---|--|
| a) <input type="checkbox"/> Special subsidy loan scheme | d) <input type="checkbox"/> Past banking history with SIDBI |
| b) <input type="checkbox"/> Loan mela organized by SIDBI where concessional rates were being offered to all | e) <input type="checkbox"/> SIDBI did not give me the reason for offering a lower rate of interest |
| c) <input type="checkbox"/> SIDBI insisted on SMERA rating which lowered my interest cost | f) <input type="checkbox"/> Other, please specify _____ |

To FRA –

Use Show Card No.2 to explain the terms Other Institutional and Other Non-Institutional Sources of Finance for question no. 12.

Use Show Card No.3 to explain the terms (a), (b), (c), (d), (e), (f) and (g) in the first column of the table below.

12. Please indicate the collateral required for availing loan from the various entities listed below.

(To FRA: Please capture the response only if the respondent has actually availed the loan from a particular financial institution.)

Terms	SIDBI		Public Sector Banks / Regional Rural Banks		Cooperative Banks		Private Indian Banks / Foreign Banks		Other Institutional Sources of Finance		Other Non-Institutional Sources of Finance	
	Working Capital	Term Loan	Working Capital	Term Loan	Working Capital	Term Loan	Working Capital	Term Loan	Working Capital	Term Loan	Working Capital	Term Loan
(a)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(b)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(c)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(d)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(e)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(f)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
(g)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
To FRA – If the respondent selects option (d) for question no. 8, then ask question no. 13.												
13. Please indicate the reasons due to which SIDBI was not be able to offer you a loan satisfying your terms and conditions. (Multiple ticks allowed)												
a) <input type="checkbox"/> Processing time was too long b) <input type="checkbox"/> Processing charges were too high c) <input type="checkbox"/> Collateral / margin money requirements were too high d) <input type="checkbox"/> Did not have the required documents e) <input type="checkbox"/> Did not match the eligibility criteria of SIDBI f) <input type="checkbox"/> Any other, please specify												
B.2) Operational parameters related												
14. How did you come to know about SIDBI?												
a) <input type="checkbox"/> Referred by existing SIDBI customer b) <input type="checkbox"/> Referred by peers, friends, suppliers c) <input type="checkbox"/> Advised by external CAs / consultants d) <input type="checkbox"/> Advised by in house finance team e) <input type="checkbox"/> SIDBI marketing team f) <input type="checkbox"/> Loan melas g) <input type="checkbox"/> Local / industry associations h) <input type="checkbox"/> Personal contact at SIDBI Branch office i) <input type="checkbox"/> Advertisements j) <input type="checkbox"/> Internet k) <input type="checkbox"/> Any Other, please specify												
To FRA – If for question no.10, the time taken by SIDBI either for working capital or term loan is significantly higher (over 6 weeks) than others then ask question no. 15.												
If for question no.10, the time taken by SIDBI either for working capital or term loan is significantly lower (less than 4 weeks) than others then ask question no. 16.												
15. Please indicate the TOP 3 ways according to you by which SIDBI can reduce the time taken for loan processing (Only 3 options to be checked)												
a) <input type="checkbox"/> Single window facility for loan processing b) <input type="checkbox"/> Financial counseling by bank staff about SIDBI schemes c) <input type="checkbox"/> Simplify the procedure for execution of loan documents (loan agreement, mortgage creation) d) <input type="checkbox"/> Bank staff should keep me informed about the status of my application e) <input type="checkbox"/> Reduce the time for legal verification f) <input type="checkbox"/> Reduce the time taken for physical / project Site inspection g) <input type="checkbox"/> Staff to provide the list of supporting documents required h) <input type="checkbox"/> Other, please specify												

<p>16. Please indicate the TOP 3 reasons according to you because of which SIDBI takes lower time for loan processing (Only 3 options to be checked)</p>	
<p>a) <input type="checkbox"/> Document collection and other formalities done at a single window</p> <p>b) <input type="checkbox"/> Pro-activeness of the staff to suggest the best scheme suited to my needs</p> <p>c) <input type="checkbox"/> Timely updates from the bank if any additional information is required</p>	<p>d) <input type="checkbox"/> Lower time taken for execution of loan documents</p> <p>e) <input type="checkbox"/> Physical / project Site inspection process is done on time</p> <p>f) <input type="checkbox"/> Other, please specify _____</p>
<p>17. Please indicate the way SIDBI disbursed the loan (Single Tick)</p>	
<p>a) <input type="checkbox"/> Direct credit to specified bank account</p> <p>b) <input type="checkbox"/> Cheque sent by post / courier</p>	<p>c) <input type="checkbox"/> Personally collect the cheque from the branch</p> <p>d) <input type="checkbox"/> Other, please specify _____</p>
<p>18. Please select the areas where SIDBI can improve its offerings or services.* (Multiple Ticks)</p>	
<p>a) <input type="checkbox"/> Making the application form easy to understand</p> <p>b) <input type="checkbox"/> Providing a checklist of all the documents to be submitted along with the application form</p> <p>c) <input type="checkbox"/> Assisting you to fill the application form</p> <p>d) <input type="checkbox"/> Providing information about applicable interest rates at the time of application</p> <p>e) <input type="checkbox"/> Providing information about applicable processing fees at the time of application</p> <p>f) <input type="checkbox"/> Providing information about prepayment fees if any at the time of application</p>	<p>g) <input type="checkbox"/> Providing all required information to compare with similar product offerings of other banks</p> <p>h) <input type="checkbox"/> Acknowledge in writing the receipt of application form</p> <p>i) <input type="checkbox"/> Ensuring that all required information and documents are collected at the time of submission of the application form</p> <p>j) <input type="checkbox"/> Ensuring that request for additional information / documents is made within 7 working days of receipt of application form</p> <p>k) <input type="checkbox"/> Providing online access about your application status</p>
<p>19. Please indicate the options which are applicable to your loan application with SIDBI.* (Multiple Ticks)</p>	
<p>a) <input type="checkbox"/> Bank officials did not ask for compulsory deposit as `quid pro-quo` to sanction your loan</p> <p>b) <input type="checkbox"/> Informing you that your overdraft limit is repayable on demand</p> <p>c) <input type="checkbox"/> Providing you a certified written copy of all terms, conditions and other caveats applicable to your credit facilities</p> <p>d) <input type="checkbox"/> Providing you the parameters used in the rating system to evaluate your loan proposal</p> <p>e) <input type="checkbox"/> Providing you authenticated copies of executed loan documents and all enclosures</p>	<p>f) <input type="checkbox"/> Providing you with a collateral free high value loan because of your past banking relationship with SIDBI.</p> <p>g) <input type="checkbox"/> Providing you in writing the reasons for rejecting your application</p> <p>h) <input type="checkbox"/> Disbursing the loan amount with 2 working days, once you have complied with all applicable terms and conditions</p> <p>i) <input type="checkbox"/> Not exerting undue interference in business matters post disbursement</p> <p>j) <input type="checkbox"/> Informing you about the debits made to your bank account due to interest, fees and other charges.</p>
<p>20. Please indicate which of the following describes your relationship with SIDBI (Multiple Ticks)</p>	

- a) Availed a SIDBI loan but experience was unsatisfactory, hence not interested to avail any further loans from SIDBI.
- b) I would apply for further SIDBI loans, if SIDBI simplified the terms and conditions
- c) SIDBI took longer time to process and disburse the loan as compared to other banks
- d) SIDBI unlike other banks insisted that I had to get my credit appraisal done by a rating agency which added to my cost
- e) SIDBI offered more favorable terms as compared to other banks.
- f) SIDBI is the preferred bank of choice for all my funding needs.
- g) I would refer SIDBI to my friends, peers or relatives.
- h) Other, please specify _____

To FRA – If the respondent selects option (c) for question no. 8, then ask question no. 21.

21. Please indicate the reasons for rejection of your loan application. (Multiple ticks allowed)

- a) Did not match the eligibility criteria of SIDBI
- b) Not able to provide the collateral / margin money
- c) Not able to provide the required documents
- d) Bank officials did not explain the reasons for rejection of my proposal
- e) Bank officials did not agree with my project proposal (technical and financial viability)
- f) Any other, please specify _____

B.3) Overall satisfaction related

22. Please indicate your satisfaction level for the listed options on a 4 point scale; where 4 = Completely satisfied & 1 = Completely dissatisfied (**To FRA – Use show card no. 4.**)

Options	Rating Value
Availability of products suited to my needs	
Availability of information about SIDBI schemes	
Ease of understanding of the information available about the various SIDBI schemes	
Terms and conditions offered by SIDBI (including tenure, interest rates, collateral requirements, processing charges etc.)	
Ease of filling up the application form	
Assistance offered by SIDBI officials during the application process	
Time taken to process the loan application and conduct site inspection	
Time taken to execute the loan documents	
Time taken to disburse the loan amount	

23. Please indicate the options by which the effectiveness of the various SIDBI schemes can be increased (Multiple Ticks)

- a) Increased publicity to create awareness about the schemes
- b) Make the application form simpler
- c) Reduce the documents required for application
- d) Reduce the time taken to decide on the fate of the applications
- e) Other, please specify _____

C) CREDIT GAP ASSESSMENT				
C.1) Existing products				
24. Total sales in value over the last 3 years				
		2008	2009	2010
	Total Sales (Rupees)			
	- Domestic Sales (%)			
	- Export Sales (%)			
	Total	100%	100%	100%
25. Break up of Current Assets and Current Liabilities for the last three years				
		2008	2009	2010
	Current Assets (Rupees)			
	Current Liabilities (Rupees)			
26. Please provide the total funding required for each of the 3 financing needs listed. Please also provide the total amount that you need to borrow and the actual amount borrowed for each option. Please indicate the various sources from which funding is availed and also provide the breakup of funding among the options you select.				

	Working Capital loan	Short term loan (less than 1 year maturity)	Long term loan (more than 1 year maturity)
Total funding requirement (Rupees)			
Total amount that you need to borrow (% of funding requirement above)			
Total amount actually borrowed (Rupees)			
Source of borrowing			
- SIDBI (%)			
- Public Sector Banks/ Regional Rural Banks (%)			
- Cooperative Banks			
- Private Indian / Foreign Banks (%)			
- State Financial Corporation (%)			
- NABARD (%)			
- NBFCs (%)			
- Micro Finance Institutions (%)			
- Other Formal Sources (%) Please Specify: _____			
- Informal Sources (includes Friends / Family, Customers, Suppliers, Private money lenders) (%)			
Total	100%	100%	100%
If you have availed bill discounting facilities, please provide the following two values			
- amount availed under this facility			NA
- name of the bank / financing agency from which the bill discounting facility is availed			
C.2) New product development			
27. Please select the features by which the attractiveness of the listed financing options can be increased.			

Working Capital loan	Short term loan (less than 1 year maturity)	Long term loan (more than 1 year maturity)
<input type="checkbox"/> Reducing the interest rate	<input type="checkbox"/> Reducing the interest rate	<input type="checkbox"/> Reducing the interest rate
<input type="checkbox"/> Reducing the collateral and margin requirement	<input type="checkbox"/> Reducing the collateral requirement	<input type="checkbox"/> Reducing the collateral requirement
<input type="checkbox"/> Automatic renewal in case of loan being fully paid up	<input type="checkbox"/> Reducing the margin requirement	<input type="checkbox"/> Reducing the margin requirement
<input type="checkbox"/> Reducing the processing charges	<input type="checkbox"/> Reducing the processing charges	<input type="checkbox"/> Reducing the processing charges
<input type="checkbox"/> Providing ready top-up facilities for consistent payment history	<input type="checkbox"/> Enhancing funding under cluster specific loans (such as IDLS for leather, TUF for textiles)	<input type="checkbox"/> Increasing the tenure for fixed-tenure products
<input type="checkbox"/> Others, please specify :_____:	<input type="checkbox"/> Others, please specify :_____:	<input type="checkbox"/> Providing cluster specific loans (such as IDLS for leather, TUF for textiles)
28. In addition to the above listed options, what other products / features would suit your requirements?		

Annexure A.3

RBI Committees Reports

RBI Committees on SSI Financing: Small enterprises owe their importance not because they are small and require less capital but because they and they alone have the potential to generate large scale employment opportunities and at the same time contribute significantly to GDP and national exports. Adequate and timely availability of credit at reasonable rate of interest has been considered as an essential requirement for the working of small enterprises. With this end in view both the Government of India and the Reserve Bank of India have been taking appropriate policy measures for the promotion of these enterprises. However, inadequate and delayed supply of credit has been one of the major complaints of this sector.

To analyze the impact of policy initiatives taken to improve the flow of Funds to the SSI Sector, including complexities of the system and procedure relating thereto, the RBI has constituted various committees since the decades of nineties. Prominent among these are Nayak Committee, S.L. Kapur Committee, and Ganguly Committee. These committees have given a number of recommendations covering various aspects relating to flow of credit to the SSI sector. A number of recommendations of these committees have been translated into policy prescription by the RBI and the Government of India for players in the financial system and support service institutions engaged in the development of SSI sector. Key highlights of the relevant reports are reproduced here.

Nayak Committee Report (1991)

- **Review of the Report**

The Reserve Bank of India constituted a Committee under the Chairmanship of Shri P.R. Nayak, Deputy Governor during 1991 to examine the difficulties confronting (the then small scale industries (SSI) and now MSME Ministry) the MSMEs in the country in securing finance. Of the broad contours set for the committee, one of the key requirement was to examine the adequacy of institutional credit for the SSI sector, particularly, with reference to the increase in the cost of raw materials and locking up of the available resources due to delay in the realization of sale proceeds from large companies and Government agencies. The committee was an extension of the earlier work done by Tandon/ Chore committee.

In the process of examining the adequacy of institutional credit, the committee, outlined methods for estimating the credit gap through developing credible demand estimates for credit. While the committee stressed on strong quantitative methods for Working Capital credit estimation, the term credit estimation was fairly qualitative in nature.

For the estimation of working capital, the committee suggested using the forecasted sales approach. 25% of the forecasted sales for the enterprises would be considered as requirement for working capital. The working capital bank credit would be 80% of the estimated working capital requirements. The Committee also suggested three ways to assess the 'Maximum Permissible Level of Bank Finance (MPBF)'. These are:

- Banks could provide finance up to a maximum of 75 percent of the Working Capital Gap (defined as Current Assets less Current Liabilities other than short term bank borrowings). The balance should be contributed by the borrowing units out of their long-term funds, owned or borrowed. This method of arriving at MPBF known as the First Method of Lending would ensure a minimum Current Ratio of 1:1.
- A borrowing unit will be required to contribute a minimum of 25 per cent of the total Current Assets out of its long term funds. This method of assessing MPBF known as the Second Method of Lending, would, ensure a minimum Current Ratio of 1.33:1.
- A borrowing unit is required to contribute from out of its long term funds towards the build-up of the entire Core Current assets, as also a minimum of 25 per cent of the balance Current Assets. The third method of assessing MPBF will, therefore, ensure a further strengthening of the Current Ratio as compared to the second method.

For estimation of term credit, SIDBI's internal growth rates were used to define future growth in term credit. This was suggested to be at around 16% during 1991. However, Nayak committee was able to provide a quantitative estimate of the credit gap. To quote the committee report directly: *If the same ratio continues to operate in the 8th Plan, SIDBI will be able to provide Rs. 4,000 crores to SSI (now MSMEs) as compared to Rs. 9,950 crores required for the purpose, leaving a gap of Rs. 5,950 crores.*

■ **Summary**

Finally, one of the recommendations of the Nayak committee involved continuing the Tandon Committee recommendations of 80% working capital being financed by banks. The committee also advised the review of creation of a separate fund for extending financial assistance to SSI units for modernization at a concessional rate of interest.

The methodology proposed by Tandon committee for working capital estimation was thus further reiterated by Nayak committee.

[Abid Committee Report on Small Enterprises \(1997\)](#)

■ **Review of the Expert Committee Report**

The Expert Committee chaired by Mr. Abid Hussain (Former Member, Planning Commission) was set up in December 1995 to review the small scale enterprise development policy and recommend on guiding principles of its future course, in order to facilitate the growth of efficient enterprises with respect to economic reforms, globalization and technological advancement being witnessed by the country. The primary objectives of the committee were to examine the promotional and protective policies and direct assistance programs for small industry development, to examine the efficacy and desirability of the small industry reservation policy, to review the present institutional arrangements for small and medium enterprises, to view the impact of various fiscal policies on small enterprise development, and to examine the impact of various regulatory laws and procedures.

■ Recommendations

The Expert Committee recommended that the small scale enterprise development policy of protection should be replaced by promotion through adequate supply of credit, services, technology assistance, infrastructure and low transaction costs. The Committee recommended that the new approach should increase focus on public private partnership particularly in clusters of small scale enterprises, and state governments should promote new types of organizations in existing clusters.

The Expert Committee proposed that policy support must be broadened from the current support of only small scale industries to all small scale enterprises. To improve regional focus in small enterprises development, the Committee recommended that the District Industry Centers should play a pivotal role and be more promotional rather than regulatory.

One of the important recommendations of the Committee was that reservations in the small scale industry should be abolished so that adequate new investment and technology up gradation take place in these industries to be able to compete with imports. For units that are likely to be affected by de-reservation, the Expert Committee recommended that the government should provide annual resources of the order of Rs. 500 crores over the next five years, totaling Rs. 2,500 crores. Incentives, credit facilities, and promotional facilities should be available to all small scale enterprises.

With regard to restructuring of financial support, reforms in the financial system was recommended to increase access of small scale units to term loans and working capital and to lower the costs of credit. The Expert Committee endorsed the recommendations of the Nayak Committee (particularly the prescribed target of providing working capital of a minimum of 20 percent of the projected turnover) and urged the RBI to implement them. The Committee also recommended that distinction between term lending and working capital institutions could be done away with and SFCs should get into composite loans. Also, SFCs and SIDCs should be made autonomous by reducing government equity and encouraging that of other financial institutions, commercial banks, private banks, etc.

The Expert Committee further endorsed the plan for local area banks and specialized branches of commercial banks to service the needs of SSEs. Mechanisms for credit recovery should be strengthened through community guarantees, credit rating and creation of data bases which would lead to decreased costs of credit to SSEs. The Expert Committee recommended that SIDBI in co-operation with the national credit rating agencies should promote the establishment of local credit rating agencies in the identified SSE clusters. The Committee suggested that other sources of financial can also be tapped if the 24 percent ceiling on equity participation by large companies and foreign direct investment in SSEs is removed. Since the Delayed Payments Acts has not been very effective in helping SSEs collect their dues, a more practical approach would be to encourage a bills culture and to expand factoring services.

In the context of financing for technology up gradation, the Expert Committee recommended that the government should provide funds to the Bureau of Industrial Standards (BIS) in the Ninth Plan to fund a special exercise for providing technology support to SSEs to achieve prescribed technical standards. For Research and Development, the Expert Committee was of the view that assistance could be provided most effectively through institutions based around clusters of similar industries so that they are able to specialize as well as reap economies of scale.

With regard to infrastructure development in clusters, the Committee stressed upon integrated development of infrastructure in industrial estates with redirection of central and state governments' infrastructure development schemes to existing SSE clusters. The Expert Group recommended increased participation of the private sector risk sharing by the Government in large investments in infrastructure.

The Expert Committee also recommended a new single business law called the "Basic Law for Small Enterprises" to define the small enterprise sector and outline the broad framework for the promotion of the sector. The Committee recommended that the Ministry of Industry set up a Steering Committee under the chairmanship of the Industry Minister to oversee the evolution of the new policy approach suggested.

■ **Summary**

The Abid Committee report threw light on different aspects of structure, growth and economic characteristics of the SSI sector in India. The recommendations of Committee headed by Dr. Abid Hussain were, by and large, accepted by the Government.

The investment ceiling for SSI/Ancillary/Micro units was enhanced. The Committee's recommendation on setting up of a floating collateral reserve fund to support first generation entrepreneurs taking up micro ventures was adopted with an initial corpus of Rs.100.crores The

Committee's recommendation on earmarking 70% credit to SSI units having investment in plant and machinery up to Rs. 5 lakh and between Rs. 5 lakh and Rs. 25 lakh was also adopted by the RBI.

For technical assistance, the Central Government set up the Small Industries Development Organization (SIDO), based on Abid Committee report. The Committee's recommendation on financial superstructure to provide SSIs easier credit led to the setting up of a special fund for taking care of the equity support and interest rate concession for expansion of SSIs, technology up gradation, modernization and training in sectors which were recommended to be de-reserved.

Kapur Committee Report on Credit (1998)

■ **Review of Report**

The committee headed by Mr. S. L. Kapur (IAS, Ret.), Former Secretary, Government of India, and Ministry of Industry was established in 1998, "to look into various problems germane to credit flow to SSI sector and suggest appropriate measures for their redressal". The committee analyzed the impact of the existing institutional and policy framework on the credit delivery system for Small Scale Industrial (SSI) units, now MSMEs.

■ **Key Recommendations**

The key recommendations suggested by the committee include:

- Banks to use simplified application forms for loan application.
- Bank officials to assist the customers in filling out the application form and try to ensure that all supporting documents are submitted along with the properly filled in application form.
- Banks to adopt a flexible policy regarding margins while funding technology up gradation programs, equipment for pollution control and implementing International Standards Organization (ISO) program.
- Banks should have the independence to decide their own norms for assessment of credit requirements.
- In order to augment the skill levels of the bank staff for appraising small projects, the committee proposed training programs with an emphasis on proper motivation, development of project appraisal skills, monitoring of credit and modern banking procedures etc.
- Banks to launch innovative products such as factoring services etc. and promote other avenues for fixed asset financing such as equipment finance, hire-purchase, leasing.
- Efforts to be made to increase the number of specialized SSI branches. Adopting a cluster based approach to encourage the growth of the SSI sector.
- Banks to formulate special schemes addressing the needs of the backward states.

- The policy framework for recovery of assets needs to be simplified to ensure that the recovery process can be completed in a time bound manner.
- The committee stressed the need for streamlining the grievance handling mechanism in the banks. The banks should have a transparent system for handling customer complaints within defined time frames.

■ **Summary**

The committee stressed the need for banks to adhere to the Nayak committee recommendation for sanction of working capital to the enterprises. The Nayak committee proposed method of estimating the working capital limits for an enterprise on the basis of 25% of the turnover of which 5% points to be contributed by the promoters and the balance 20% points by the banks, was accepted by RBI (refer RBI circular RPCD.PLNFS. BC. No.83/ 06.02.31/ 2004-05).

The committee focused on the operational aspects of the credit delivery process by urging banks to simplify and expedite the loan application procedure. In order to reduce the time taken for disposal of applications for granting ad hoc limits, the committee proposed delegations of sanction powers to branch managers.

A major concern highlighted by the committee was the need for programs to train branch managers for appraising small projects. The committee also urged banks to take a more proactive role to facilitate the growth of the SSI sector by setting up technology cells offering advice to entrepreneurs. In order to improve the access to modern technology for MSMEs, the committee urged the banks to adopt a flexible policy regarding margins while funding technology up gradation programs, equipment for pollution control and implementing International Standards Organization (ISO) program. The committee called for increased collaboration between banks and industry associations to identify technical consultants for advising the MSME entrepreneurs to prepare project reports and other documents required to obtain bank funding.

Gupta Committee Interim Report on Development of Small Enterprises (1999)

■ **Review of the Interim Report**

The study group headed by Mr. S. P. Gupta (Member, Planning Commission) was set up in 1999 to “review the problems faced by small enterprises and to suggest new programs and modifications in the existing policies for the development and growth of small enterprises in the country in the light of international experience and recent economic policy reforms under implementation by the government”.

■ **Recommendations**

The study group stressed that in order to increase the flow of credit to the Small-Scale Industries (SSI) sector, now MSMEs; it should be given equal treatment similar to agricultural sector under priority sector lending. The study group urged the banks to directly lend to the SSI sector instead of adopting soft approaches like subscription to bonds of SFCs (State Financial Corporation) / NABARD (National Bank for Agriculture and Rural Development) / HUDCO (Housing and Urban Development Corporation Limited) etc.

In order to increase the capacity of the credit delivery system, the study group stressed the need for growth of micro credit, restructuring of SFCs and setting up more specialized SSI branches. With special focus on the needs of first generation entrepreneurs, recommendation was made to set up a special venture fund for providing equity funding.

The study group strongly recommended the formulation of a policy governing the closure of terminally sick units. The formulated policy should look after the interests of both the entrepreneur and the workers of the enterprise. For potentially viable sick units the study group advocated formulation of time bound rehabilitation package.

One of the key issues faced by the SSI sector is technology up gradation, the study group recommended setting up of technology information banks and providing funds at concessional rates of interest. In addition the study group also suggested giving concessions on customs duty on imported equipment for technology up gradation. In order to further encourage the SSI sector to invest in technology up gradation the study group proposed the idea of allowing accelerated depreciation benefits.

In order to strengthen the linkages of the SSI sector with the export market, the study group proposed subsidizing the cost of attending international trade fairs and ensuring timely availability of credit while units undertake bulk export orders.

■ **Summary**

The study group built on the work of the Nayak and Kapur committees to focus on the major problems obstructing the growth and development of the MSME sector. The study group endorsed the views of Nayak and Kapur Committee for simplifying the loan application procedure. The study group undertook an assessment of the efficacy regarding the policies and programs for development of MSME sector. In addition to inadequate access of credit, the study group also stressed on the need for improving the access to latest technology and export markets for the MSME sector.

The study group stressed the need for provision of low cost funds for entrepreneurs in the SSI sector. The study group commented on the need for establishing more specialized SSI branches to improve the access to credit for SSI sector. The study group also highlighted the need for actively

encouraging the growth of factoring services which is now offered by many banks. In order to speed up the rehabilitation of sick units the study group proposed formulation of time bound rehabilitation packages.

Chakraborty Committee Report on Rehabilitation of Sick SMEs (2008)

■ **Review of the working group report**

In order to revive the sick MSMEs and also to look into the problems faced by MSMEs in terms of timely and adequate credit access, a small working group was formed in the year 2007 under the chairmanship of Dr. K. C. Chakrabarthy (CMD of PNB) with SBI and SIDBI as members. The group studied issues related to timely and adequate flow of funds for start-up capital and also for rehabilitation so that potentially viable sick units can be rehabilitated at the earliest.

■ **Recommendations**

- The study group recommended simplification of procedures in preparing techno-economic feasibility reports in order to cut delay in credit disbursements. For this, a committee was proposed to be formed, comprising of 2-3 major banks in preparing reports for firms up to Rs.1 crore project cost so as to obviate the need for project viability studies.
- The working group suggested that banks should not seek for CMA data for working capital loans up to specified limits in the MSME sector. Also lending in case of advances up to 2 crores was proposed to be done on the basis of scoring models. Information required for scoring models was proposed to be incorporated in the application form for loans.
- The group recommended simplification of application forms for loans extended to micro enterprise. For the loans extended to small and medium enterprises, application form was proposed to have a checklist of all documents that need to be submitted.
- In order to expedite the loan sanctioning process the group suggested to set up a Centralised Credit Processing Cell which can be utilised as a single point for appraisal, sanction, documentation, renewal and enhancement.
- It was noted that very few banks were engaged in extending factoring services to MSMEs. The group suggested that all banks may take up factoring for small and medium enterprises. In order to implement this, the group recommended to bring in legislation for factoring and refinance at concessional rates from SIDBI/RBI
- The group suggested setting up a rehabilitation fund for revival of sick MSMEs and a National Fund Equity scheme that can be utilised for Greenfield or expansion projects.

■ **Summary**

The working group stressed the need to simplify procedures in preparing project feasibility reports, setting up of single point cells in regional bank branches to reduce the delay of loan processing. The group felt that financials reporting for MSME units should have simplified disclosure norms to increase the practice of bookkeeping among these units. The group suggested guidelines in order to avoid incidence of sickness at the initial stage of setting up of unit. The working group proposed new financial products/ services for MSMEs like single facility for stock and receivables, legislation of factoring services as a separate act, Rehabilitation fund, National Equity fund scheme and a restructuring package at the time of rehabilitation for sick MSMEs.

Report on Prime Minister Task Force's Sub-Group on Credit to MSMEs

■ **Review of the Report**

The Task Force under the chairmanship of Principal Secretary to the Prime Minister was constituted to address the issues of micro, small and medium enterprises (MSME) sector. It constituted seven Sub-Groups on credit, marketing, labor, exit policy, infrastructure/technology/skill development, taxation and special packages for North East and Jammu & Kashmir. The Sub-Group on credit operated under the chairmanship of Mr. R. M. Malla (Chairman cum Managing Director, SIDBI) and addressed the issue of availability and cost of credit to the MSE sector.

■ **Recommendations**

The Sub-Group on credit also recommended setting up of a National Fund for the Unorganized Sector and that the Special Cell set up by SIDBI for refinancing micro enterprises should be adequately equipped to manage its operations and monitored by an Advisory Group.

In the context of interest subvention, the Sub-Group recommended that the Ministry of MSME formulate a scheme and work out the budgetary implication in consultation with SIDBI.

Another important recommendation made by the Sub-Group was with respect to setting up of an SME Exchange. The Sub-Group was of the view that SEBI may examine the proposals related to formation of SME Exchanges received by them early and expedite setting up of such exchanges in consultation with all the stakeholders.

Other broad policy-issues that the Sub-Group recommended on are change in bank lending norms for innovation start-up firms, and introduction of new debt instruments, tax incentives including allowing setting up of domestic angel / venture capital funds in a Limited Liability Partnership (LLP) structure with a tax-pass through status, allowing listing of angel / venture capital funds on the existing Stock Exchanges, and public funding for setting up new venture funds.

With respect to implementation of recommendations of Report of the Working Group on Rehabilitation of sick SMEs, the Sub-Group recommended that RBI's instruction regarding a more liberalized One Time Settlement Scheme to be introduced by all banks and placed on their web sites for wider dissemination.

The Sub-Group emphasized on a suitable facilitating environment to enable banks to extend advances to MSEs for undertaking viable activities. Based on the recommendations of earlier Committees / Working Group and the suggestions of MSE Associations, the Sub-Group also recommended the following:

- Implementation of the RBI High Level Committee to review the Lead Bank Scheme to draw up of a road map for providing banking services at every village with a population of over 2000 at least once a week and other recommendations
- Extension of RBI refinancing facility of Rs. 7,000 crores extended by SIDBI to public sector banks from March 31, 2010 to March 31, 2011, and increasing mandatory coverage under CGTMSE from Rs. 5 lakh to Rs. 10 lakh for MSEs
- Cluster-based approach for financing MSEs for reduction in transaction costs and mitigation of risks
- Encouragement to banks to use a scoring model to ensure speedy disposal of the loan applications, adoption of Banking Code by banks for MSEs
- Expediting the process of Working Group looking into the matter of conversion of receivables of MSE suppliers into cash as quickly as possible
- Evolution of suitable legal framework for promotion of factoring services without recourse for MSMEs
- Setting up of 'MSME Helpline' by the Ministry of MSME for facilitating easy access to loan related information

The report provided implementation status of recommendations of various committees and working groups. With respect to sub-target for micro enterprises under priority sector lending, the report mentioned that the Ministry of MSME earmarked 6% of NBC for micro enterprises under the priority sector lending targets to facilitate an additional credit flow to the tune of about Rs. 18,000 crores from the public sector banks. RBI had responded to the above by mentioning that domestic scheduled commercial banks have already been set various targets for lending to priority sector and additional targets may not serve much purpose and instead a suitable facilitating environment needs to be ensured to enable banks to extend advances to borrowers for undertaking viable activities.

With respect to setting up of National Fund for the Unorganized Sector, the National Commission on Enterprises in the Unorganized Sector (NCEUS), the decisions were taken to set up a Special Cell for refinancing to micro enterprises, and the earmarked amount of Rs. 1,000 crores was disbursed to the banks by SIDBI. However, since the corpus was for loans to be returned within 3 years and thus, there is a need for having another source of funding for enterprises in unorganized sector for giving long term loans.

With regard to setting up of SME Exchange, SEBI had agreed to creation of a separate Exchange for the SMEs in October 2007 and was examining the EOIs received from some organizations to set up the platform.

In the context of the Chakrabarty Working Group report, the banks had been advised to consider speedy implementation of the recommendations made by the Working Group with regard to timely and adequate flow of credit to the MSE sector. While RBI has addressed many of the recommendations of the report, few recommendations related to change in definition of sick MSEs and a more liberalized OTS Scheme had not been addressed.

- **Summary**

The Task Force took into consideration recommendations of previous committees, working groups and study groups, such as those of Nayak Committee, Abid Expert Group, Kapur Committee, Gupta Study Group, Ganguly Working Group, and Chakrabarty Working Group in order to examine specific issues highlighted by these reports and provide recommendations on the same.

The Sub-Group on credit examined the issues impacting adequate and timely credit flow to the Micro and Small Enterprises (MSEs) and the Unorganized sector, and considered various suggestions made by the MSE Associations, particularly related to a separate sub-target under the priority sector lending, setting up of a Fund for the Unorganized Sector, setting up of SME Exchange, etc. It also considered the recommendations of the various Committees/Working Groups relating to credit and sickness, and recommend measures to improve the credit flow to the MSE / Unorganized sector, and delivery mechanism for credit to MSE / unorganized sector.

Annexure A.4

Overview of Credit Related Schemes

Credit Linked Capital Subsidy Scheme

Aimed at technology up gradation of the small scale enterprises, the Government (Ministry of SSI) has been operating a Credit Linked Capital Subsidy Scheme since the year 2000. The scheme aims at facilitating technology up gradation for improvement in productivity of the SSI units, by providing them 15 per cent (initially it was 12 per cent) upfront subsidy. This scheme is available to all types of SSI units including agro and rural industry units, on institutional finance (credit) availed by them for the modernization of their production equipment (plant and machinery) and technology.

Existing SSI units registered with the State Directorates of Industries, which upgrade with the state-of-the-art technology, with or without expansion as well as new SSI units which are registered with the State Directorate of Industries and which set up their facilities only with appropriate eligible and proven technology are eligible for subsidy under this scheme.

SIDBI, NABARD and other select commercial banks implement this scheme, while credit is made available by eligible Primary Lending Institutions (PLIs). Eligible PLIs include scheduled commercial banks, eligible cooperative banks (other than Urban Cooperative Banks), eligible Regional Rural Banks, National Small Industries Corporation, State Financial Corporations (SFCs) and North Eastern Development Financial Institution (NEDFI)

The guidelines of the scheme have been revised from time to time by the Governing and Technology Approval Board of CLCSS to include more sub-sectors/products and approved technologies under the scheme. The scheme currently covers 45 sub-sectors important among them are **food processing, poultry, leather and leather products, electronic equipment, auto parts, bicycle parts, general engineering works, bio-tech industries, foundries, toys, sports goods, wooden furniture, khadi, and village industries, coir and coir products, agricultural equipment, plastics, rubber, glass and ceramics**, etc.

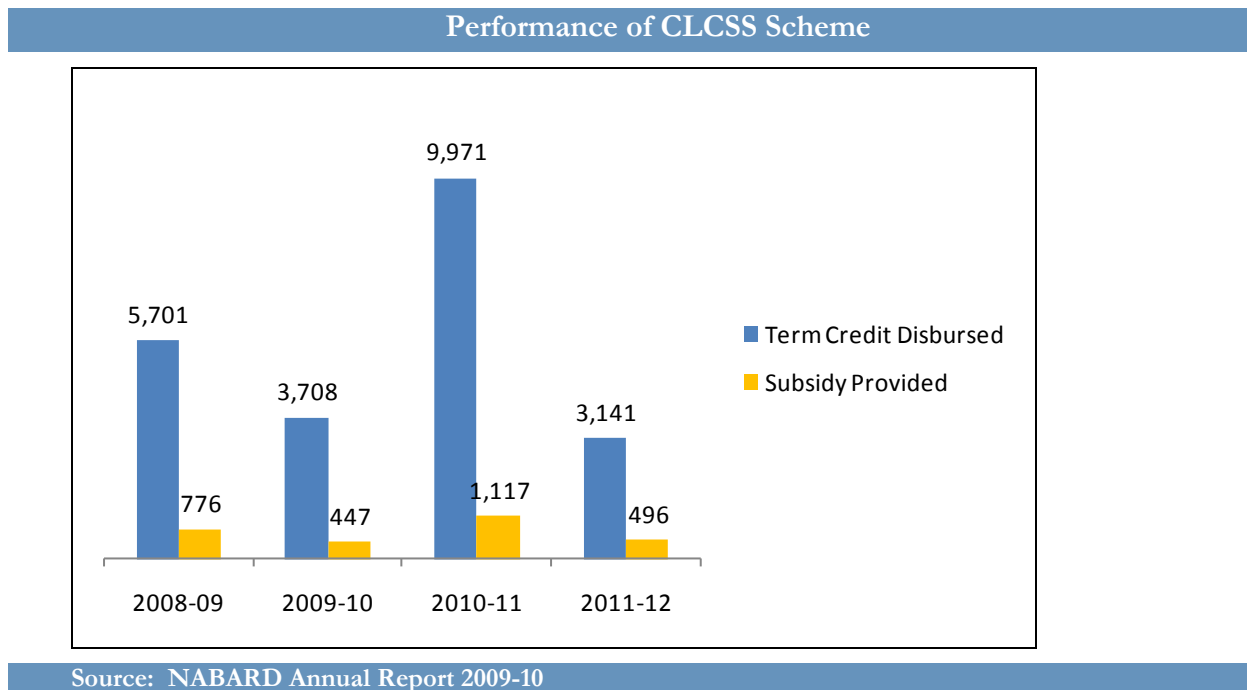
To accelerate the pace of implementation of the scheme and also on the basis of the experiences gathered in implementing the scheme, the scheme has been revised recently (2005). Main features of the revised scheme are as under.

- The ceiling of loan under the scheme has been raised from Rs.40 lakh to Rs.1crore.
- The rate of capital subsidy has been raised from 12 per cent to 15 per cent.

- The method of calculating capital subsidy has been changed with respect to the amount of term loan disbursed to the beneficiary.
- Earlier, the SSI units were categorized into various investment slabs which have been changed to their present investment for determining the eligible subsidy.

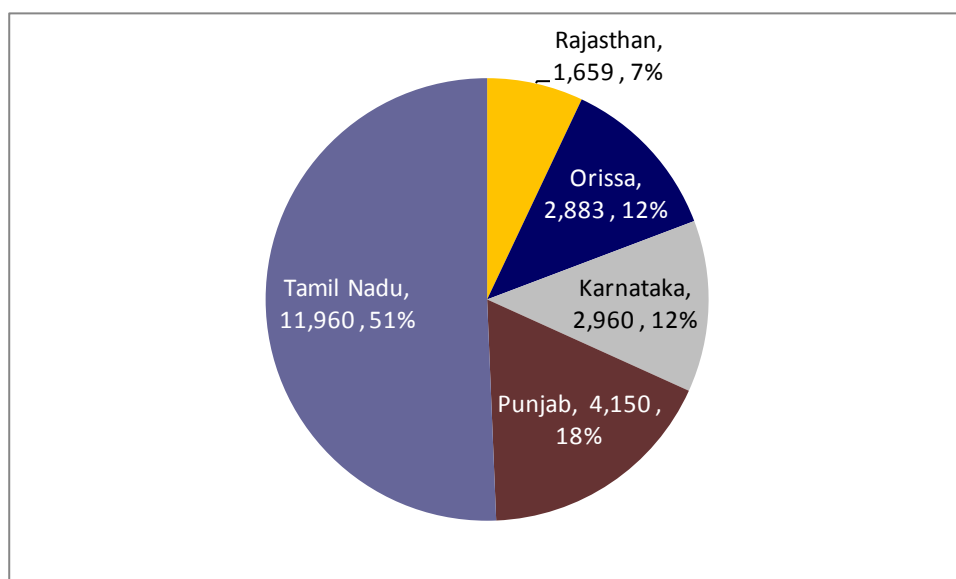
Performance of the CLCSS:

Over the five-year period, 2008-12, the aggregate credit disbursed under term loans for the scheme was around Rs. 26000 crores. The following presents the growth of disbursements over this period:



In terms of credit received by the states, the five states of Rajasthan, Orissa, Karnataka, Punjab and Tamil Nadu contribute to around 90% of the total amount received for term credit. The following chart presents this scenario

Performance of CLCSS Scheme in select States



Source: NABARD Annual Report 2009-10

Technology Up gradation Fund Scheme for Textile

The Technology Up gradation Fund Scheme (TUS), the flag ship scheme of the Ministry of Textile was launched on April, 1999 with the objective of making Funds available to the domestic textile industry for upgrading technology of existing units and also to set up new units with state-of-the-art technology for enhancing their viability in the domestic and in international market. The scheme provides for 5 per cent interest reimbursement of the normal interest charged by the lending institutions on rupee term loan. Through the scheme covers both large mills and small units such as handlooms but it has mostly been utilized by the large units. In the decentralized segment the scheme also covers handlooms which account for 13 per cent of total cloth production in the country and also the power loom sector. In lieu of interest subsidy an additional option of credit linked capital subsidy has been offered for decentralized textile sector. Under TUFs, a power loom owner can reduce cost of borrowing capital either by (i) availing 20 per cent upfront credit linked capital subsidy from enlarged credit network that include cooperative banks and other genuine NBFCs recognized by RBI, or (ii) by obtaining 5 per cent interest subsidy on loan. It appears that the decentralized sector is not a significant beneficiary of this scheme.

Review carried out by the Task Force on Credit Access in 2010 to understand the low response of TUFs in power loom sector has highlighted the following persistent problems: -

- A large number of small units in the decentralized power loom sector are not able to access TUF Funds due to the absence of books of accounts. A large number of these power loom units work

on job basis; they neither have need nor capacity to maintain book of account; they are consequently unable to meet the requirements of bankers for loans, who are, in any case, wary of advancing credit to decentralized units.

- The average power loom unit has 4.5 plain looms, set up at an investment in machinery that does not amount to more than Rs.2.5 to Rs.3 lakh. Such units require credit below the norms for minimum project size, required by most banks under TUFS to be Rs. 25 lakhs, and SIDBI Rs.10 lakhs. Banks consider that to be an economically viable venture. A power loom unit requires at least 8-10 shuttle less looms; lower levels of technology or size are not economical, and an incremental approach to technology or size is, therefore, discouraged.
- When banks advance credit, the assessment of the proposal for feasibility includes an assessment of working capital availability with the loaned. However, they do not ordinarily agree to advance working capital loans where it can improve viability. As a large number of the smaller units cannot show, or do not have working capital, their proposals for loans for technology up gradation are generally turned down.
- Loans for margin money requirement from the National Equity Fund (NEF) Scheme have been a non-starter, due to the SIDBI condition of refinance. Since banks are not in need of refinance, they do not entertain applications for loan under NEF. Power loom units that cannot raise the power loom contribution of 35 per cent are consequently unable to modernize.
- Significantly, a large number of small-scale power loom units can conveniently access Funds from sources other than the banks, and several other than the banks, and several of them, aware of the need to modernize, have done so even within the existing constraints. It is significant that the ratio of looms acquired outside TUFS is 91%.

Credit Guarantee Scheme for small enterprises

Obtaining bank loan without collateral has been one of the main problems of small entrepreneurs. Besides, banks find lending to small enterprises as risky proposition. To take care of this problem, the Credit Guarantee Fund Trust Scheme for Small Industries was introduced by the Government (Ministry of Small Scale Industries) in May 2000 with the objective of making available credit to small scale industrial units, particularly micro units (with investment in plant and machinery less than Rs.25 lakh) for loans up to Rs.10 lakh without collateral/ third party guarantees. The scheme is being operated through the Credit Guarantee Fund Trust for Small Industries (CGTSI) set up jointly by the Government of India and the Small Industries Development Bank of India (SIDBI). The loan limit under the scheme, which was Rs.10 lakh per borrower, has been enhanced to Rs.25 lakh per borrower in accordance with the Comprehensive Policy Package on SSI announced on 30th August 2000 when the Scheme was formally launched.

The scheme covers collateral free loan (term loan and/or working capital including non-Fund based working capital) extended by eligible lending institutions to new and existing SSI Units as well as Small Scale Service and Business (industry related), Entities (SSSBs) including Information Technology and Software Industry up to Rs.25 lakh per borrowing units.

The guarantee cover under the scheme is up to 75 per cent of the credit subject to a maximum guarantee limit of Rs.18.75 lakh. However, the member lending institutions (MLIs) are allowed to extend additional credit facilities against collateral security and/or third party guarantee to the borrowers already covered under the scheme in those cases where the credit facility already covered under the scheme has already reached the ceiling of Rs.25 lakh.

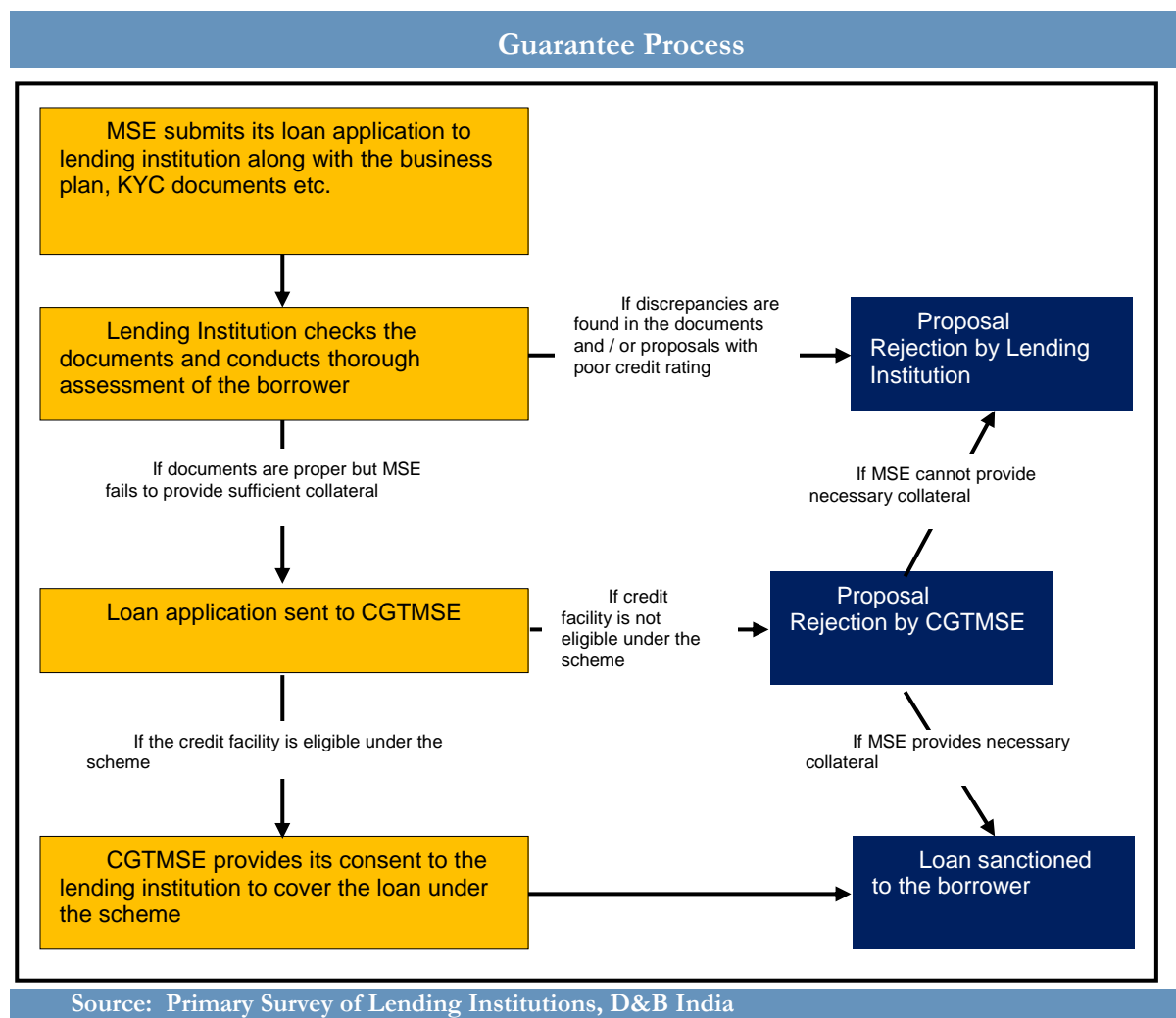
The initial corpus fund of CGTMSE in the year FY2001 was Rs. 125 Crores, out of which Rs. 100 Crores was contributed by the Government of India and the rest by SIDBI (“Settlers”). In the subsequent years, both the settlers maintained the ratio of contribution to the fund of 4:1. By the end of FY2009, the corpus fund of CGTMSE stood at Rs. 1,754.07 Crores, out of which Rs. 1,403.25 Crores (80%) is contributed by the Government of India and the rest is contributed by SIDBI.

In September 2008, CGTMSE introduced Risk sharing facility (RSF-I) scheme on pilot basis (for 3 months), which enhanced the scope of the scheme to cover credit facilities in the range of Rs. 50 Lakh and Rs. 1 Crores. RSF-1 was implemented through 8 Member Lending Institutions²³ and covered a total of 64 loans under the scheme

Based on the response obtained on RSF-I, the scope of CGTMSE scheme has been enhanced to cover collateral-free credit facilities (term loan and / or working capital) extended by eligible member lending institutions (MLIs)²⁴ to new and existing micro and small enterprises up to Rs. 100 Lakh per borrowing unit. The guarantee cover provided is up to 75% of the credit facility up to Rs. 50 Lakh with an incremental guarantee of 50% of the credit facility above Rs. 50 Lakh and up to Rs. 100 Lakh.

²³ “Banks” and “Member Lending Institutions” were interchangeably used in this report

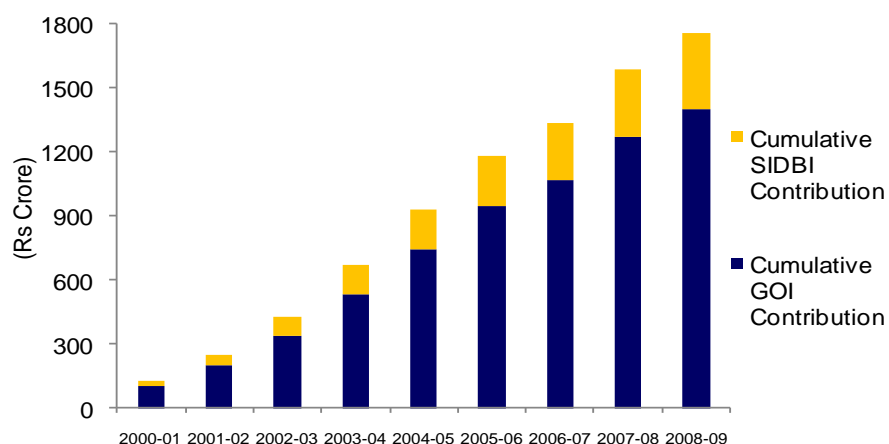
²⁴ CGTMSE currently has 111 MLIs as on date, which include Regional Rural Banks, Public and Private Sector Banks, Foreign Banks and Financial Institutions



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²⁵ Represents 70.16% of the total committed capital by the two settlers of Rs. 2500 Crores

Capital Fund of CGTMSE



Source: CGTMSE

The performance history of CGTMSE

Year	No. of Active MLIs	No. of Credit Facilities Approved	Key Initiatives
2000-01	9	951	<ul style="list-style-type: none"> • Introduction of Credit Guarantee Scheme for SSI / SSSBE
2001-02	16	2,296	<ul style="list-style-type: none"> • Promotion activities by CGTMSE to lending institutions • Modifications in scope of the scheme and payment terms (one-time guarantee fee)
2002-03	22	4,955	<ul style="list-style-type: none"> • Promotional activities by CGTMSE to lending institutions
2003-04	29	6,603	<ul style="list-style-type: none"> • Awareness creation programs (training and workshops) to MLIs • Software support to MLIs for submitting online applications • Introduction of minimum credit limit for SSIs (Rs. 5 Lakh)
2004-05	32	8,451	<ul style="list-style-type: none"> • Lending institutions were allowed to extend additional loans to SSIs with credit facility requirements of over Rs.

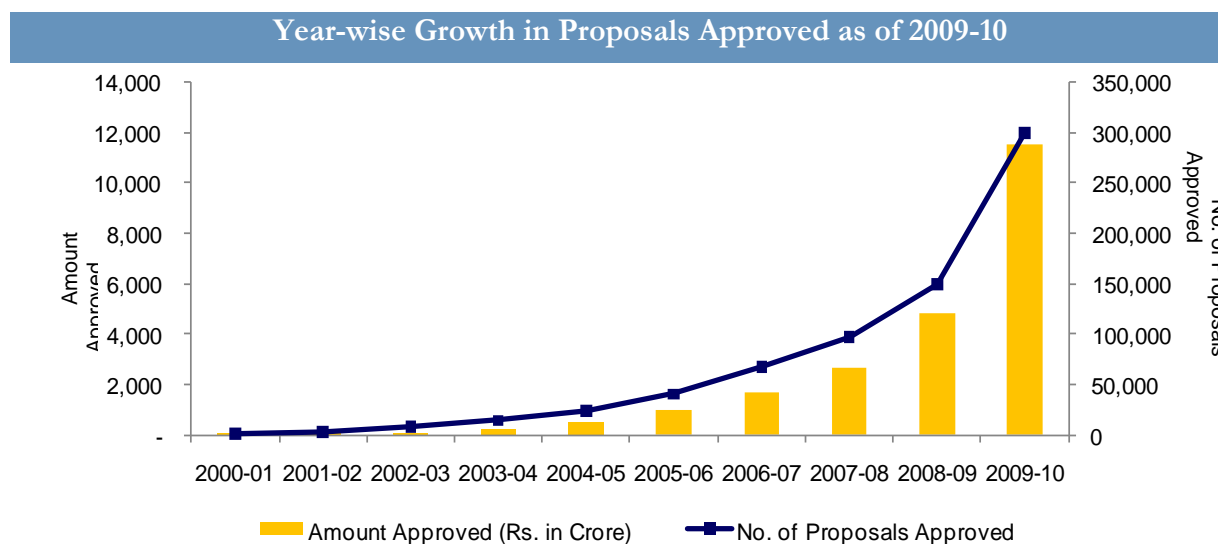
Year	No. of Active MLIs	No. of Credit Facilities Approved	Key Initiatives
			<p>25 Lakh, which were already covered under credit guarantee scheme. However, credit guarantee cover was to be available up to Rs. 25 Lakh only.</p> <ul style="list-style-type: none"> • Lending institutions were allowed to take collateral for additional loan amount (beyond Rs. 25 Lakh that was covered under the scheme)
2005-06	36	16,284	<ul style="list-style-type: none"> • In order to make the scheme attractive to lending institutions, CGTMSE has brought changes in one-time fee structure (reduced it from 2.5% to 1.5%)
2006-07	40	27,457	<ul style="list-style-type: none"> • CGTMSE provided a one-time extension for lodging applications (because of problems in software). So, few applications pending in the previous year also got registered in the year. • CGTMSE introduced differential pricing (One-time guarantee fee and annual service fee) to MLIs based on extent of guarantee cover.
2007-08	47	30,285	<ul style="list-style-type: none"> • Change in definition of SSI • Based on the modifications suggested in the "Package for promotion of Micro and Small Enterprises", the scope of scheme was changed to cover Micro and Small enterprises also. • The limit for credit facility requirements was increased from Rs. 25 Lakh to Rs. 50 Lakh • Changes in fee structure for North-East Region
2008-09	57	53,708	<ul style="list-style-type: none"> • The limit for credit facility requirements was increased from Rs. 50 Lakh to Rs. 100 Lakh • Modifications in scheme structure to benefit artisans and SC / ST borrowers

Year	No. of Active MLIs	No. of Credit Facilities Approved	Key Initiatives
2009-10	85	151,387	<ul style="list-style-type: none"> • The extent of guarantee cover was increased for credit facility requirements up to Rs. 1 Crore • CGTMSE made it mandatory for lending institutions to follow a centralized ASF payment system, following the model's success with few leading Member Lending Institutions

Source: CGTMSE

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

In the year 2007, RBI advised lending institutions to provide collateral-free loans to MSEs up to an overall limit of Rs. 5 Lakh. This policy decision had a positive impact on the performance of CGTMSE as witnessed from high growth in number of proposals and guarantee amount from the year 2007. By March 2009, around 3 Lakh cases amounting to Rs. 11,559 Crores were approved by CGTMSE under the Scheme.



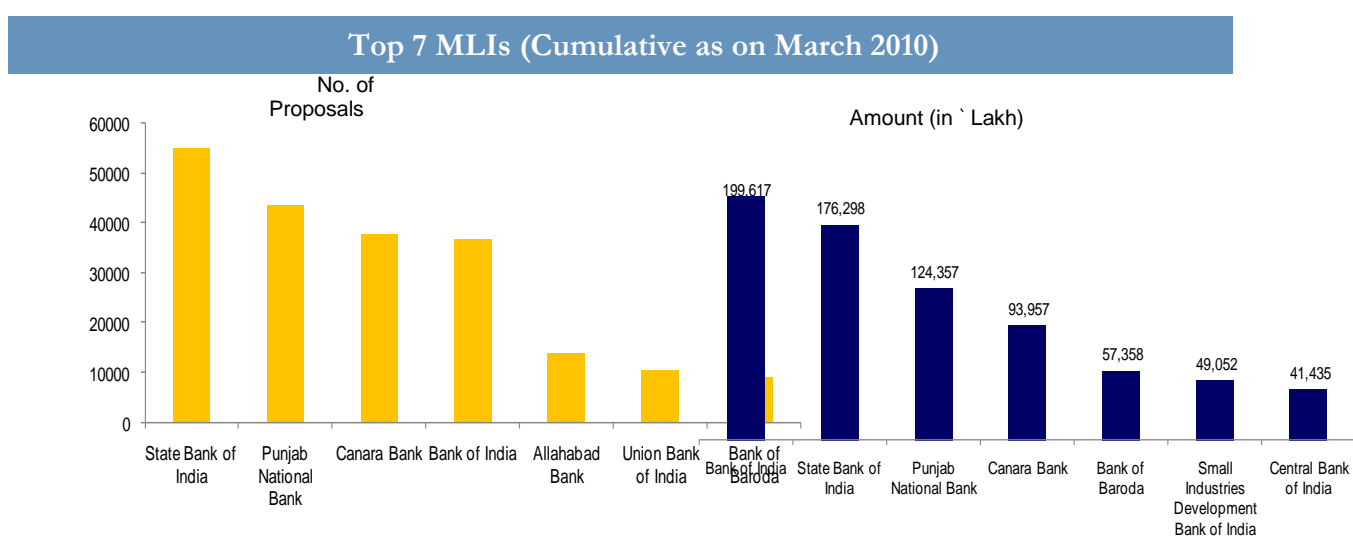
Source: CGTMSE

The scheme was slow in taking off in the initial years and the cover availed remained below 10,000 proposals during the first five years. However, since 2005-06, there has been a steady growth in the issue of guarantees and the same has increased exponentially from 12,747 proposals involving Rs.

462.99 Crores in the year 2005-06 to 1, 51,387 guarantee proposals for Rs. 6,875.11 Crores in the year 2009-10. Cumulatively, as on March 31, 2010, 3, 00,105 guarantee proposals have been approved involving an aggregate amount of Rs. 11,559.61 Crores.

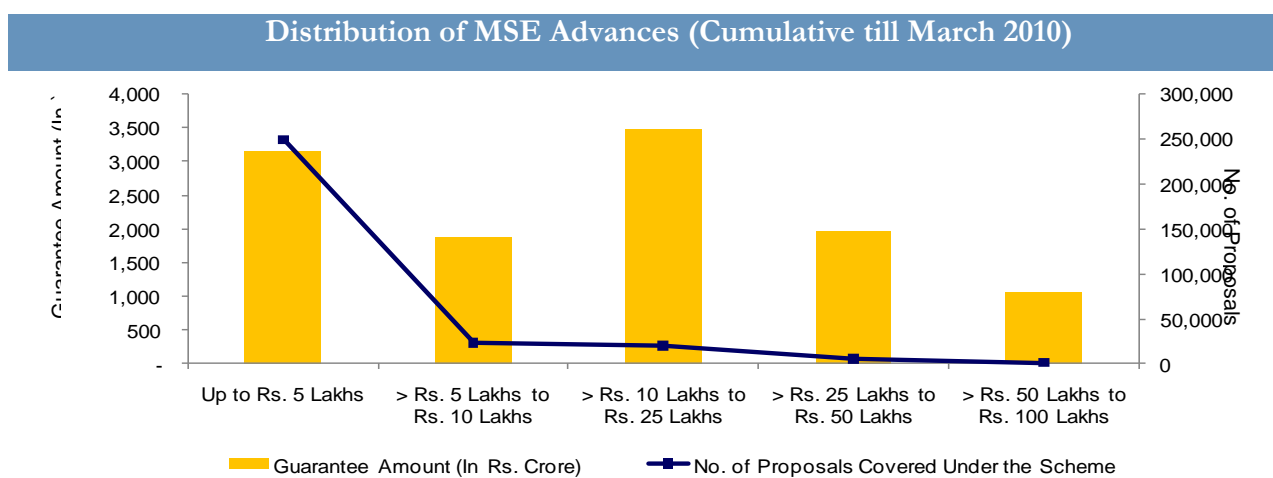
Public Sector Banks (including State Bank group) are the key MLIs for CGTMSE as compared to other categories of financial institutions. They contribute about 94% of the total proposals covered under CGTMSE and 89% of the total guarantee amount. State Bank group alone contributes about 25% of total proposals and 20% of total guarantee amount covered under CGTMSE.

The top 7 participants of CGTMSE scheme as on March 2010, which contributes about 69% in terms of no. of proposals and 64% in terms of amount approved are as follows:



Source: CGTMSE

The distribution of MSE advances covered under CGTMSE is as follows:



Source: CGTMSE

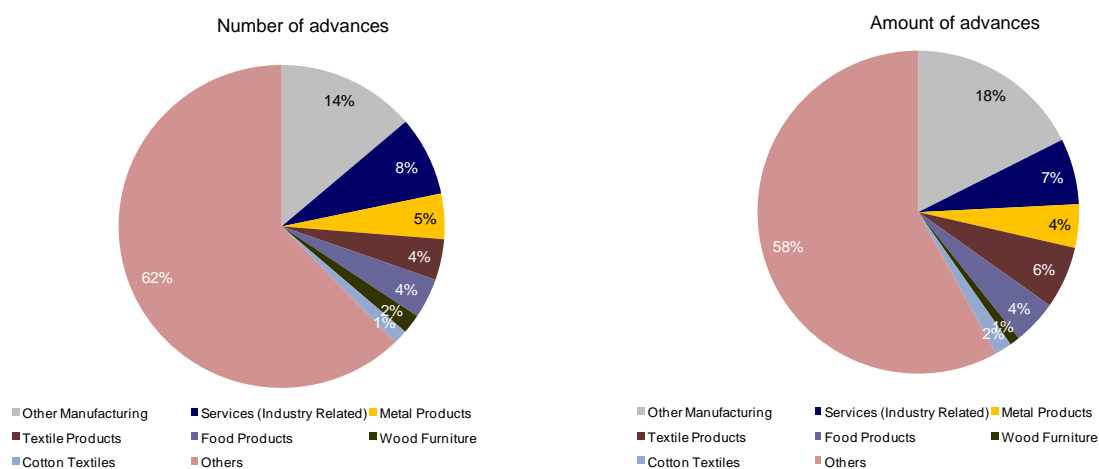
The following observations can be made based on distribution of cumulative MSE advances covered under CGTMSE as on March 2010:

- Concentration of total volume of proposals is high in lower credit requirement slabs, while it is low in higher credit requirement slabs (especially in credit facility requirements over Rs. 50 Lakh and up to Rs. 100 Lakh). In volume terms, about 83.2% of total number of proposals covered under CGTMSE are credit facility requirements up to Rs. 5 Lakh, about 14.7% of total proposals guaranteed are credit facility requirements are between Rs. 5 Lakh and Rs. 25 Lakh and about 2.2% of total proposals guaranteed are credit facility requirements between Rs. 25 Lakh and Rs. 1 Crore.
- In value terms, 27.28% of amount guaranteed pertains to loan size below Rs. 5 Lakh, 16.34% of the amount guaranteed belongs to loan size between Rs. 5 Lakh and Rs. 10 Lakh, 30.14% of loans belongs to loan size between Rs. 10 Lakh to Rs. 25 Lakh, 17.03% of loans belongs to loan size between Rs. 25 Lakh to Rs. 50 Lakh, 9.21% of loans belongs to loan size between Rs. 50 Lakh to Rs. 1 Crore.

The sector-wise assistance made available through MLIs under the Credit Guarantee Scheme is as follows:

- ‘Other Manufacturing’ units received maximum coverage in terms of amount of assistance as well as number of approvals.
- Other major beneficiary sectors are Industry-Related Services, Metal Products, Textile Products, Food Products, Wood Furniture and Cotton Textiles.

Sector-wise distribution of advances as on March 2010



Source: CGTMSE

Moreover, in order to facilitate flow of credit to Handicrafts sector, the Office of DC (Handicrafts) has disbursed Rs. 2.80 Crores in April 2009 to CGTMSE. This fund will pay the Guarantee Fee and Annual Service Fee to CGTMSE for any advances provided by lending institutions to artisans.

Major Observations on Credit Gap as observed by the Prime Minister's Task Force on Access to Credit

The factors affecting the flow of credit to SSE Sector can be broadly categorized into two segments.

One set of reasons indicate shortcomings inherent to SSE Sector. These are: -

- A weak financial base, which eventually prompts the entrepreneurs to bring in Funds by own efforts such as family saving or sale of property, ornaments, etc. and less by way of institutional loan and still lesser by way of equity capital or investment from the capital market.
- Improper maintenance of books of accounts.
- Inability to provide collateral security
- Delay in payments by the larger units, and
- Lack of appreciation of financial data required by banks/financial institutions etc.

The second set of reasons could be attributed to the operational restraints and perception of banks and financial institutions: -

- The administrative cost of lending to small borrowers being relatively high there by resulting in disincentive to lend to SSE Units.
- High mortality rate/sickness amongst the SSE units.
- The concessional/regulated interest rate works as disincentive to motivate the financial institutions intrinsically to invest in SSE units.

The large gap in the supply of working capital is hampering the growth of small scale enterprises. This is indicated by the fact that ratio of commercial banks funding for working capital to output in the medium and large scale industries is 19.4 per cent while for SSIs (now MSEs), it was 8.1 per cent according to Nayak Committee (1992), 6 per cent according to NCAER/FNST study (1996). Even the limited data for SSI and KVIC show that in any case this ratio is still less than 13 per cent, which is much lower than the RBI's stipulated ratio of 20 per cent. This has also been observed by D&B India in its surveys.

Diagnostic Study Reports on Individual Cluster

MSME Financing and Development Project (MSMEFDP), a multi activity, multi-agency Project on Financing and Development of MSMEs attends to demand and supply needs of MSME sector through provision of financial and non-financial services and creation of enabling environment wherein sustainable growth of MSMEs are assured & ensured. While Department of Financial services, MOF GOI is the nodal agency, SIDBI, as an implementing agency, extends umbrella support to international partners World Bank and KfW (who have extended credit Facility for meeting financial needs) and DFID UK, KfW and GtZ Germany (who have extended Technical Assistance to meet non-financial needs).

To better understand the needs and challenges of MSME sector, several industry clusters have been identified across India and diagnostic study has been done by various institutions such as EDI, APITCO etc., under the supervision of SIDBI. Similar to the D&B survey technique, a sample of enterprises has been surveyed to arrive at key findings of any cluster

Annexure A.5– Financial Inclusion Initiatives under MSME-FDP

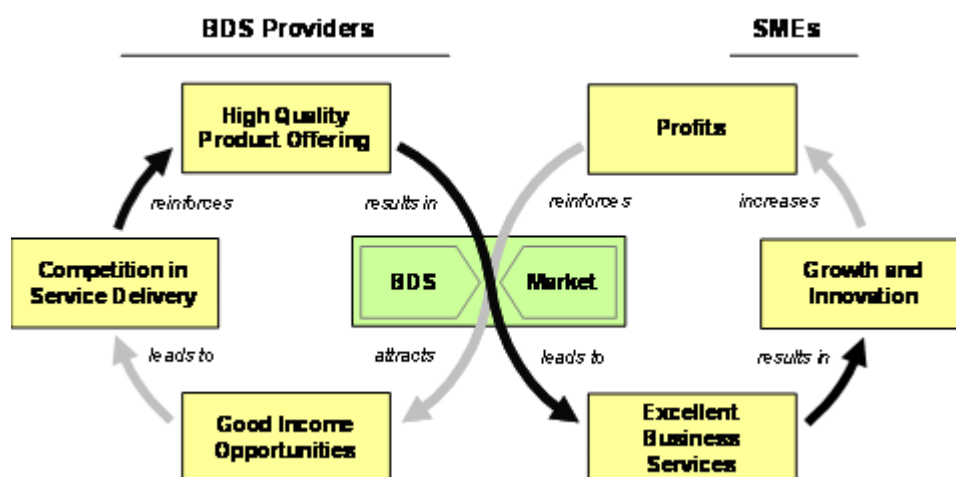
By achieving integration of BDS market development with 'access to finance' initiatives, a greater multiplier effect can be unleashed. Every cluster has different financial needs and look for customized products and services. Leather and Pharma cluster firms, for example, need financial products that can cater well to the needs of the firm there. The terms and conditions of granting loans need to be suitably amended as well depending on the profile of cluster firms. It is felt that momentum can be rendered to the mission of enabling access to finance by attending to this through BDS approach.

MSME Financing and Development Project

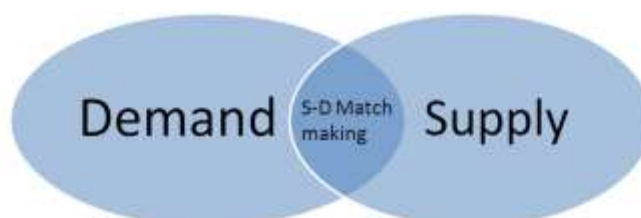
SIDBI is the implementing agency for the MSME Financing and Development Project (MSME-FDP) involving the World Bank, DFID, UK and GIZ, Germany as partners. The project attends to demand and supply side needs of MSMEs through judicious provision of financial and non-financial services. It has reached out to over 35,000 beneficiaries, which are largely MSMEs & stakeholders.

By fostering Business Development Services (BDS) in 19 clusters, project has given new dimensions to cluster development by acting as market enabler. This systemic change has been brought about by developing sustainable & technically competent - locally relevant experts, 450 BDS providers -both individual/ Institutional which also include BDS Providers(BDSPs) in area of Skill development, Technology, Quality, Marketing, Finance and so on. This has not only enabled national/international compliances by MSMEs in clusters but also fostered competitiveness by enabling markets to work for MSMEs. Financial BDS have given reference for linkages to Banking fraternity for around Rs 4.35 billion.

The BDS market development believes in the theory that once BDS are capacitated and are successful in satisfying the appetite of MSMEs, the market rejuvenates. By using services, MSMEs get growth impetus and subsequent profit. They seek more services of BDS and as profitability of service provider goes up, it attracts other players. The market attributes get imbibed in form of a self-sustaining loop (exhibited below – courtesy OTF USA and Cluster Pulse) which brings in innovation, cooperation and competition.



At the very early stage, project realized that the main problem in clusters is not the availability of the finance but the lack of awareness about its availability and how to approach lenders. Project has not only created awareness programme to enhance the knowledge of MSMEs in the area but also hand hold them to get to the finance from various Banks/FIs. A total number of 786 enquiries for Rs 435 Crores were generated through the programs and an amount of Rs. 119 Crores availed by 347 MSMEs across various clusters. A list of few empanelled BDSPs in finance area in the clusters under study for credit gap which includes CAs, finance management experts etc. is appended as annexure.



Project has worked with various models and took various initiatives which have acted as catalysts. Major models which project have adopted are:

- **BDS centric model**

In BDS centric model, individual BDS providers were strengthened to provide better services to cater the customized needs of MSMEs in various clusters. MSMEs were sensitized and grouped together to avail BDS services at affordable prices. Efforts have been made to facilitate their initial transactions through voucher support to showcase the demonstrative effect in the clusters. Later some of the BDS formed consortia have to provide one stop shop services to MSMEs.

- **MFI centric model**

In this model to reach the enterprise at the bottom of pyramid, assistance was provided on pilot basis to a MFI. Besides sanctioning a credit limit, capacity building support in form of handholding support was extended. Project also piloted a downscaling model (doing small loan profitably) by roping in a consultancy agency of international experience. Later it is planned to scale up this model for wide replication.

- **BMO led model**

In this model, BMOs capacity was build and they were promoted as BDSP for financial linkages. This enabled the strengthening of credit delivery channel for the financial linkages with the Bank. The primary responsibility of due diligence rested with the BMOs which formed a separate SPV to create awareness among MSMEs. Few other bankers have joined the initiative with the BMO. Further this initiative is being replicated by SIDBI at another state also. Few other BMOs have evinced interest to adopt the model.

Along with facilitation of credit in the clusters project has also focused towards Credit Dispensation and Supplementation. For Credit Dispensation, it has channelized over USD 445 mio to 3500 MSMEs through Environment and Social Risk (E&S) aligned facilities for which 110 plus credit officials of 45 branches have been trained. For credit supplementation, it has supported piloting of Risk Sharing Facility (through CGTMSE) which has been institutionalized, setting up of SME commercial Bureau in CIBIL (database has grown from 0.04 mio to 6.4 mio with 0.3 mio reports accessed), SME Rating Agency (emerged sustainable through 10000 plus ratings and launch of Green ratings etc.), and capacity building of strategic institutions in Risk Capital, Technology Access etc.)

Few Case Studies on “Access to Finance”

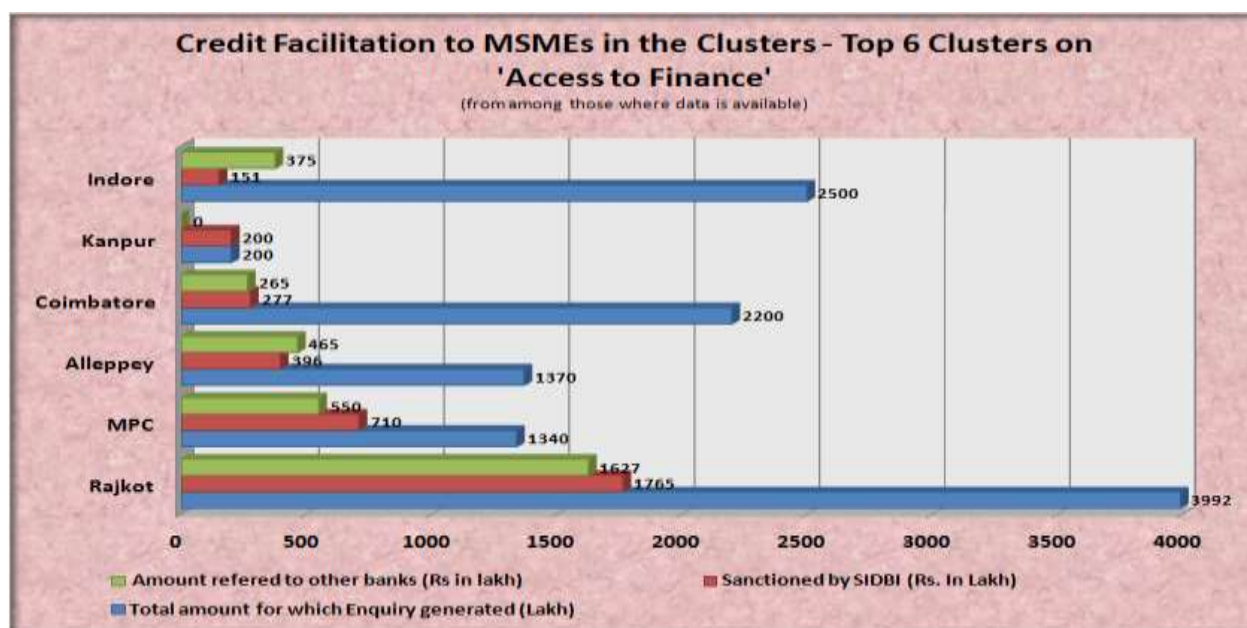
BDS centric model

Cluster level Access to finance initiatives: Clusters have seen efforts for facilitating linkages of MSMEs with SIDBI and other bank branches. In BDS clusters, the major focus was on creating awareness among MSMEs about the availability of credit from organized sources viz. Banks, FIs etc. to create demand for the same and to build the capacity of the BDS providers to cater the needs of MSMEs at affordable prices. In cluster need based initiatives viz. formation of BDS consortia, SPVs were also taken in order to smoothen the credit linkages.

Some of cluster specific achievements are captured in the table below:

Access to Finance Initiatives in the Clusters			
Cluster	Sector	Access to Finance - Linkages and Sensitisation	Effectiveness and Impact
Coimbatore	Engineering	Credit linkages	6 firms got SIDBI loans
Rourkela	Engineering	Financial linkages to SBI, SIDBI & local MFI (Sambandh)	37 Micro Firms are in the process of getting loans
Alleppey	Coir	- Connected 9 SHG to Micro Finance Institution - Finance BDS supported SMEs to access credit of more than Rs.200 lakhs	- Over Rs.8 crores of credit linkages generated - Disbursed loan up to Rs. 2 lakh / SHG. Recovered 100% loan in 12 months
Ganjam-Gajapati	Fruit and vegetable processing	- Units linked with financial institutions, with direct support of BDSPs - 5 MSME units linked under CGTSM scheme by Andhra Bank	50 units linked with Financial Institutions in both the districts (Ganjam- Gajapati) and accessed finance of around Rs. 18.8 crores from both bank and non bank sources. In addition, Rs.10.48 crores were mobilised from the Govt. schemes.

SPVs (like RTPSHCL for relocation of firm in Rourkela cluster) and consortia's (like Ahmedabad Dychem manufacturers Cluster Ltd.) were facilitated for easing the access to finance to MSMEs. Participating Bank officials were sensitized towards SME lending with better tools to lower transaction costs.



In Indore cluster, diagnostics identified the bankers' reluctance to provide funds to MSMEs for the working capital. The cluster agency organized 2 Bankers meeting with SIDBI and other 4 financial Organizations. Another workshop with Cluster firms was organized to strengthen their Business Profile. Due to these efforts finance linkages worth Rs. 250 Million was mobilized for the 6 cluster firms. These efforts improved industry-financial institutional linkages.

In another case in Coimbatore cluster, four interaction meets were organized with Financial Institutions, nearly 200 cluster firms attended in the program. As a consequence, many firms have

obtained loans from TIIC and Banks and SIDBI. Coimbatore implemented Faridabad financial model for the benefit of MSMEs. 24 cluster firms got financial support Bank of Baroda and 3 firms got financial support from SIDBI.

In Ganjam Fruit & Vegetable Processing cluster, where MSEs were operating at very micro level and were not paying their statutory liabilities viz. Income tax, sales tax, provident fund for workers etc. were sensitized about the benefits and need of paying these liabilities. MSEs were helped to prepare their books of accounts, registration etc. As a result where no bankers were interested in extending loans / credit / financial assistance in absence of required papers, many banks / FIs turned up to extend credit to these MSEs.

MFI centric model

Under GIZ portion of MSMEFDP, an innovative financial product and delivery model for the upstream apparel supply chain had been worked out in association with Satin Creditcare Network Ltd (SCNL) – a Micro Finance Institution (MFI). SIDBI had sanctioned a line of credit to Satin Creditcare Network Ltd. for onward lending to the MSEs in this apparel supply chain.

There are a large number of MSEs in the unorganized sector at various industrial centers, who are engaged in activities relating to readymade garments such as fabrication, embroidery etc. While they have necessary experience and expertise in their line of activity and many of them have been operating from this area for the last 10 to 20 years but they do not have necessary financial resources to manufacture and market their production. Hence they were not able to access credit. The owners/promoters of these enterprises were not in a position to provide the comfort of collateral security to the banks. Their credit requirements range from Rs. 1.00 Lakh to Rs.5.00 Lakh (small ticket), depending upon their volume of operations.

SCNL operates in Delhi and nearby areas since 1990. The ticket size of the loans granted by SCNL was very small – around Rs. 10000/- to 15000/-. After a series of discussions with key functionaries of SCNL they were persuaded to take a limited risk on at least a small select group of MEs engaged in fabrication and embroidery of garments in Govindpuri, Tuglakabad Enclave and Sangam Vihar areas. They were helped

- To Design and develop a special credit scheme with the following features:
 - Loan ticket size in the range of Rs.50000/- to Rs.200000/-;
 - Loan to be available for investment in machinery or for work capital needs;

- Repayment period up-to 2 years;
- Repayment in fortnightly/monthly installments instead of daily installments depending upon cash flow of the borrower;
- No collateral security;
- In human resources development for appraising and risk assessment of credit to MEs.
- Interactive sessions were held with apparel supply chain MEs to understand their needs followed by sensitization workshops to motivate them to borrow from SCNL. They were given an orientation course in accounting, finance, quality improvement and marketing in the evenings after their working hours.

The results of pilot intervention (started in the latter half of 2008) are as under:

- SCNL granted loans to 60 MEs. Each ME, on an average, employed 40 workers and therefore this intervention impacted the lives of around 2400 families and around 12000 people (assuming that each family has 5 members) at pilot stage;
- The enterprises financed under the scheme have shown much better financial discipline and have been repaying installments in time with no default.

Cash Flow Based Lending

SIDBI, under MSME-FDP –GiZ portion, organized 25 programs on cash flow based lending for bankers. This was widely appreciated that the institutional BDS from private sector (which was roped in) has since adopted the agenda of CB of bankers .

BMO Centric Model

A model was attempted in the clusters on pilot basis. Faridabad Small Industry Association (FSIA) and SIDBI spearheaded this model under MOU arrangement. It worked thus:-

Need / Issue

The major issue identified in the auto component dominated cluster was unavailability of timely and appropriate credit to MSEs operating in the cluster. MSMEs were aware about banking services but

reluctant to go to banks for their requirements due to various reasons viz. unawareness about banking procedures, rates etc.

Scenario

In the cluster, the BMO (FSIA) was proactive and forward looking in the cluster. The BMO was majorly taking care of advocacy related issues.

Initiative

SIDBI structured a special loan product and extended CB Support to FSIA to create awareness on credit linkages, CB of BMO officials, Documentation Centre - setting up / documenting the process etc.

Responsibility of BMO (FSIA)

- Conduct the due diligence
- Complete all pre application formalities
- standardization of forms / requirements
- Gathering of information at single point.

Success

- This exercise led to reduced turnaround time and lower transaction costs.
- Credit linkages 50 MSMEs, Sanctioned Rs. 17Cr, Disbursed Rs 12 Cr
- Awareness enhancement
- Capacity was built of BMO officials on financial linkages
- Reduction in turnaround time and lower transaction costs.
- Replicated in Gujarat. Demand from Coimbatore and Panipat

It shows that the need of MSEs for BDS providers differ and depends on multiple factors like their level of operation, their surrounding atmosphere, their span of existence etc. The most crucial agenda is to identify the need and kind of support commonly required for the MSMEs in a particular cluster. Sensitizing the MSEs about the right kind of services is the foremost and the biggest challenge, afterwards making available the right kind of BDS provider and their matchmaking comes up. This enables market mechanism to operate on its own.

Annexure A.6– Terms of Reference (TOR)

Project Overview

Project Name	MSME Umbrella Programme
Component	MSME Financing and Development
Project Number	09.2459.7-001.00
Partner Organization	Small Industries Development Bank of India
Brief Description of the Assignment	Measurement of MSMEs satisfaction/perception on SIDBI's services, gap in credit supply & demand and Development of alternate modes of credit delivery in select MSMEs clusters

GIZ (or “the client”), under Micro, Small & Medium Enterprises Financing and Development Project (“MSMEFDP” or “the project”), desires to undertake a study on ‘Measurement of MSMEs’ Satisfaction / Perception on SIDBI’s Services, Gap in Credit Supply & Demand, and Development of Alternate Modes of Credit Delivery in select MSMEs Clusters’ (“the study”). Dun and Bradstreet Information Services India Pvt Ltd. (“D&B India”) has undertaken the aforementioned study.

MSMEs form the backbone of India economy, and play a critical role in the country’s agenda on inclusive growth. According to the Prime Minister’s Task Force on MSMEs, availability of timely institutional credit and adequateness of quality of such institutional credit is an important issue currently faced by the MSMEs. It has also been suggested that banks should adopt alternate and innovative modes of credit delivery such as:

- Cluster-specific approach to achieve lower transaction and monitoring costs through reduction in costs of data, standardization and reduction of documentation
- Identification of common risk elements and their mitigation
- Better inter-firm comparison
- Improved outreach
- Better monitoring and design of cluster specific products/interventions as the targets are well-defined and recognized groups

The World Bank's parent project, 'the Multi-Donor Micro Small and Medium Enterprises Development Project (MSMEFDP) for MSME financing and development became effective on April 4, 2005. SIDBI is the implementing agency for the project supported by international partners - The World Bank, DFID, KfW, and GIZ. Department of Financial Services, Ministry of Finance Government of India is the nodal agency for the project. The objective of the project has been to improve MSME access to finance and business development services, thereby fostering SME growth, competitiveness and employment.

As a part of MSME umbrella programme, GIZ and SIDBI aim to provide improved access to financial and non-financial services that are innovative & tailored to suit market needs under the component MSME Financing & Development. In order to improve financial and non-financial services to MSMEs, it is important to understand the current schemes implemented by SIDBI for MSME financing, evaluate their adequacy, measure customer satisfaction and perception of these schemes and evaluate the finance need gap. Basis this need gap, the study will develop directional inputs to eliminate such gap by proposing alternate financing products and provide for a detailed implementation plan for the same.

Objectives

The project aims to study the current status, desired situation, and appropriate actionable measures to achieve the desired situation with reference to financial and non-financial services provided by SIDBI to MSME (in select Clusters), so that it facilitates enhanced and improved services to the MSME sector.

The objectives of the study are:

1. Customer Perception and Satisfaction

- To assess of the current level of MSME satisfaction, their perception and feedback regarding the services (financial and non-financial) from SIDBI through a sample survey
- To assess the impact and specific contribution of SIDBI's services on the growth, competitiveness and responsible business behaviour of the enterprises
- To identify key issues, which SIDBI needs to implement: its context; rationale and its possible impact
- In light of expectations, develop customized / innovative financial products and credit delivery model / mechanism

2. Credit Mapping

- To map the credit demand and supply status, measure the credit gap and reasons for the current status in the select identified clusters (10 clusters in 7 subsectors)
- To develop tailor made specific financial products, alternate delivery models and institutional mechanism for implementation in these clusters and others in the project

Scope

The scope of this assignment is divided into following tasks:

1. Survey Design and Resource Planning

To achieve the objectives, it is required to undertake a sample survey amongst MSME and select key stakeholders and therefore the first task would be to develop a detailed methodology , sample selection criteria, survey questionnaire , planning of resources, finalization of cluster locations, stakeholders to be consulted etc. Design of the survey methodologies and tool would be to get the desired information for further analysis on the following:

- Document the current level of satisfaction, perception and expectations vis-à-vis actual services by SIDBI (e.g. Adequacy of credit, timely availability, rate of interest, inspection procedures, application and approval process etc.)
- Key bottleneck (e.g. procedural, awareness, delay in decision making etc.) in access to finance from SIDBI
- Document the suggestions in terms of:
 - Existing facilities / products / services rated high
 - Refinement in existing products and procedures
 - Customized / innovative financial products which SIDBI and banks can introduce
 - New credit delivery channels
- Credit demand and supply status, gap and reasons thereof

2. Sample Survey in 10 identified clusters

To carry out a sample survey as per the approved questionnaire in 10 identified locations covering 500 Micro, Small, Medium enterprises and key local stakeholders and further analysis and interpretation of the data to derive the key findings. These locations would be finalized from the major industrial clusters wherein SIDBI is active under the project MSME financing

and development (www.msmeftp.net). The final list of clusters may be decided in consultation with GTZ / SIDBI.

3. Development of specific financial product and alternate credit delivery models Suitable tailor-made credit delivery model will have to be devised to meet the genuine credit needs of the enterprises in the sector. It is understood that SIDBI and some other banks already has pilot experience of such credit transmission mechanism in different locations.
 - To develop cluster specific financial products and delivery channel.
 - As a part of overall credit delivery model, to identify suitable institutional transmission mechanism of credit delivery models delivered under the project.

Annexure A.7 – List of Documents Reviewed

- Survey of Past Committee Reports
 - Nayak Committee Report, 1991
 - Abid Committee Report on Small Enterprises, 1997
 - Kapur Committee Report on Credit Flow to SSI Sector, 1998
 - Gupta Committee Report on Development of Small Enterprises, 1999
 - Chakraborty Committee Report on Re-habilitation of Sick SMEs, 2008
- Report on Prime Minister’s Task Force on MSMEs, 2010
- Financing of Enterprises in the Unorganized Sector & Creation of a National Fund for the Unorganized Sector (NCEUS, Nov 2007)
- RBI Guidelines for Priority Sector Lending
- RBI Annual Publications, Basic Statistical Returns
- RBI Quarterly Publications
- RBI Branch Banking Statistics
- RBI – Functions and Working
- SIDBI Annual Report, 2009-10
- IDBI Annual Report, 2009-10
- Annual Survey of Industries (ASI), Government of India
- Handbook of Indian Economy Statistics
- Fourth All India Census of MSMEs, 2006-07
- State Level Bankers Committee Reports
- World Bank Report on “Finance For All – Policies and Pitfalls in Expanding Access”, 2008
- Diagnostic Study Reports for 10 identified clusters

- Faridabad Auto Components and Engineering Cluster
 - Coimbatore Engineering Cluster
 - Rajkot Engineering Cluster
 - Rourkela Engineering Cluster
 - Ahmedabad Dyes and Chemicals Cluster
 - Hyderabad Pharmaceuticals Cluster
 - Ludhiana Knitwear Cluster
 - Chennai Leather Cluster
 - Kolkata Leather Cluster
 - Pune Fruits & Vegetable Processing Cluster
- Report of the Working Group on Discounting of Bills by Banks (1999)
 - The SME Banking Knowledge Guide, IFC Advisory Services (2009)



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